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Defined Contribution: Structuring for Success

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Defined Contribution (DC) plans are inundated with new solutions promising to improve retirement readiness and provide enhanced participant experiences. The challenge for plan sponsors is evaluating all the market offerings — some of which are new and complex — and determining whether they have a place in their plans. Reviewing solutions in isolation can be time consuming and take a toll on even the most robust governance plans.[1] Therefore, we suggest grounding all DC investment decisions with a structure review to determine the fundamental building blocks used in the plan lineup.

A structure review, at the highest level, aims to specify the exposures the plan will offer in advance. This includes asset classes, benchmarks and solutions categories, in an attempt to provide options that are suitable across numerous different investor types.

Participants can be classified in different ways, but often appear as some variation in Exhibit 1 below. As shown, participant types span the gamut between those that want to fully outsource their decision-making to a professional to those that want full discretion over all their retirement investment decisions.

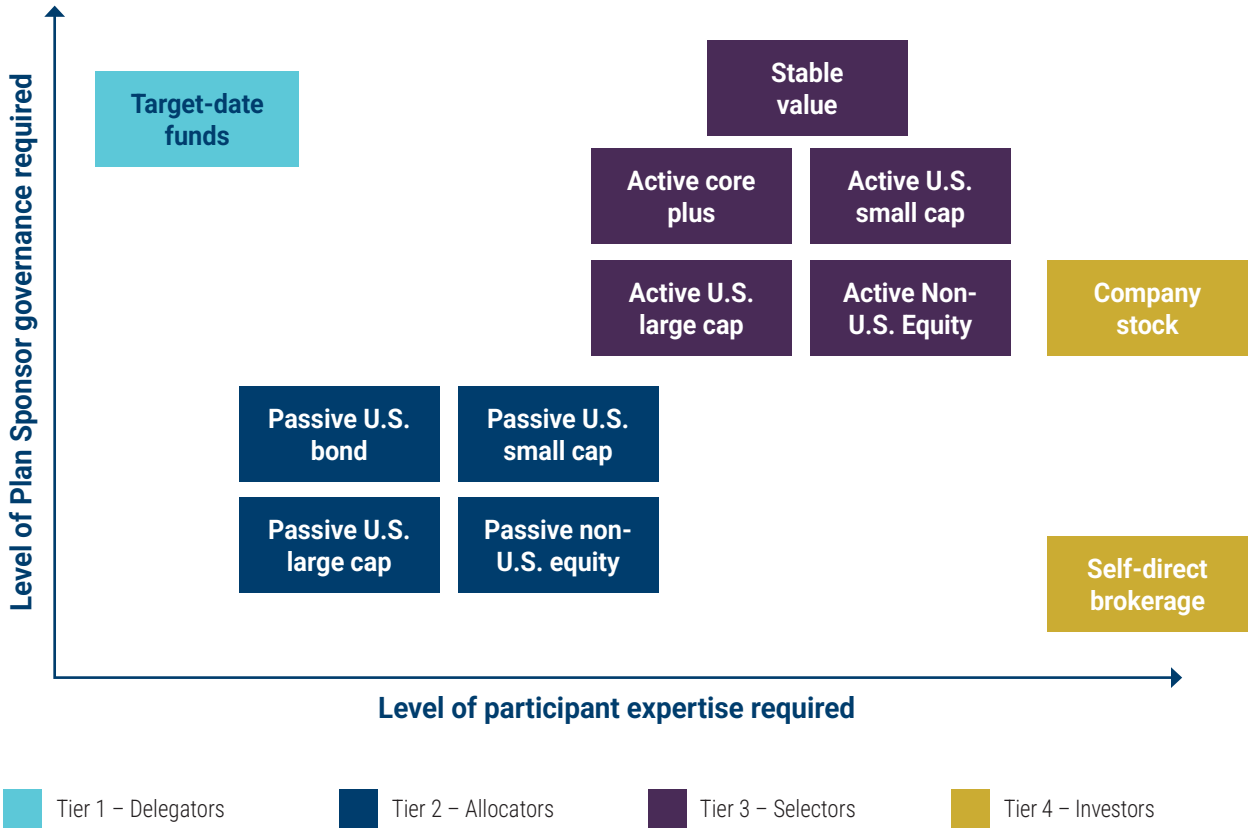
Exhibit 1

Tier I Delegators	Participants that prefer a professional manager to handle asset allocation, portfolio construction and manager selection. Typically consist of the Qualified Default Investment Alternative which is most often a target-date fund.
Tier II Allocators	Participants that prefer to make their own asset allocation decisions tailored to their goals and objectives but have a preference against, or are not capable of, evaluating active manager skill. Typically include a suite of passively managed core options.
Tier III Selectors	Participants that want to not only choose their asset allocation but also want to afford themselves the opportunity to outperform passive benchmarks. Typically consist of several actively managed funds from different asset management firms.
Tier IV Investors	Participants that feel comfortable investing across a broader spectrum of choices than the plan sponsor offers in the core menu. May include options such as a self-directed brokerage window and company stock.

