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QDIAs: One Size Does Not Fit All

Understand your options. Uphold your fiduciary duty. Promote retirement success.

The mainstream adoption of the QDIA (Qualified Default Investment Alternative), or a plan's "default" investment, is one of the most significant developments in the defined contribution (DC) space over the last two decades. Unsurprisingly, auto-enrollment into a QDIA nearly doubles plan participation and successfully gets the once "unengaged" participant population saving for their retirement. Since the QDIA's introduction in the mid-to-late 1990s, 60-70% of the country's over 660,000 DC plans now automatically enroll individuals.

Today, therefore, the decision is much less, *"To QDIA or not to QDIA?"* but, *"As a fiduciary, what is the most prudent, capable selection for my plan's QDIA?"*

A Hybrid QDIA Solution

Increasingly, advisors and employers are 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 dynamic default solution that serves plan participants at each stage of the employment and retirement lifecycle. This progressive approach pairs two QDIA-eligible investment options: target date funds ("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—when their financial situations are generally more complicated.

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 preferred approach for the workplace QDIA. TDF managers, themselves, have identified that hybrid products incorporating a transition are the most advanced in the field of product development.

History of the QDIA

The Pension Protection Act (PPA) was signed into law by President George W. Bush in 2006. Its enactment importantly removed many of the barriers that had prevented the adoption of automatic enrollment features in DC plans. Namely, the PPA amended the Employee Retirement Income Security Act (ERISA) to provide a "safe harbor" for plan fiduciaries investing participant assets in certain default investments in the absence of participant investment direction.[1] The Department of Labor (DOL) issued a corresponding set of requirements that plans must meet in order to receive this protection, including criteria stating that participants who do not proactively select an investment be invested in the plan's designated QDIA. Such participants must be properly notified and informed of their enrollment.

According to Douglas Neville, a leading employee benefits attorney, providing a QDIA offers sponsors two primary advantages: 1.) it relieves fiduciaries of liabilities related to investment losses, and 2.) it has the added benefit of automatically providing investments that can lead to future growth.[2] QDIAs are "crucial for plans with participants who are not going to be making investment elections," Neville explained. "For someone who fails to make an investment election, if you can meet the requirements to satisfy the QDIA rules, it reduces your fiduciary liability significantly."

With widespread adoption of the QDIA leading to more participants saving more money, it seems like 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.

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[1] Fact Sheet: Default Investment Alternatives Under Participant-Directed Individual Account Plans; Department of Labor

[2] A Review of QDIA Regulations; PLANSPONSOR

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Traditional QDIA Optionality

Under the PPA, there are only three types of investments that qualify as eligible QDIAs, the two most notable being target date funds and managed accounts.

Target date funds—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 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 these fundamental shortcomings of today's QDIA options, it is clear that they must evolve in order to truly facilitate retirement success for a broad participant base.

Hybrid QDIA & Fiduciary Responsibility

The QDIA options 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 PPA-compliant 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 best interest of your employee base while remaining compliant with applicable regulations such as ERISA. As sponsors, and the professionals with whom they work to make plan decisions, become more educated on such structural QDIA enhancements, they must earnestly and continually analyze the efficacy 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[3] 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 very apparently 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.

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[3] 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

PSNC 2020: New Thoughts About QDIAs; Plan Sponsor

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

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