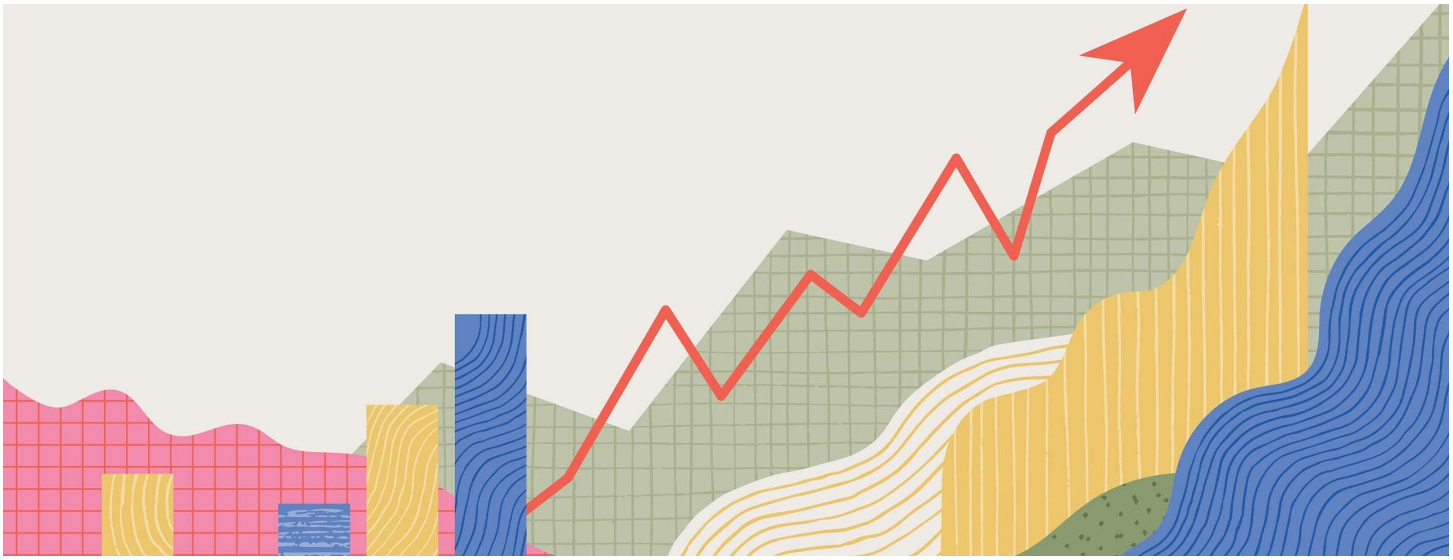

2023 Trends and Predictions for Retirement Plan Sponsors

As we close out 2022, U.S. employers continue to grapple with the challenges of high inflation, excessively tight labor markets, elevated and sticky wage inflation, and an abnormally low labor participation rate, which is as frustrating as it is difficult to comprehend. Now, mingle those challenges with an acceleration in the decades-long shifting social contract between employers and employees, disappointing equity market returns, and frustrating fixed income market declines, driven by rapid interest rate hikes by the Federal Reserve.

Atop all this, many employers find themselves having to do more with less as it relates to their staff, and company leaders are no different. They, too, are being asked to do more with less, with many people working harder and longer hours than they can ever remember. In this context, 2023 starts to look like more of the same of what we've seen in 2022.

As Shakespeare writes in *The Tempest*, "What's past is prologue." Throughout history, we've seen that the economy and markets—even labor markets—typically work in cycles. In that regard, we believe history will once again repeat itself.

As Scott Matheson, CAPTRUST institutional practice leader, says, "With employers facing so many uncontrollable challenges this year, now is the perfect time to refocus on what can be controlled instead of what cannot. Amid countless opportunities to be frustrated by the current landscape, there are equally myriad opportunities to lean into today's adversity and set yourself up for great success when this cycle turns in the favor of U.S. employers."

With optimism—and an appropriate dose of humility—CAPTRUST presents our annual retirement industry predictions for the year to come.

