QDIAs & Consultant Expectations

Meeting Retiree Needs and Enhancing Personalization

October 2024

The Pension Protection Act of 2006 introduced the Qualified Default Investment Alternative (QDIA), allowing employers to automatically enroll employees in retirement plans and invest their contributions in default options. QDIAs simplify employee retirement planning and reduce legal risks for employers, encouraging better investing behavior with minimal employee effort.

While QDIAs have been highly effective in addressing the accumulation phase of retirement savings, their development has focused predominantly on helping participants grow their assets during their working years. Target date funds (TDFs), which automatically adjust risk exposure as participants near retirement, have been foundational to these strategies. However, QDIAs have yet to address the decumulation phase adequately. As the retirement landscape continues to evolve, institutional consultants see two emerging trends shaping the future of QDIAs: an increased emphasis on retirees' income needs and a growing movement toward greater personalization of investment solutions. The accumulation-focused design of earlier QDIAs is gradually giving way to strategies that focus on the complex realities of retirement income and distribution.

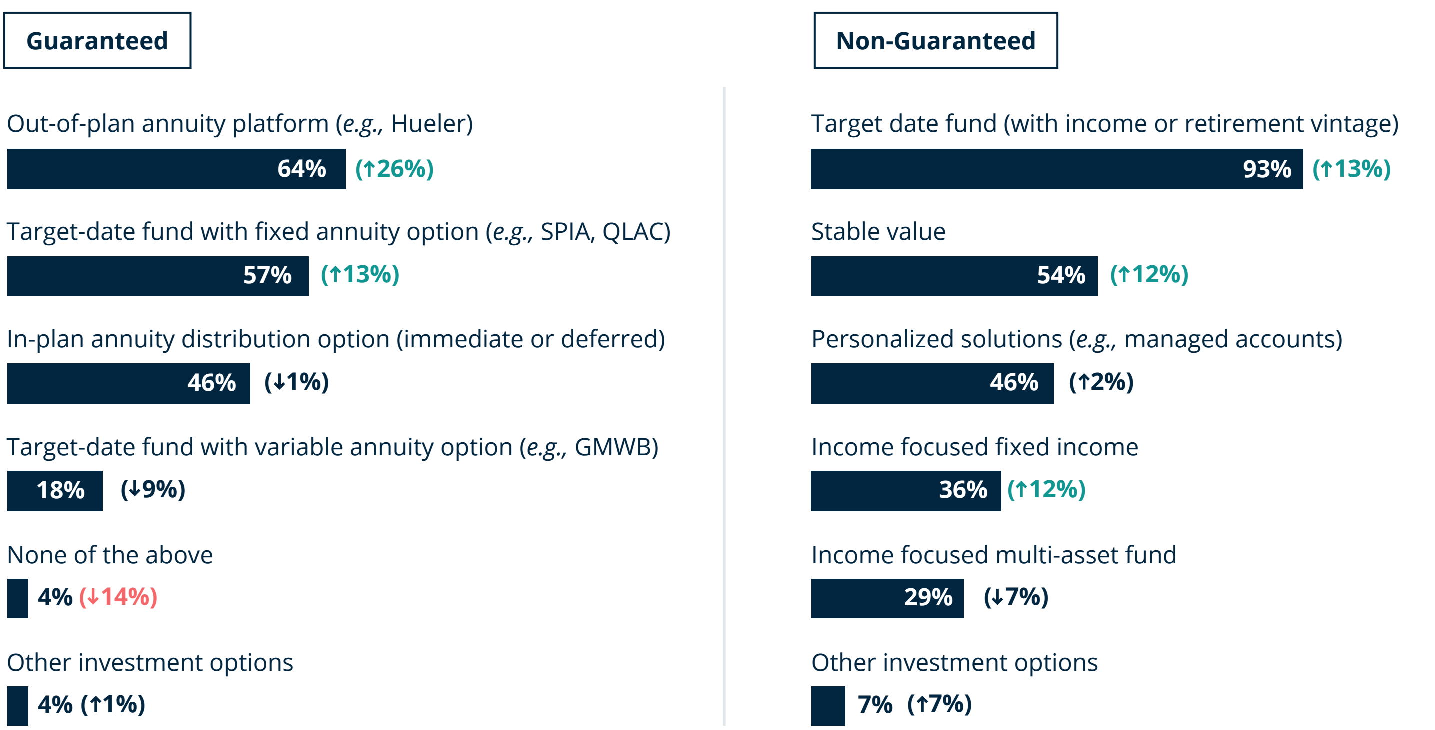
Addressing the needs of retirees is evolving on two fronts: guaranteed and nonguaranteed solutions. According to PIMCO's 2024 U.S. DC Consulting Study (DCCS), 44% of consultants anticipate that, aside from off-the-shelf target date funds, the greatest growth among QDIA options over the next three years will be in TDFs with embedded guarantees. The leading reason, cited by 79% of consultants, is that plan sponsors aim to provide participants with various options to address diverse retirement needs. Additionally, 61% of consultants say their plan sponsor clients have considered offering a guaranteed solution because their existing defined benefit plan is frozen or closed.

