TOP PRIORITIES FOR DC PLAN SPONSORS FOR 2018: FROM A FOUNDATION OF SOUND PLAN MANAGEMENT TO POWERING PARTICIPANT SUCCESS

As a sponsor of a defined contribution (DC) plan, have you felt increasingly responsible for participants' financial well-being and success in retirement? Do you break into a cold sweat when someone starts talking about excessive fee litigation and your fiduciary responsibilities? Are you feeling stressed at the thought of handling manager underperformance? If you do, you are not alone.

Fiduciary rules clearly state that the decisions a sponsor makes need to put the interests of participants first. Beyond the investment and operational duties, this means that plan sponsors must also place priority on improving participant outcomes. Our experience and recent surveys show sponsors aligning with this approach. Rather than simply negotiating plan fees with a "race to the bottom" approach, sponsors are starting to integrate three major levers within their control or influence: improving participant engagement and decision-making, adopting strategies that enhance returns and prudently reviewing fees.

With this in mind, we present some of the major trends Mercer believes warrant consideration as the Top Priorities for 2018.

1

ENSURE A FOUNDATION OF SOUND PLAN MANAGEMENT

Establishing sound plan management practices may not be the most exciting activity, but things like establishing a regular cadence to activities such as performance meetings and fee and vendor management reduce the risk that your plan's fiduciaries will end up in news headlines or court papers (as recently happened[1]).

Action to consider:

✓ Review our revamped fiduciary checklist.

[1] *Sacerdote et al. v. NYU Langone Hospitals et al.*

2

CONDUCT A FINANCIAL NEEDS ANALYSIS FOR YOUR EMPLOYEES

Understanding what issues your employees have or are expected to have is critical and yet often overlooked. In our recent Inside Employees' Minds™ financial wellness survey, US workers across two of three generation groups said retirement was not their biggest priority. Millennials were most worried about credit card debt, monthly expenses and saving to buy a home. Gen Xers cited monthly expenses as their biggest concern, and credit card debt was barely beaten by saving for retirement.

Understanding employees' needs is critical to delivering a solution appropriate to them.

Actions to consider:

- ✓ Survey employees using conjoint methods.
- ✓ Analyze the activity of participants within your DC plan as well as the utilization of any other programs you sponsor.
- ✓ Incorporate externally provided data to suggest what the needs and circumstances of people like your employees would be.

3

TARGET YOUR ENGAGEMENT EFFORTS

A clear communication strategy that simplifies decisions and drives engagement can enhance participant outcomes. Mercer's research suggests, among other things, segmenting your population based on key economic and demographic data; driving action through creating simple investment tiers; offering binary choices where possible; and customizing priorities based on the key needs of each segment.

Actions to consider:

- ✓ Segment your population based on key economic and demographic indicators to understand the natural groupings within your workforce.
- ✓ Establish clear priorities by employee segment, and develop appropriate actions and interventions.
- ✓ Develop an engagement strategy that targets the desired actions by cluster/demographic.

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ESTABLISH SUCCESS MEASURES

Once you have a clear understanding of your employees' needs, you can monitor these over time. A wide variety of measures can be considered, and all can form part of a dashboard where you assess your progress toward achieving success.

Actions to consider:

- ✓ Agree to a series of success measures by employee segment.
- ✓ Monitor success over time by refreshing analytics annually and adjusting strategies based on results.

5

CONSIDER ESG OPTIONS

Environmental, social and governance (ESG) factors are, in our opinion, critical risk factors that should be assessed by investment managers, and they form part of our manager evaluation program.

In addition, a reasonable argument can be made that offering ESG-focused options may encourage more participants to participate — not only among millennials but also generation X employees. For example, Natixis[2] reported that "individuals in the U.S. who have access to a defined contribution retirement savings plan believe ESG factors can play an important part in their investments. More than eight in ten of these individuals say they would like to have their investments reflect their personal values."

Actions to consider:

- ✓ Consider whether an education session about the background to ESG factors and their incorporation into pension plan investments would be helpful.
- ✓ Understand the current orientation of your existing managers toward ESG.
- ✓ Assess the alignment of your managers with your corporate social responsibility agenda and with your participants' social responsibility orientation.
- ✓ Consider introducing more specifically focused ESG options into the plan line-up. A simple start could be an ESG-focused global equity fund.

