MORNINGSTAR®

How Can You Help Your Employees Retire?

Choosing the Right Investment Solution Can Make All the Difference

You’ve read the recent headlines about retirement:
Employees aren’t prepared. Employers aren’t confident. Retirement is in trouble.

But the path toward solving the problem isn’t well-defined. How can plan sponsors assist employees who are unsure about what the future holds? They can help participants reach their retirement goals by making sure their 401(k) plan features the right benefits. Plan sponsors have choices. We analyze three investment options and evaluate the merit of personalized portfolios to help answer the question: “What’s the right choice to help my employees retire?”

Defining Your Choices

Throughout the past two decades, the retirement industry has started to move away from defined benefit plans to defined contribution plans, shifting the burden of retirement planning on to employees — a task that few are equipped to take on. Plan sponsors can benefit from implementing an option that's designed to help participants get on track for retirement. With the right solution, employees can work toward meeting their retirement goals, and plan sponsors can trust they've helped their participants.

We'll explain target-date funds, custom target-date solutions, and managed accounts to help you determine which option may be most appropriate for your plan and participants.

More Participant Expertise Required

Target-Date Fund

A standard target-date fund is an off-the-shelf solution that offers an asset allocation (or the investment types represented in the portfolio) that considers a retirement date. It reflects what the fund manager believes is the best asset mix for the average investor by age. In some cases, the solution may consist of only the recordkeeper's or target-date provider's proprietary funds, which may not be suitable as investment options on their own.

Custom Target-Date Solution

Like a target-date fund, a custom target-date solution is a one-stop investment option for participants. It presents an asset mix and investment selection for various retirement dates, but it may also take into account the demographics of the employees at a company. Built from funds the sponsor selects for the plan lineup, this solution provides more visibility into how these funds are constructed. And often, fees are tied to assets under management, so the more assets participants put into the funds, the greater the cost savings to the plan sponsor.

Managed Accounts

Managed accounts use data about individual participants to create professionally managed, personalized portfolios. Next to retaining the services of a personal financial planner, they're the only option that could offer participants a full retirement strategy, including a recommended savings rate, a target retirement date, and a retirement income projection and goal.

Less Participant Expertise Required

Finding the Right Investment Option

You might have some of the same concerns about retirement planning as other plan sponsors do. You're thinking about the cost involved for the company and your employees. You're questioning if the solution will be difficult to implement and what the long-term advantages will be for employees. And which option provides the fiduciary oversight you need.

Among these three options, target-date funds have become the early favorite for plan sponsors, but does that mean they are the best choice for participants? Let's compare the options side-by-side.

	Off-the-Shelf Target-Date Funds	Custom Target-Date Funds	Managed Accounts
Level of Participant Personalization	Low	Plan-specific personalization	Individual personalization
Level of Plan Sponsor Personalization	None	High	High
Ability to Use Plan Lineup	No	Yes	Yes
Retirement Date	Age-based only	Often based on plan sponsor's median or average retirement age	May include a recommendation for each individual
Retirement Income Goal	Standard goal	Tailored goal for overall plan	May include a personalized goal for each individual
Considers Participant's Other Assets	No	No	May consider other assets
Participants Able to Adjust Retirement Strategy	No	No	Yes
Fiduciary Coverage	Consultant who selects the target-date fund may act as fiduciary	Custom target-date providers typically offer 3(21) or 3(38) fiduciary coverage	Managed accounts provider typically serves as a 3(38) investment manager
Personalized Communications	None	None	Some programs may offer these
In-Retirement Options	Some	Some, depending on provider	Many managed accounts providers offer a way to help participants convert their balance into a sustainable income amount

When is a target-date fund the best option?
Target-date funds are readily available through the recordkeeper's platform, so typically they are easy to implement. And the process for conducting due diligence is straightforward, because there is so much public information available on target-date funds. Cost is also considered a pro. There are no additional fees required for off-the-shelf target-date funds, aside from the underlying expenses. At a company with similar employees, or in the absence of an investment committee, a target-date fund may be all that's needed.