[1] Investment governance refers to the structure (e.g., resources, expertise, processes) established to make informed investment decisions and oversee the plan.

Asset class options should allow a participant to "materially affect the potential return on amounts in his individual account with respect to which he is permitted to exercise control and the degree of risk to which such amounts are subject."[2] To accomplish this while also providing options that appeal to participants with different levels of investment knowledge, plan sponsors can consider a couple of key structure dimensions — governance level and participant expertise — as shown in Exhibit 2.

Exhibit 2

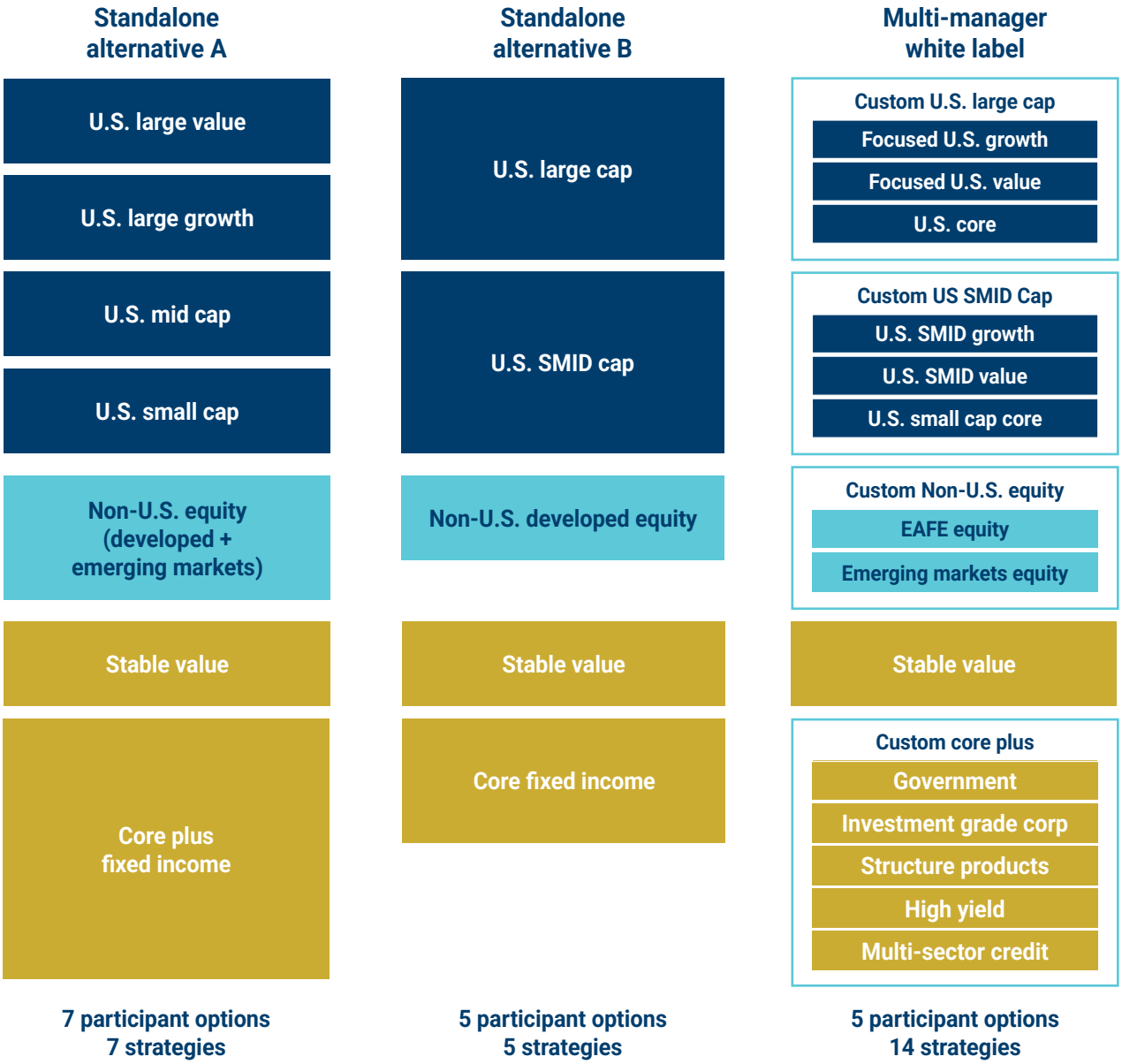


While purely illustrative, the chart above shows how a plan sponsor can create a structure that gives participants sufficient choice to create tailored portfolios to align with their goals and objectives.