Over the coming years, consultants expect certain asset classes to be added to core plan line-ups, focusing on retirees' needs. Although plan menu consolidation is expected to continue, 84% of consultants see annuities as a top choice for menu expansion. The only asset class to garner more consideration is income-focused/multi-sector (92%).

PIMCO's DCCS (see Figure 1) also highlights the leading options for nonguaranteed investment options. For instance, 93% of consultants

Figure 1 | Retirement Income Recommendations – Guaranteed Solutions

Increased preference for out-of-plan solutions when offering guaranteed income options; Target date fund remains top choice to deliver non-guaranteed retirement income



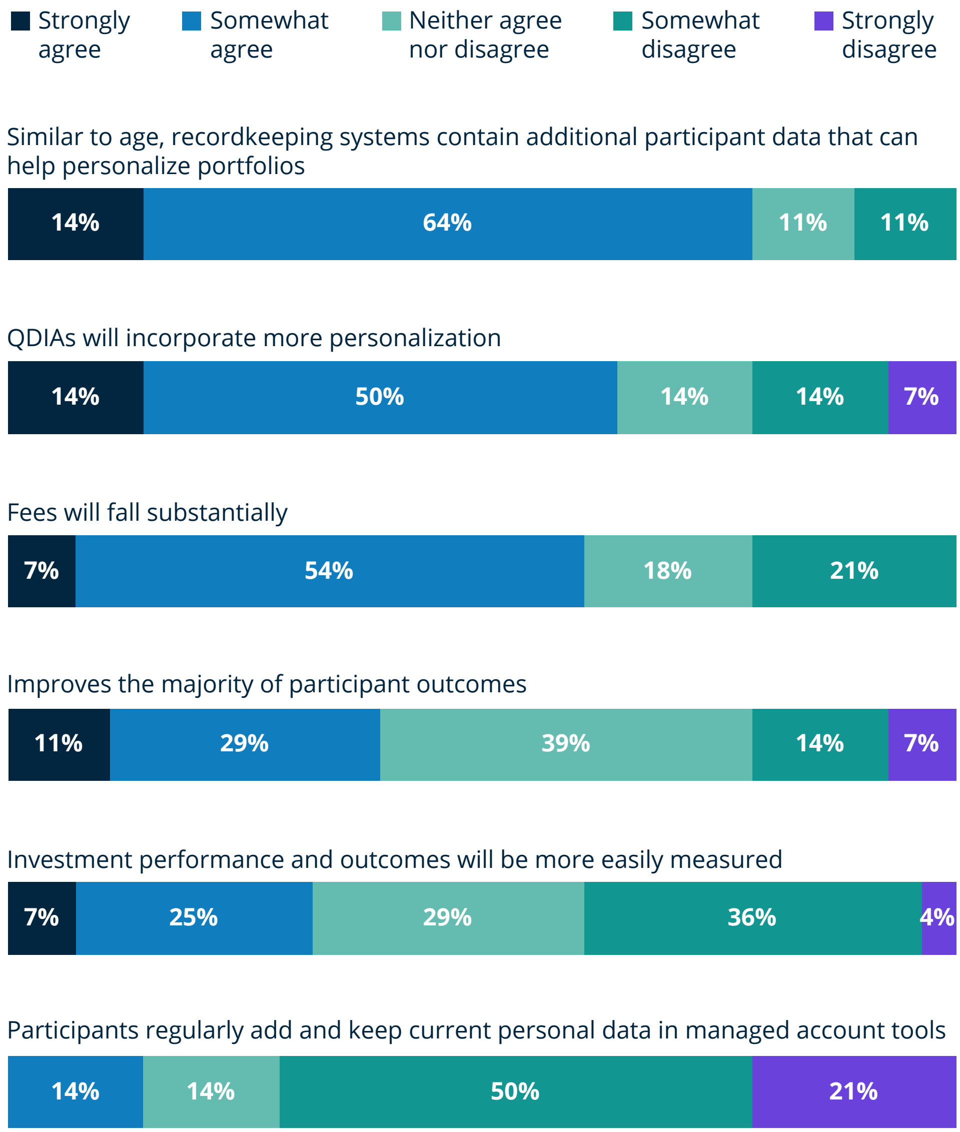
Which of the following investment options and tools, if any, are you most likely to recommend to support participants' retirement spending needs? Select up to 3 options for each category. (n=28) | Analyst Note: "Other" includes "Any one of the above depending on the plan's needs." ( ) – Corresponding YOY results from the 2023 PIMCO DC Consulting Study, June 2023.