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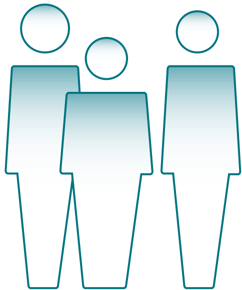
But target-date funds won't hit the mark for most participants. They allow for different allocations based on age only. Target-date funds consider the asset mix for an administrative assistant the same as an executive at the same company. Often a participant is enrolled automatically, and rarely are participants encouraged to increase their savings rate over time.



Why would a plan sponsor choose a custom target-date solution?
A custom target-date solution still uses a diversified portfolio approach like a target-date fund, but it allows for modifications. This option can incorporate overall workforce demographics including pensions, industry, location, and employee risk capacity. Plan sponsors would be able to adjust asset allocation (or their glide path) based on data—for instance, the custom target-date fund for an energy company might want to consider underweighting commodities to manage the risk the participants are taking on because they already work in the oil industry.

Custom target-date solutions work well for a plan sponsor if employee demographics are similar, but vary from the average investor. For example, a custom target-date solution might be a good option for a health-care company with a defined benefit plan, a low employer match, and high salaries. If the plan sponsor wants to offer a custom target-date solution, but also wants to provide more detailed recommendations and guidance to participants, the plan sponsor could offer custom-target date funds and managed accounts together.

There is some work involved in implementing custom target-date solutions, so this route is better suited for investment-savvy plan sponsors. And additional costs are involved if the plan sponsor decides to hire an investment manager to design and apply the asset allocations.

What's the value of managed accounts?

The advantages of managed accounts stem from the ability to personalize your plan—down to the participant level. And it's the only choice of the options discussed here that works toward a specific retirement goal.

Managed accounts encourage a level of engagement that target-date funds don't: Personalized communications can contribute to an increase in retirement income and a greater savings rate, arguably the most substantial benefit of managed accounts. According to a study we conducted of individuals using our advice and managed accounts service, on average 87% of participants increased their savings rates; the average increase of their savings rate was 28%.[1]

Managed accounts could be ideal for a company employing a diverse workforce—like a global manufacturing company—that includes well-compensated engineers and mid-level production workers. Plan sponsors operating in an industry that competes for specialized skills (technology or science, for example) could use managed accounts to attract top talent.

Plan sponsors might be hesitant about managed accounts because of the potential costs involved. These costs can fluctuate significantly by provider (including some where the service is included in the base recordkeeping fee.)

Our study found that a 25-year-old participant could have almost 40% more retirement income after using an advice and managed accounts service with an annual fee of 0.40%[2]

+40%

And while fees are paid for by the participant, our research shows that even after paying these fees, on average, managed accounts participants are likely to see more income in retirement than those who do not use such a service. Our study found that a 25-year-old participant could have almost 40% more retirement income after using an advice and managed accounts service with an annual fee of 0.40%.[2]

There's a misconception that managed accounts act like target-date funds unless each participant takes the time to submit personal information. The more individual data provided, the more detailed the recommendations will be. But at a minimum, a significant level of personalization can happen just with the data that the recordkeeper can provide to you.

What if my participants would benefit from more than one of these options?

Plan sponsors don't necessarily have to choose between these three options—often they decide to offer some combination of target-date fund, custom-target date solution, and managed accounts to address the needs of various types of participants who are part of their retirement plan.

Making Retirement Personal—Does One Size Ever Really Fit All?

People don't walk into the doctor's office and expect their doctor to give them the same treatment as everyone else their age. They probably aren't expecting that from a retirement plan either. How can a solution that invests everyone with the same retirement date in the same portfolio—regardless of risk capacity or retirement readiness—be successful for every participant? The simple answer: For most organizations, it can't. Each participant has an optimal asset allocation based on that individual's goals and unique financial situation.

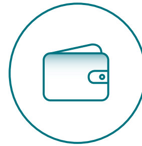
Sometimes aligning a participant's asset allocation with the average investor makes sense, but most participants' financial situations are more complex than that. Even details around where a participant lives—like state taxes, housing costs, and market volatility—can affect a portfolio.

