Objection Handling

Thoughtful responses to common plan sponsor Hybrid QDIA objections

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I am required to make plan decisions based on what's best for my participants. How do I know a Hybrid QDIA will check that box?

With widespread adoption of the QDIA over the last several years leading to more participants saving more money, it's reasonable to assume that retirement success should be that much easier to achieve. So why, then, are 7 in 10 pre-retirees in the United States reporting that they are not well prepared for retirement? One reason stems from the traditional QDIA options that are available to plans.

The Pension Protection Act designates three types of investments that qualify as eligible QDIAs, the two most notable being target date funds and managed accounts.

Target date funds (TDFs)—or a diversified fund that automatically shifts a participant towards a more conservative mix of investments as it approaches a specified year—are the most common default investment option selected by plan sponsors. While they mark a useful ingredient for retirement success, today, however, they are being asked to do more than ever before: to be a retirement readiness vehicle for a heterogeneous population of plan participants. Inherently, TDFs are not designed to incorporate the planning, customization, tools, and integrations necessary for those in their mid-to-later career stages who seek retirement success.

Likewise, **managed accounts**—or personalized, professionally managed retirement plans—though critical for optimal retirement planning, typically increase their value add over time—particularly in mid-to-later career stages. The technology supporting these platforms has vastly improved over the last several years, helping to significantly reduce fees, and the types of investments that can be included are more extensive. Even so, not all younger investors may initially need the enhanced planning and increased functionality that comes with a managed account until they accumulate more assets and/or their financial profiles become more complex.

Given the opportunity to improve on today's most commonly used QDIA options, advisors and employers are increasingly selecting a Hybrid QDIA solution to better facilitate retirement success for their employees. The Hybrid QDIA fills a significant void—the lack of precision and flexibility—in the retirement ecosystem created by default investment options that are simply not serving plan participants' retirement needs.

A **Hybrid QDIA** provides a personalized and dynamic default solution that serves plan participants at each stage of their employment and retirement lifecycle. This progressive approach pairs TDFs and managed accounts. Those earlier in their career are defaulted into a TDF and are automatically transitioned to a professionally managed portfolio as they get closer to retirement.

The development of the Hybrid QDIA is a very welcome and worthy advancement—the combination of two investment options that create, overall, a more personalized, outcome-enhancing retirement plan at a fee largely on par with traditional QDIAs. TDFs are a prudent investment for those younger participants who don't always require the enhanced functionality provided by a managed account. But, once that participant reaches mid-to-later career stages, it is crucial that they amplify their retirement planning in order to best reach their goals. Studies[1] have proven that managed accounts cost effectively

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[1] Successful Retirement Plan Communications for Various Population Segments; Aon Hewitt

provide increased value to participants, particularly those closer to retirement whose financial needs vary greatly from person to person and are typically more complex. The ability to automate that transition from TDF to managed account at a predetermined date is a valuable, efficient, and prudent feature that defines the Hybrid QDIA.

The benefits of this "best of both worlds" approach clearly outweigh a single-solution approach for a diverse population of plan participants. TDF managers themselves have identified that hybrid products incorporating a transition are the most advanced in the field of product development. With the growing industry acceptance and momentum the Hybrid QDIA is experiencing today, it is natural to envision a future scenario in which a hybrid approach is both the necessary and sufficient approach for the workplace QDIA.

The purpose of a QDIA is to offer a prudent option for participants in the absence of an active investment choice. It seems like a Hybrid QDIA requires engagement (by those participants triggered into the managed account) in order to realize the benefit.

THIS ARGUMENT ASSUMES THAT THE HYBRID SOLUTION IS MORE EXPENSIVE THAN THE PLAN'S CURRENT QDIA

While the more data provided the more personalized the advice will be, a hybrid solution is designed to provide value whether there is participant engagement or not. Some points to consider:

- **Significant technological advancements.** NextCapital's solution is able to pull in significantly more information without participant engagement, such as salary, account balance, age, contribution rate, retirement age, gender, state of residence, marital status, health information, and outside assets. Over the last several years, as the ability to customize with less engagement has grown, so too has the value proposition for Hybrid QDIAs.
- **Participant inertia.** Studies show that retirement readiness declines from age 25 to 65 and that a more personalized strategy benefits more participants as they age. Participant inertia results in minimal participation in managed accounts as it becomes more necessary and limited understanding of retirement readiness. NextCapital's hybrid QDIA solution automatically puts participants in the right place at the right time, both pre- and post-trigger, and increases the probability of a better retirement outcome.
- **Trust in plan sponsors.** Studies like this one assert that many sponsors think of passive members as "uninterested" or "unengaged" in their retirement savings, but passive members say they trust their plans and lack the skill rather than the interest. The heterogeneity, trust, and general lack of investment knowledge of passive members make opting out of the default less likely and smart defaults more appealing.
- **Quantitative benefits.** In a 2020 analysis conducted by NextCapital, "unengaged" managed account participants were shown to benefit from additional returns when compared to a target date fund. We observed the average value-add for unengaged participants to range from 11-21 basis points over a TDF, while certain unengaged cohorts saw a value-add ranging from 8-70 basis points.
- **Tactful communications that drive engagement.** [**INTERNAL NOTE: DISTRIBUTOR TO INSERT ENGAGEMENT PROGRAM**]

The Impact of Managed Accounts on Participant Savings and Investment Decisions; Morningstar Research

Managed Accounts Growing More Attractive in DC Plan Market; ThinkAdviser

PSNC 2020: New Thoughts About QDIAs; Plan Sponsor

Recalculating Route: The Value Add of Managed Advice; NextCapital Advice

As a plan sponsor, I am worried about increasing my fiduciary risk.