Prediction One: Employees Keep the Driver's Seatâ€¦for Now

At time of writing, the U.S. labor market remains tight, with an unemployment rate of 3.7 percent. For much of 2022, unemployment has hovered below the 4 to 5 percent rate that most economists consider the standard for full employment. This tightness adds to the frustrations of American employers who currently report, in aggregate, more than ten million open positions.

Also affecting the unemployment rate and the sum of job openings is the number of workers who have not returned to the labor force in the more than two and a half years since labor participation peaked in February 2020, the month before the U.S. began its pandemic-induced shutdown. Adding insult to injury, in 2022, American workers reported work-related burnout at all-time highs, and more than four million workers quit their jobs each month.

Yet, every dark cloud has a silver lining. Here, it seems to be that recent labor market trends are coming to an end and may be showing early signs of turning back in favor of employers. While we recognize that a few data points do not make a trend, there are some signs of hope for employers.

As we approach the end of the year, quit rates are slightly down, unemployment claims are up, and the use of temporary labor has dropped for three months in a row. If past really is prologue, this may be a leading indicator of a reduction in open positions and a corresponding rise in unemployment as more economically sensitive employers retrench and reduce their workforces.

In 2023, perhaps more than ever, employers have the opportunity to increase emphasis on employee retention, especially in executive roles, and rethink employee benefits and policies to better align with needs and expectations. To that end, CAPTRUST experts offer three suggestions.

Don't Try to Read Employees' Minds. Increasingly, employers are polling their employees to learn which benefits are most attractive and which can be removed from benefit lineups as population demographics—and needs—shift. Depending on employee makeup, employers can expect priorities to vary, but one thing is predictable: Retirement plans are here to stay.

Research from Voya Financial shows that, among working Americans, 60 percent are more likely to stay with their current employer if they are offered an employer-sponsored retirement plan. Equally important to working individuals were a competitive salary or compensation package (64 percent) and flexible work hours (63 percent). And when it comes to health spending and savings accounts, 47 percent say they are more likely to stay in their current jobs if offered an HSA, FSA, or dependent care account.

Meet People Where They Are. One employee benefit CAPTRUST experts expect to take the stage in 2023 is financial wellness programs. Participant education, guidance, and advice will likely become more personalized over time.

While personalization may trigger knee-jerk reactions about scalability at first, advances in technology now make it more cost effective than ever before. And research shows that a personalized experience is worth the investment—as are financial wellness programs. According to data from HR Professional and Ernst & Young, companies with financial wellness programs in place saw increases in employee retention (56 percent), employee well-being (50 percent), and employee productivity (46 percent).

Chris Whitlow, head of CAPTRUST's financial wellness and advice group, says financial wellness programs show a clear return on investment. "Financial wellness programs benefit participants who need help navigating the complex world of investments, debt, spending, and saving," he says. "But they also benefit plan sponsors by improving participation in retirement plans and, more generally, increasing engagement, satisfaction, and productivity at work. We see plan sponsors make thoughtful, future-focused lineups and choices for their participants, but those plans mean little if employees don't know how to put them to the best use."

Don't Forget to Take Care of Your Leadership Team. Another benefit trend that's expected to continue is the increase in employers offering nonqualified deferred compensation (NQDC) plans, with corresponding increases in employee eligibility and participation expected among existing plans. "This year we've seen the biggest spike in startup plans in any year of my 23 in the business," says Jason Stephens, CAPTRUST's executive benefits practice leader.

"NQDC plans are an attractive benefit for executives, especially when considering the increased need for employee retention," Stephens says. With an increase in NQDC offerings, experts like Stephens also predict a greater need for financial wellness programs directed at NQDC participants—again, with an increasing level of personalization of advice.

Prediction Two: A Market-Driven Rethinking of Plan Lineups and Asset Allocation

In the wake of market volatility and rising interest rates, defined contribution (DC) plan sponsors are likely to reevaluate what worked and what didn't among the investment options and solutions their participants have access to. Many will look to reaffirm the appropriateness of their fixed income, target date, and capital preservation options. Others will consider whether it might be worth investing in assets that are more protective in a negative market environment, including in-plan annuities as retirement age continues to extend and retirees increasingly keep assets in the plan.