Think about your own financial situation. Which data points would say something about you that diverge from the average investor? Maybe you live in a state with a higher-than-average income tax rate. Perhaps your company provides a better than average 401(k) match, or maybe it doesn't match your contribution at all. By incorporating data about individual participants, like the nine items we've listed below, plan sponsors can apply a personalized approach to retirement planning—helping to identify a clear path for each of their participants to prepare for retirement.

Data-Driven Retirement Planning
The more individual data provided, the more detailed the recommendations will be. But a significant level of personalization can happen just by using data that's accessible—many of the data points pictured here are available through the recordkeeper.

Location

+



Account Balance

+

Social Security Impact

Age

+

Pension and Other Plans

+

Savings Rate

Gender

+

Salary

+

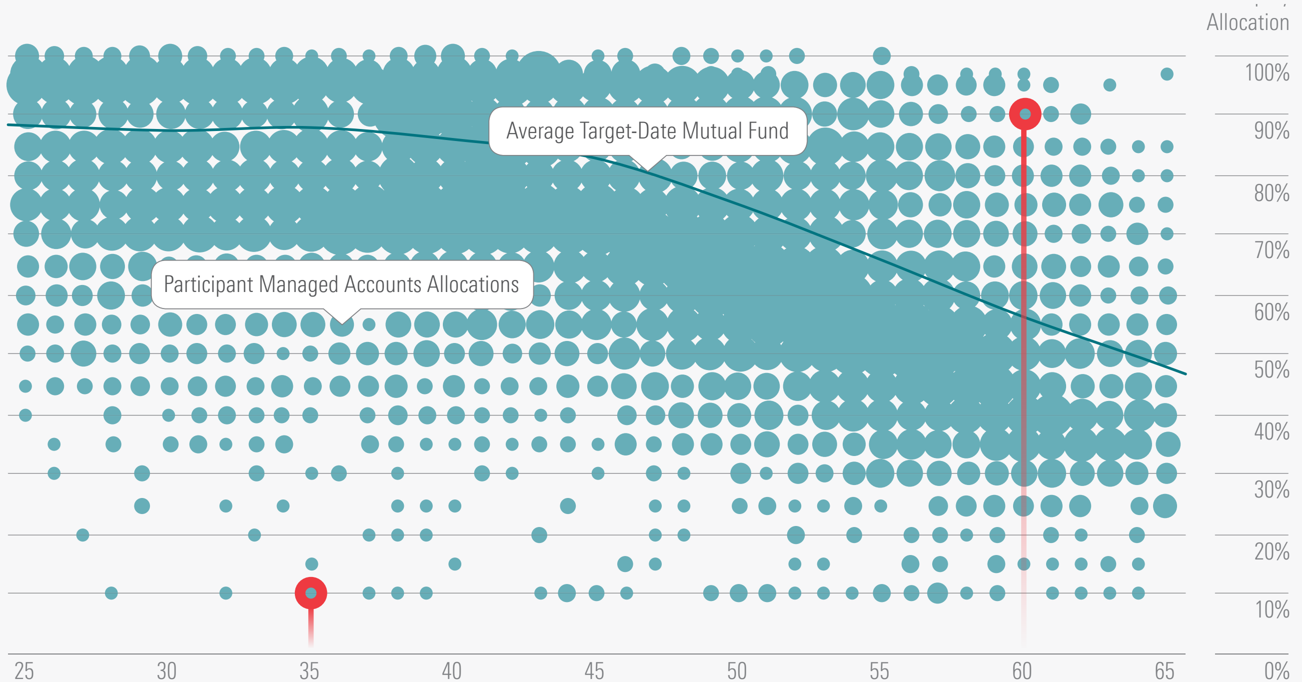
Sponsor Match

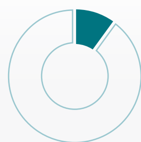
How Does Personalization Affect Allocation?

You probably have some things in common with your employees. You live in the same city. Maybe you're of a similar age. Even if you do share these circumstances, chances are you are significantly different, too. These differences are what contribute to a participant's total risk level and influence that individual's target asset allocation. While some employees may be like the average investor and fall into the target-date fund's path, most won't. The chart below shows how allocations for participants can vary when additional data is used.