6

EXPLORE A COMBINATION 401(K)/RAINY DAY FUND

Mercer's Inside Employees' Minds financial wellness survey reported that 52% of workers would find a $400 unforeseen expense or a major crisis difficult to cover (but would manage). The CFPB Wellbeing Survey[3] reported that "savings and financial cushions provide the greatest differentiation between people with different levels of financial well-being, highlighting the importance for many people of emergency savings."

The industry is beginning to explore parallel retirement and "rainy day" savings accounts. These are in their early days but could prove very effective.

Actions to consider:

- ✓ Consider the need for access to "rainy day" accounts across your participant base.
- ✓ Explore some of the options being developed.

[2] "Mind Shift: Getting Past the Screens of Responsible Investing," Investor Insights series, Natixis Global Asset Management, 2017.
[3] "Financial Well-being in America," Consumer Financial Protection Bureau, September 2017.

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INCREASE DIVERSIFICATION THROUGH MULTI-MANAGER/ WHITE-LABEL FUNDS

Multi-manager funds provided through a white-label structure can offer great benefits, including reduced manager risk, broader diversification, simple naming conventions that are easy for members to understand, and the ability to quickly and efficiently switch out managers when needed.

Although the opportunities for multi-manager and white-label funds exist across a typical DC line-up, we foresee activity particularly in the area of diversified fixed income in 2018.

Actions to consider:

✓ Determine which areas of your DC line-up could benefit from a multi-manager solution.

✓ Assess any practical implications (including the costs) of introducing multi-manager funds.

8

CONSIDER FINANCIAL WELLNESS SOLUTIONS

Clearly, some financial wellness needs cannot be addressed by the DC plan. That said, a wide variety of financial wellness providers are able to provide solutions that address specific needs, such as financial coaching, student loan repayment plans, short-term loans and income smoothing.

Actions to consider:

✓ Evaluate what needs your employees have that cannot be addressed through the DC plan.

✓ Explore the possibility of offering a point solution to address a specific need.

9

EVALUATE MANAGED ACCOUNTS

Although managed accounts are not a new addition to the DC landscape, their role is evolving for a number of reasons:

- The cost of managed account services has been decreasing.
- The ability of managed accounts to tailor asset allocation advice to personal circumstances, even if participants don't input information themselves, has increased significantly.
- Managed account providers typically provide strong support for retirees and are increasingly addressing more financial wellness needs.

Actions to consider:

✓ If you have a managed account solution in place, ask yourself when you last reviewed it.

✓ If you do not have a managed account solution in place, consider whether it is time to add one. It does have a role and can lead to better, more tailored outcomes for your participants.

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EXAMINE RETIREE-FOCUSED TOOLS AND INVESTMENTS

Increasingly, we are seeing plan sponsors allowing — and even encouraging — retirees to remain in the plan post-retirement and to take partial withdrawals. A recent PIMCO Survey[4] reported that 55% of plan sponsors either actively seek to retain or prefer to retain retiree assets.

With retirees in the plan and with participants approaching retirement, we believe two key areas should be explored:

- How suitable is the investment structure for retirees? There may be a place for some investment options more aligned with retirees' needs.
- Retirees and pre-retirees can be materially advantaged by being given good guidance. For example, extensive research shows that one of the best options for a retiree to explore is when to take social security benefits.

Actions to consider:

✓ If you do not allow partial withdrawals from your plan, consider allowing them.

✓ If you do allow partial withdrawals:
  - Re-evaluate your investment line-up through the lens of a retiree, considering whether some additional retiree-focused investments make sense.
  - Perform an inventory of what guidance and advice tools are made available to retirees or near-retirees.
  - Check whether your participants have access to software that assists with social security optimization.

A FINAL WORD: DELEGATION

The fastest-growing trend in DC plan management is the move to delegating responsibilities to a professional organization. In fact, in a recent PIMCO DC Consulting Survey[4] conducted in 2017, "perceived mitigation of fiduciary risk (e.g. litigation)" was seen as the top expected driver of growth in delegated/outsourced CIO services. Although much of the delegation has occurred with investment 3(38) services, professionals are also increasingly taking on the role of "named fiduciary" under ERISA.

We believe that delegation is more than just risk mitigation. We see that delegated/outsourced CIO services can potentially improve participant outcomes through simplified investment structures, better diversified investment options, lower fees and more.

Although this paper sets out a number of initiatives for 2018, most plan sponsors will need to prioritize those most important for their plan and participants. Please reach out to your Mercer consultant to assist with setting your plan for 2018.

[4] PIMCO Defined Contribution Consulting Support and Trends Survey, April 2017.

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