The QDIA options that plan sponsors are able to select today were determined in 2006. Since then, vast innovations in finance and technology have occurred at lightning speed, while the eligible QDIA options have remained the same. The development of the Hybrid QDIA is a very welcome and worthy advancement—the combination of two eligible investment options that create, overall, a more personalized, outcome-enhancing retirement plan at a fee largely on par with traditional QDIAs.

As a fiduciary, it is your duty to act solely in the interest of your employee base while remaining ERISA compliant. As sponsors, and the professionals they work with to make plan decisions, become more educated on such structural QDIA enhancements, they must continually review the effectiveness of their current QDIA selection. To learn about an innovative QDIA solution, such as the hybrid model, that is designed to use personalization and planning to strengthen retirement outcomes and NOT do more to understand its benefits for their own employee base will, by definition, increase fiduciary liability.

Why?

TDFs are a prudent investment for those younger participants who don't always require the enhanced functionality provided by a managed account. But, once that participant reaches mid-to-later career stages, it is crucial that they amplify their retirement planning in order to best reach their goals. Studies have proven that managed accounts cost effectively provide increased value to participants, particularly those closer to retirement whose financial needs vary greatly from person to person and are typically more complex. The ability to automate that transition from TDF to managed account at a predetermined date is a valuable, efficient, and prudent feature that defines the Hybrid QDIA.

The benefits of this "best of both worlds" approach clearly outweigh a single-solution approach for a diverse population of plan participants, and the implementation of such a solution, thereby decreasing plan sponsors' fiduciary risk. For more information about plan sponsor fiduciary responsibilities, please see the IRS guide to A Plan Sponsor's Responsibilities.

Aren't managed accounts a lot more expensive than other plan options, like target date funds (TDFs) or a "DIY" model?

No. When managed accounts, or the post-trigger investment in a hybrid QDIA solution, were first developed they were distributed more like a product—one that was not fully differentiated versus a TDF. Managed accounts traditionally offered less customization than they do today, and were fairly inflexible in terms of configurability with advice/methodology. On top of that, they were more complex vehicles and charged more in fees than a TDF.

The logic that spurred the development of a Hybrid QDIA solution is that TDFs are a prudent investment for younger participants who don't always require the enhanced functionality provided by a managed account. But, once that participant reaches mid-to-later career stages, it is crucial that they amplify their retirement planning in order to best reach their goals. Studies[2] have proven that managed accounts cost effectively provide increased value to participants, particularly those

[2] Successful Retirement Plan Communications for Various Population Segments; Aon Hewitt

The Impact of Managed Accounts on Participant Savings and Investment Decisions; Morningstar Research

Managed Accounts Growing More Attractive in DC Plan Market; Cerulli

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The development of the Hybrid QDIA is a very welcome and worthy advancement—the combination of two compliant investment options that create, overall, a more personalized, outcome-enhancing retirement plan **at a fee on par with traditional QDIAs.**

In fact, a 2020 analysis conducted by NextCapital found that even the most unengaged participants (i.e., participants that did not further personalize their profile beyond the data set provided via the record keeper) benefit from additional returns when compared to a target date fund. NextCapital observed the average value-add for unengaged participants was 11-21 basis points over a TDF, while certain unengaged cohorts saw a value-add ranging from 8-70 basis points.

I know TDFs are the most common type of QDIA. Is the Hybrid QDIA an established approach in the industry? Do you have reputable sources I can reference?

The QDIA options, including TDFs, that plan sponsors select from today were determined in 2006—a technological lifetime ago. Since then, vast innovations in finance and technology have occurred at lightning speed, while the eligible QDIA options have remained the same. The development of the Hybrid QDIA is a very welcome and worthy advancement—the combination of two compliant investment options that create, overall, a more personalized, outcome-enhancing retirement plan at a fee largely on par with traditional QDIAs.

The retirement industry is quickly realizing that the benefits of a hybrid approach outweigh a single-solution approach for a diverse population of plan participants. Several of the U.S.' largest and most successful retirement providers (e.g., Fidelity, Empower) offer this QDIA model, with several others ramping up solutions this year. TDF managers, themselves, have identified that hybrid products incorporating a transition are the most advanced in the field of product development.

With the growing industry acceptance and momentum the Hybrid QDIA is experiencing today, it is natural to envision a future scenario in which a hybrid approach is both the necessary and sufficient approach for the workplace QDIA. The Hybrid QDIA is a prudent, compliant, and established approach in the industry—and it's only gaining more traction.

A few reputable resources can be found here, here, here, and here. Please reach out if you're interested in further and/or more specific research.

Recalculating Route: The Value Add of Managed Advice; NextCapital Advice nextcapital

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