Amid market volatility, both plan sponsors and their participants are seeing the value of diversification. But sponsors can only provide the tools for participants to diversify insomuch as they have access to diverse investment vehicles and tools for managing them. As a result, CAPTRUST experts predict that plan sponsors will feel an increased desire to challenge their current offerings to ensure participants have adequate options to diversify their investment portfolios. And plan sponsors will want more tools to help them diversify.

“Managed accounts present a new way to provide plan participants with diversified investment options, such as private real estate or in-plan annuities, but with guardrails in place in terms of access,” says Jennifer Doss, senior director of CAPTRUST’s defined contribution practice.

Doss and her team predict plan sponsors will also take a fresh look at qualified default investment alternatives (QDIAs), especially considering the rise of auto-enrollment in DC plans and participants’ lack of engagement. At present, 97 percent of designated QDIAs are invested in target-date funds, according to Vanguard’s “How America Saves 2022” report. But Doss predicts a growing trend toward hybrid QDIA programs that employ target-date funds for younger participants and managed accounts for older participants.

Within the current environment, plan sponsors may also consider reorganizing their NQDC plan investment menus instead of automatically mirroring their DC plans. Since NQDC plan participants often represent a different investor profile than a company’s broad employee base, this may be a good idea for many organizations. These plans also are not subject to the same fiduciary constraints as qualified plans, while participants often have more dollars at stake.

Employers sponsoring defined benefit (DB) plans will share the same desire to ensure they have the options needed to diversify. Yet, unlike their DC plan sponsor peers, DB sponsors will have to balance their desire to consider diversifying asset classes with their willingness and ability to take on illiquidity within their portfolio.

For many, alternatives were previously off the table because stated objectives, including time horizon, and fee tolerance, left them unwilling to consider nontraditional asset classes and investment vehicles. With significant losses in 2022 in traditional long-term-only portfolios, those with longer time horizons will choose to explore the role of these nontraditional, or alternative, asset classes in asset allocation.

Additionally, the increase in fixed income yields will lead some to reconsider the level and duration of risk necessary to achieve their target returns. This may be true for entities sponsoring cash balance plans—specifically, entities with partnership structures where years with significant negative returns create challenges, including discontent among partners.

For those with traditional, corporate DB plans, rapidly rising rates in 2022 had a meaningful and positive impact on plan liabilities but an equally disappointing impact on long-duration corporate bond portfolios, which have been the cornerstone of most liability-driven investing (LDI) portfolios.

Despite overall improvement in funding levels, many committees will grapple with losses in these portfolios. But, for those who had been hoping to rid themselves of the ongoing liability and maintenance of their DB plans, we expect a rush to pursue a roadmap toward termination.

Prediction Three: A Rising Tide of Annuity Purchases

Rising interest rates in 2022 improved funded status for most DB plan sponsors. For those who have adopted dynamic de-risking glidepaths or significant allocations to LDI, the focus will now shift toward executing an established roadmap towards further pension risk transfer or termination. This will mean engaging various partners to ensure plan participant data is in good shape and preparing to approach the single premium group annuity market.

These preparatory steps could lead to a scenario in which the market for single premium group annuities is constrained by insurers' balance sheets. It may also be constrained, to some degree, by the capacity of the teams of placement specialists and insurers that will be needed to implement and document the process, as well as do the underwriting, structuring, and execution.

As Grant Verhaeghe, CAPTRUST's defined benefit and institutional asset pool practice leader says: "DB sponsors wishing to move in 2023 should move now to develop a timeline. They should plan to approach the market early and engage the appropriate partners with established processes and relationships. These sponsors will need the right insurers to run the placement and follow correct fiduciary processes as outlined in DOL 95-1."

For those seeking to utilize lump sum windows as part of this de-risking process, plan sponsors will have to consider the impact of rate movement in 2023 on pre-established lump sum rates and the implication to their risk management strategies.

Plan sponsors who enter 2023 without a formal roadmap to align assets with liabilities—or a plan to pursue various forms of pension risk transfer—should be aware that it is likely that their year-end funded status estimates will be a positive surprise. "This surprise may be of the magnitude that, going forward, they embrace developing liability-driven strategies to minimize the future risk of impairing this positive funded status they now find themselves in," says Verhaeghe. "Partial risk transfer may be an attractive answer for those who are seeking to reduce liabilities but are not yet prepared for full termination."