recommend traditional TDFs (with an income or retirement vintage) as a primary nonguaranteed retirement income solution. In comparison, nearly half of consultants (46%) prefer a more personalized approach. The motivation behind these choices is rooted in a desire for lower cost, decreased complexity, and increased liquidity. Examples include managed accounts or personalized TDFs to deliver nonguaranteed retirement income. These options offer participants a customized experience that aligns with their unique financial situations and retirement goals.

The movement toward personalization within QDIAs is partly driven by a growing demand from younger participants. Research from Cerulli Associates highlights this trend, revealing that participants across different generations place significant value on retirement income plans tailored to their personal circumstances and lifestyle expectations. For instance, 27% of millennials, 24% of Generation Z, and 22% of baby boomers place importance on personalized retirement income plans.

This demand for tailored solutions is expected to drive innovation in the QDIA space as participants increasingly seek retirement solutions that reflect their individual needs. PIMCO's DCCS (see Figure 2) shows that nearly two-thirds (64%) of consultants agree that QDIAs will incorporate more personalization. Additionally, more than three-quarters (78%) of consultants believe recordkeepers can play a vital role in increasing personalization, given how much personal data they possess within their systems. Asset managers should partner with recordkeepers to leverage this data to help craft customized portfolios for plan participants. As few consultants (14%) believe participants regularly update their personal

Figure 2 | Perspective on Managed Accounts



Regarding personalization, how much do you agree or disagree with the following statements? (n=28)

78%

of consultants believe recordkeepers can play a vital role in increasing personalization.

data, this presents an opportunity for new solutions that can provide personalization without requiring further participant input or engagement.