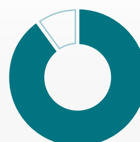
Average investors are only a small part of the overall group of participants—participants whose allocations fall out of the average may have trouble meeting their retirement goals with a target-date fund.

The Power of Personalization Some participants' allocations will align with the average target-date fund, but many won't. We used data on participants enrolled in our managed accounts program to show how, when additional data is provided, allocations for participants can differ significantly from the average target-date fund. The size of the bubbles corresponds to the relative number of participants, so the larger the bubble, the more common the allocation.





When would a 35-year-old participant invest less in equities? With additional personal data, like risk capacity, a participant with substantial outside investments in stocks may be advised to invest less in equity assets to balance that individual's overall portfolio.



When would a 60-year-old participant invest more in equities? If personal data revealed bond-like assets, such as a pension, a participant nearing retirement might be advised to invest more aggressively in equities.

The graphic includes data on participants enrolled in managed account programs offered by the registered investment advisors within Morningstar's Investment Management group.

Still not sure which option is right for your participants? We can help.

Morningstar Investment Management
Call +1 312 384-4074
Email retirement@morningstar.com
Visit global.morningstar.com/retirement

About Our Custom Solutions

The Morningstar Investment Management group provides investment advisory services to clients worldwide. We use your participants' unique demographic data to build customized glide paths that match their distinct characteristics. We design solutions using open architecture, implemented with the funds you've already vetted for participants. We can serve as a 3(21)(A)ii or 3(38) fiduciary to help you manage your fiduciary responsibilities.

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[1] The percentage of participants that increased their savings deferral rates is determined by comparing each participant's savings deferral rate prior to and after using the Morningstar Retirement Manager service. Participants who increased their savings deferral rate after using Morningstar Retirement Manager are included in this data point.

The average increase in saving deferral rates is determined by analyzing each participant's savings deferral rate prior to using and after using the Morningstar Retirement Manager service. The result is the average across all participants included in the study.

[2] This figure represents the potential wealth increase an average 25-year-old could have at retirement when using a managed accounts service versus an average 25-year-old that did not use a managed accounts service.

The analysis is based on 58,444 participants who used the Morningstar Retirement Manager service between the dates of January 2006 and February 2014. Participants are grouped by the age when they first implemented or received advice from Morningstar Retirement Manager and are assumed to have an initial retirement account value of $0 and a retirement age of 65.

The results show that the average participant who first uses Morningstar Retirement Manager as a 25-year-old with a 0.4% annual fee could have 38.9% more retirement income at retirement than an average 25-year-old participant who did not use Morningstar Retirement Manager. Similarly, the average 45-year-old using Morningstar Retirement Manager with a 0.4% annual fee could have 23.3% more and the average 55-year-old could have 13.8% more retirement income at retirement.

The amount of additional retirement income attributed to the use of Morningstar Retirement Manager at retirement varies by age, and tends to decrease with the age the participant first uses the Morningstar Retirement Manager service. Additionally, the potential amount of additional retirement income increases as the management fee decreases; conversely, decreases as the management fee increases.

The average difference in the saving rate before and after using Morningstar Retirement Manager is calculated for each age group. The savings rate was applied to an assumed median income value for each age group. In a similar manner, the average difference in portfolio investment return before and after using Morningstar Retirement Manager was calculated for each age group. Six different annual fee levels (0.0%, 0.2%, 0.4%, 0.6%, 0.8%, and 1.0%) for the Morningstar Retirement Manager advice service were analyzed and the fee was applied to the average portfolio balance for each age group on an annual basis. The final account value for each age group at retirement age was then compared for each annual fee level. This analysis does not account for all portfolio costs such as fees, taxes, or expenses other than the annual account fee. If included, they would lower the potential amount of additional retirement income at retirement shown in this analysis. In no way should the results of this analysis be considered indicative or a guarantee of the future performance of an actual client using Morningstar Retirement Manager or considered indicative of the actual performance achieved by actual participants that have used Morningstar Retirement Manager.

For important information regarding the research statistics, and to download the full study, go to http://corporate.morningstar.com/US/documents/ResearchPapers/Expert_Guidance.pdf

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