In the NQDC and DC spaces, while direct annuity purchases are not expected to be high, a close annuity corollary for NQDC is that sponsors will likely add more flexible distribution options that allow plan participants the ability to spread out withdrawals and create targeted income streams. Utilization of these features is the culmination of smart plan design elements and successful participant education and planning tools.

Prediction Four: The Rise in Discretion Continues

In 2023, the industry is likely to see a continuation of the years-long increase in discretionary plan management across qualified plans. Within the defined contribution segment, the primary drivers of discretion will continue to be concerns over plan sponsor time and expertise and fiduciary concerns related to the continued uptick in retirement plan litigation. This is true particularly considering shifting retirement plan rules and regulations and continued reshuffling of retirement plan committeemembers.

Two forms of discretion that CAPTRUST experts anticipate will gain more traction in 2023 are 3(38) investment manager and 3(16) discretionary plan administrator services. Hiring and regularly monitoring these providers can limit a plan sponsor's fiduciary responsibilities.

"Outsourcing may also improve participant outcomes," says Doss. "That is, leveraging discretionary services allows plan sponsors to save time and focus on broader issues, such as financial wellness and participant engagement, two of the elements that are driving employee happiness and retention and overall retirement readiness."

While plan sponsors have clearly embraced granting more discretion to their investment advisors on the defined benefit side, this is not a silver bullet. "While granting discretion allows your investment advisor or asset manager to take advantage of market opportunities and shift away from perceived risk, that discretion is often granted in the context of guidelines defined in an investment policy statement (IPS) or investment management agreement (IMA)," says Verhaeghe.

These statements often include stringent guidelines on permissible asset classes and asset allocation. "Simply put, not all discretionary asset managers utilize the same tools and are comfortable straying away from home base in asset allocation," he says. "And many plan sponsors don't want them to."

In short, the biggest determinant to performance in 2022 was likely asset allocation, and discretionary managers only have so much leeway to modify overall risk posture away from stated objectives. This may lead to revisiting and redefining stated boundaries on a go-forward basis.

Prediction Five: Litigation, Regulation, and Legislation

Litigation may be here to stay, but its ongoing drumbeat shows that sound fiduciary process never goes out of style. For plan sponsors, this means reviewing fees periodically to make sure they are reasonable given the services and providing strong oversight and documentation of all fiduciary decisions and processes.

Even for those who do not fall under the Employee Retirement Income Security Act (ERISA) definition of fiduciary, understanding fiduciary responsibilities and how to act in the best interests of participants remains a best practice.

On the regulatory front, plan sponsors will be reacting to the Department of Labor's recent ruling on ESG factors. In 2023, the industry will attempt to standardize ESG data and terminology, while plan sponsors attempt to solve for participant's personalized ESG goals.

Perhaps most impactful is the proposed legislation, the second iteration of the Setting Every Community Up for Retirement Enhancement Act (SECURE 2.0), that is slated to be passed at the end of 2022. With bipartisan and bicameral support, SECURE 2.0 has close to 100 provisions designed to increase retirement savings and coverage.

If SECURE 2.0 passes, 2023 will be spent dissecting the impact of different features and provisions on retirement plan sponsors and participants. From increased required minimum distribution (RMD) age to emergency savings and student loan debt features, to the expansion of collective investment trusts (CITs) within 403(b) plans, there is a lot to evaluate.

In the End

Economic uncertainty, market volatility, labor market challenges, a continued wave of litigation, and new legislation and regulation will keep plan sponsors busy next year evaluating the impacts and enhancing their retirement plan benefits. Of this we're certain.

But, past does not have to be prologue in all areas. A new year creates new opportunities for plan sponsors to react in new ways, adopt new ideas, and innovate in key areas. As American poet T.S. Eliot wrote: “For last year's words belong to last year's language, and next year's words await another voice. And to make an end is to make a beginning.” CAPTRUST looks forward to tackling these challenges as a partner to every client in the new year.