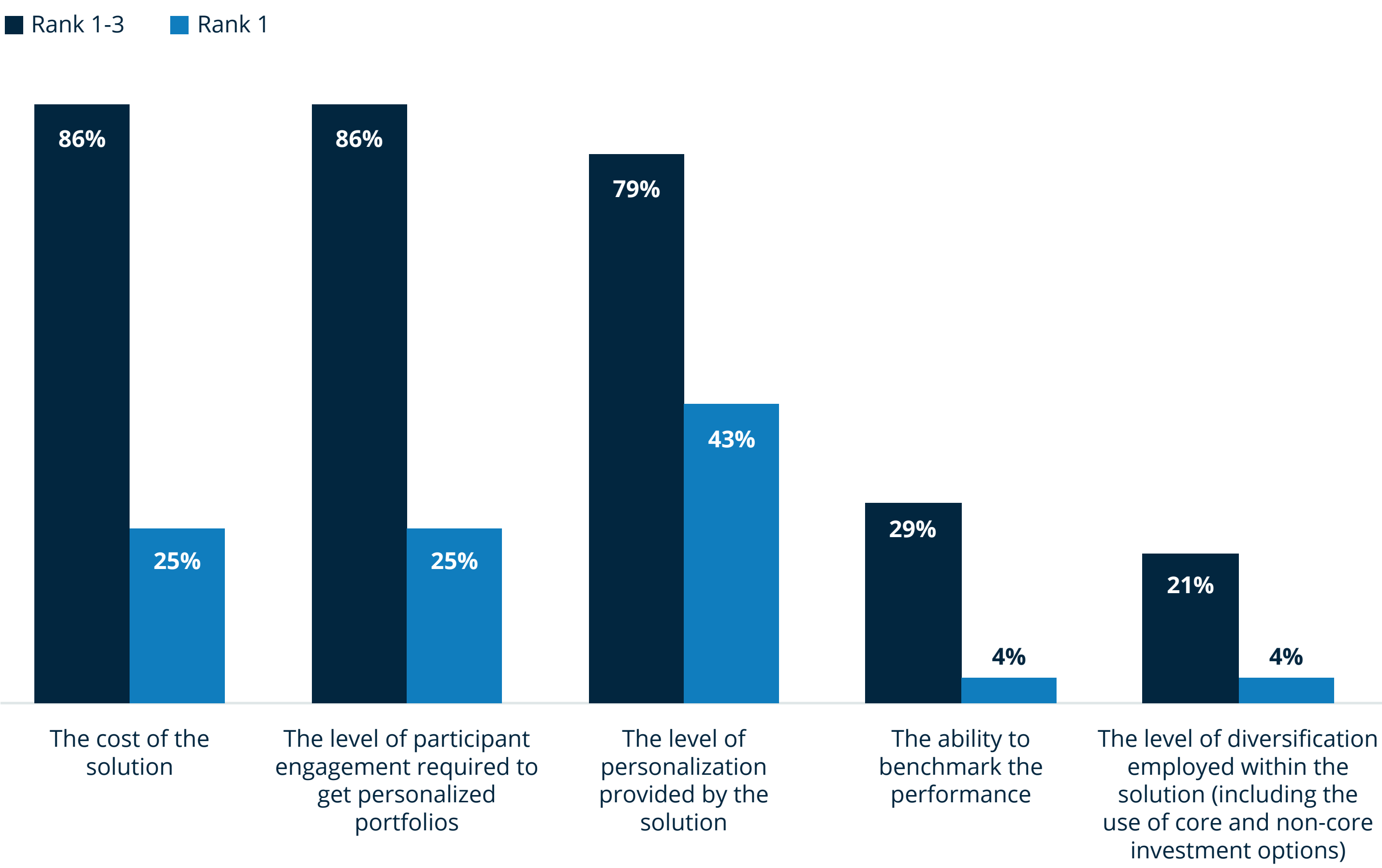
PIMCO's DCCS findings (see Figure 3) reveal that consultants prioritize several key factors when assessing personalized investment solutions: cost (86%), participant engagement (86%), and the level of personalization (79%). These factors ranked among the top three consultant selections. Among these, the level of personalization is considered the most important attribute by 42% of consultants. While managed accounts provide participants with a highly tailored retirement investing and planning experience, they are generally more expensive than personalized TDFs and require participants to manually input additional personal information for enhanced personalization. According to Cerulli's 2024 Target-Date Manager survey, target date managers emphasize that personalized TDFs offer significant advantages over other QDIAs, including more suitable investor risk profiles and lower costs compared to managed account programs. Notably, personalized TDFs do not require participant engagement. As plan sponsors consider personalized QDIAs, they must weigh the benefits of increased personalization against the associated costs and engagement requirements to identify the best solution for their participants and plan objectives.

86%

of consultants say cost is a key factor when assessing personalized investment solutions.

Figure 3 | Important Attributes when Evaluating a Personalized Investment Solution

Overall cost and level of participant engagement required cited as top attributes to evaluate personalized investment solutions



What are the most important attributes to focus on when evaluating a personalized investment solution? (Rank in order of importance, where 1 = most important.). (n=28)

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