Structure reviews can also aid in benchmarking discussions. As shown in Exhibit 3, undertaking a formal structure dialogue can unearth important sponsor preferences such as whether domestic equity exposure should be more condensed or style-box specific, whether non-U.S. equity should be developed or include emerging markets and whether fixed income should be core or include "plus" sectors, to name a few. They may also help sponsors compare the opportunity set of structures using standalone lineups versus those using multi-manager white label options.[3] These discussions can factor in valuable information such as industry trends, education about various benchmarks and markets, as well as plan demographics.

[2] ERISA Section 404(c)
[3] White label funds are bespoke investment structures with one or more strategies inside them. They are designed and maintained by plan sponsors for the benefit of plan participants and beneficiaries.

Exhibit 3

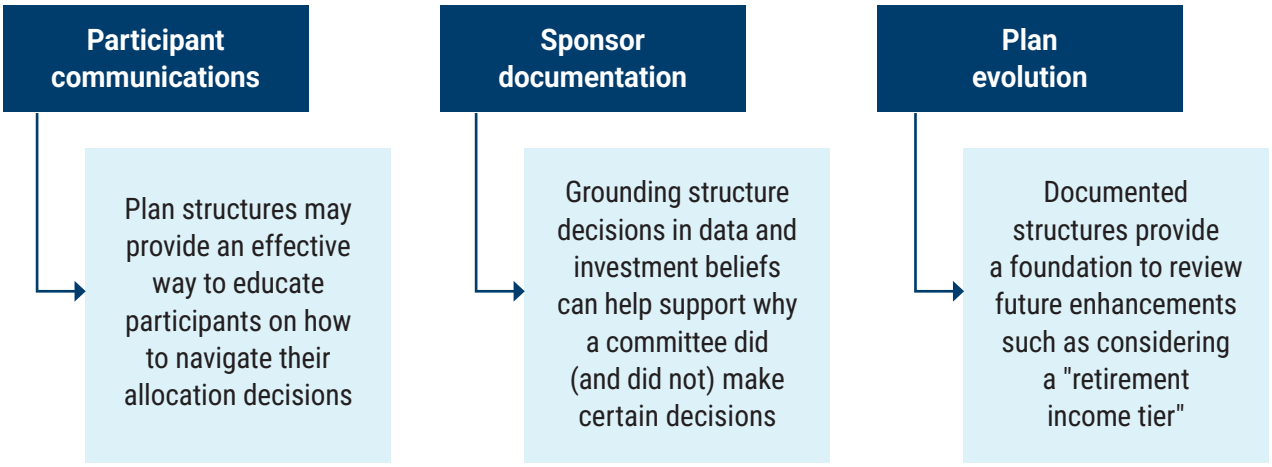


As shown above, moving from alternative A to B reduces the number of options that participants have access to which, on one hand, removes a participant's ability to express views on factors such as investment style in the core lineup. On the other hand, it streamlines participant decision-making. Moving from alternative B to a multi-manager white label structure retains the same number of participant options while affording sponsors the ability to select specialists, diversifiers and more focused strategies in an attempt to further improve participant outcomes. Importantly, the Exhibit above is only capturing active exposures in the plan. When factoring in other options such as a suite of target-date funds, passive options (that often mirror the selected active options), etc., the number of funds a participant has to choose from can quickly become daunting.

The benefit of this exercise is streamlining subsequent committee decisions. As an example, take a plan sponsor that is searching for a non-U.S. equity manager. The sponsor could begin by screening the Non-U.S. Diversified Equity universe comprising 967 distinct strategies.[4] Alternatively, the sponsor could focus on structure work upfront, and as part of that they may determine that the appropriate non-U.S. exposure for their participants is larger companies in developed markets. With this knowledge, the sponsor may review the EAFE Large Cap Equity universe consisting of 240 different strategies. Simply by taking the time to understand their desired exposure in advance, the sponsor was able to narrow their starting point by 727 names, or 75%. The same logic holds if the sponsor is working with a consultant. The consulting firm may have dozens of non-U.S. managers they'd recommend when using the broadest definition of international equities. By specifying universe and opportunity set, the sponsor may be able to narrow their search to a true shortlist of just a few names to review. This is more manageable from a governance perspective as manager searches typically have several steps including initial screening, data gathering, consolidated reporting and manager meetings.

The efficiency benefits alone make structure reviews a worthwhile endeavor. Additionally, sponsors may find value in structure reviews for participant communication, documentation and plan evolution.

Exhibit 4



Structure reviews should be conducted periodically as plans and markets change. New strategies and solutions enter the DC market regularly, so using this process to support decision-making could be a powerful tool. Regardless of the specific investment topic, sponsors may use the framework discussed as a foundational approach for structuring their plans for success.

[4] Source: eVestment as of February 6, 2025

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