Adding a ‘Retirement Tier’ to 401(k)s

By Kerry Pechter *Thu, Jun 21, 2018*

Drew Carrington, who markets Franklin Templeton funds through jumbo 401(k) plans, believes that plans should include a “retirement tier” reserved for participants who are nearing retirement. His payout funds would fit nicely into that space.

If you’re into high-end auto components, you may be familiar with Recaro seats. You may also be acquainted with Brembo disk brakes and ZF nine-gear automatic transmissions. Drew Carrington would like you to think about Franklin Templeton’s 401(k) funds in a similar vein.

Carrington is a senior vice president at Franklin Templeton Investments, where he leads the distribution of that firm’s actively managed funds through $1 billion-plus defined contribution plans. His job is to convince plans sponsors and their consultants that his company’s funds should be among the investment options they offer their participants.

Drew Carrington

He’s been spreading the word that large 401(k) plans should include a “retirement tier” reserved for participants who are nearing retirement. As participants age into this tier, they would receive new kinds of pre-retirement advice and have access to products that could help them transition from the accumulation phase to the decumulation phase.

Not coincidentally, Franklin Templeton has funds that can fill the retirement tier like fingers in a glove. Along with its Franklin Income Fund, which distributes interest and dividends, the company offers the LifeSmart Retirement Income Fund, which generates monthly paychecks, and Franklin Retirement Payout Funds, which lets participants schedule payouts up to five years before they retire.

But the current trends are not Franklin Templeton’s friends. Plan sponsors have been shrinking their fund lineups and, like investors, switching to index funds. Moreover, many plan sponsors do little to help retired participants keep their money in the plan (rather than rollover to an IRA) and draw regular income from their accounts.

The damage to Franklin Resources, the parent of Franklin Templeton Investments, has been acute: In the year ending April 2018, its funds saw net outflows of almost $28.7 billion (about 7.7%). Since the end of 2014, the Franklin Resources share price has lost about 40% of its value.

One tier, four elements

“‘Retirement Tier’ is an idea that we’ve been out in the market talking about,” Carrington told *RIJ* recently. “The word ‘tier’ is a shorthand way of describing groups of participants. On each tier you have certain participants and certain investments that are appropriate for each. The tiers typically refer to participants who either want the plan provider to ‘Do it for me,’ or ‘Do it with me,’ or who say, ‘I’ll do it myself.’

“A ‘Retirement Tier’ would be more than that,” he said. “We see it as having four characteristics. First, we think a plan should allow for partial ad hoc withdrawals for people who are over age 59½ and are separated from service. Today that type of person can only take a lump sum withdrawal, or execute a cash-out rollover or they can get one shot at setting up systematic withdrawals. Once you set up withdrawals, you can’t change your decision except to take a lump sum.”

“The second feature of a Retirement Tier would involve targeted communications for participants approaching retirement. There are many opportunities to engage these them. There are milestone birthdays, such as when they turn 50 and become eligible to make ‘catch-up’ contributions. The third piece involves providing coaching, models, or tools, such as a Social Security Optimizer.

“The final piece, which we think is especially important, is to offer a set of investments that are appropriate for retirees or near-retirees. It might be annuities. It might be income-focused investments, or managed payout funds. But it might also mean a broader set of tools on the fixed income side. You would not want to restrict the options to merely an aggregate bond fund or an asset preservation fund.”

Fund options for the retirement tier

If you surf over to the Retirement Income Solutions page of the Franklin Templeton website income generating funds on its website you find three:

Franklin Income Fund. This $77 billion fund ($2 billion in R6 retirement plan shares), which turns 70 years old this August, has an allocation of about 40% bonds and 40% dividend paying stocks. The rest is mainly in convertible bonds and cash. Almost all of its bonds are rated BBB (9%) or non-investment grade (87%). Institutional R6 shares have an expense ratio of 0.40%.

Franklin LifeSmart Retirement Income Fund. Created in 2006, this fund is a fund of

Franklin Templeton funds with a gross expense ratio of 0.97% and a net expense ratio of 0.44% for R6 shares. It has only $3.8 million in R6 shares and $56.3 million total. With an asset allocation of 60% bonds and 40% stocks, it invests in Franklin U.S. Government Securities Fund, Franklin Floating Rate Daily Access Fund, Franklin Income Fund, Templeton Global Total Return Fund, Franklin High Income Fund and outside funds.

Franklin Retirement Payout Funds. Launched in mid-2015, this series of funds enable investors to build the equivalent of a bond ladder out of a series of target-date bond funds, each designed to distribute all of its principal and interest in the target year. The funds invest in U.S. dollar-denominated investment grade fixed income securities and in U.S. dollar-denominated foreign securities. Their institutional share annual expense ratio is 0.30%.

Carrington compared Franklin Templeton to the suppliers of specialty parts for high-performance cars. "The final assembly of an automobile is labor-intensive. It's a tough business to be in. But think about companies that make specific high quality component parts: the Recaro seats, Brembo brakes, or ZF transmissions. Those companies are less labor-intensive, and they have higher profit margins. I would say, 'We make really good transmissions and really good brakes.'"

The Four Pillars of the Retirement Tier

'Nobody wins that way'

While Carrington's interest in promoting his funds is a narrow one, there's fairly broad agreement in retirement income circles that retooling 401(k) plans should be updated to reflect their evolution into de facto replacements for defined benefit plans as the principal private source of retirement income for American workers.

Just this week, Kelli Hueler, the founder of IncomeSolutions, a web platform where individual investors can buy annuities from competing life insurers, testified at an ERISA Advisory Committee meeting on this topic. She urged the Department of Labor to revise its 22-year-old Interpretative Bulletin 96-1 so that plan sponsors can educate participants about decumulation and offer partial withdrawals for retired participants.

"Obviously, plan sponsors have been reluctant to provide any guaranteed solution," Carrington told *RIJ*. "But they've also been reluctant to add additional options. The idea of a Retirement Tier sounds at first like it runs counter to the overall goal of plan simplification. But we would argue that you can communicate it in ways that make things less confusing. We're talking about a full set of tools—changes in plan design, communication and technology tools—that help people close to retirement.

"Just offering investments in a vacuum without tools—that doesn't achieve anybody's objectives. But if you provide the context, and you make it more likely that sponsors will adopt them and that participants will use them, then you have better outcomes. We want to talk about what we do as part of a bigger picture."