Boola-Boola, Retirement Moolah

By Kerry Pechter *Thu, Feb 4, 2021*

Yale's $7 billion 403(b) plan offers TIAA's RetirePlus Pro target-date solution to its 27,000 active and retired participants. The portfolios use Vanguard and TIAA CREF funds, and a liquid version of the TIAA Traditional annuity, which can be annuitized.

Yale University has offered a TIAA retirement savings plan to its professors, administrators and other employees for more than a century. Until three years, ago, the Ivy League school offered a typical 403(b) plan with a variety of investments including mutual funds and several versions of TIAA's Traditional and variable annuities.

But in 2018, Yale redesigned its $7 billion plan, which serves some 16,000 active participants and 11,000 retirees. It decided to build a custom series of 13 target-retirement-date (TD) portfolios that include TIAA's guaranteed annuity and Vanguard index funds.

Collaborating with TIAA's relatively new Custom Portfolio Group and Aon (Yale's **3(38)** investment fiduciary), Yale developed a managed account with a TD series inside it. Each TD portfolio (2010 to 2070) contains a liquid version of the TIAA annuity as its sole fixed-income option. Each portfolio comes in three risk profiles: conservative, standard and aggressive.

Because the managed account is a Qualified Default Investment Alternative (**QDIA**), Yale can default new participants into the TD series. The TIAA annuity in each portfolio provides participants a secure investment and an easy option to convert some of their savings into guaranteed retirement income if they wish. Yale's QDIA TDs built on the **RetirePlus Pro** version of TIAA's RetirePlus custom TD service.

In the process of working with Yale, TIAA saw its own custom TD business crystallize into a distinct business group, RetirePlus. (The "Pro" version was, in fact, born at Yale.) "Five or six years ago, consultants began asking if we offered custom portfolios," Tim Walsh, Senior Managing Director for Product Solutions and Distribution at TIAA, told *RIJ* recently.

"This started as a technology that allowed consultants to create custom models. Then people began to talk about leveraging annuities in qualified plans and we had the RESA Act, and we started having conversations about using annuities. What started as an accommodation has become major topic of conversation," Walsh said.

At a time when retirement plan providers and sponsors are showing more-than-usual openness to putting annuities in their plans (in part because of a liability-reducing provision of the SECURE Act of 2019), RetirePlus Pro serves as an example of what the income-friendly defined benefit plan of the future could look like, not just for 403(b) plans but for the much larger 401(k)-plan market as well.

Old Eli's plan

Hugh Penney

"We used to have 115 quality investments from Vanguard and TIAA," Hugh Penney, Yale's Senior Advisor for Benefits Policy, told *RIJ*. "The principal program, going forward, is a custom target date portfolio series. More than 80% of our participants remain straight-up defaulted investors with a portfolio corresponding to their age and expected retirement date."

About 10% of participants have actively personalized their TD portfolio by confirming or changing their retirement age or dialing the risk of their portfolio up or down.And less than 10% are managing their own investments.

Unless they choose otherwise, new enrollees contribute 5% of salary to the plan and Yale contributes 10%,a 100% match of the first 5% plus a "core" contribution of 5% of salary.

"Online participants can see the new investment line up, custom TD service, and their individually owned legacy annuities," Penney said. "Some participants have a legacy account, some a new account and some have both. There's a doorway between them. You can move money out of the legacy plan to the new plan, but you can't move money from the new plan to the legacy plan."

For most RetirePlus clients, Chicago-based Mesirow Financial designs the glidepaths (the gradually de-risking of each portfolio's allocations as participants age) using the client's existing investment options. As a RetirePlus Pro client, Yale's fiduciary selected Aon as a 3(38) fiduciary to design the glidepaths of the portfolios.

"Yale's hourly workers typically retire before age 65 while salaried professors and administrators are more likely to retire near 70. So their glidepaths are different. Hourly workers also have a pension, so their glidepaths are also heavier in equities. This is what's so useful about customizable portfolios. You can fit the plan to the population," Penney told *RIJ*.

"If you had an off-the-shelf TDF for the hourly group, it would likely be too conservative because it wouldn't know that they had a pension," he added. With the salaried group, which makes up two-thirds of our population, the off-the-shelf glidepaths would likely have them retiring too early. Another important design feature of RetirePlus Pro is that individually owned annuities in a participant's legacy account can be "considered" in the construction of a participant's TD portfolio, thus improving the allocation of their overall account.

Pending suit against Yale's 403(b) plan

Yale's 403(b) retirement is among more than a dozen retirement plans at elite universities to be the targets of class-action lawsuits brought by their participants."Cases against New York University, Emory, Duke, Vanderbilt, MIT, and Columbia University have also been certified as class actions," said Law360.com on Dec. 7, 2020.

"Some of the lawsuits assert that the use of multiple record keepers, rather than a single provider (common in many 403(b) programs) has caused duplicative fees to be charged to plan participants," according to Windes.com.

"Before Yale consolidated services with one plan provider in April 2015, Yale used both TIAA and Vanguard Group for record-keeping and administration services," reported *Investment News* on Aug. 15, 2016. "The plan paid between \$3.8m and \$4.3m (about \$200-\$300 per participant per year) from 2010-14, while \$35 per participant would have been more reasonable for a plan of its size, plaintiffs claim."

As examples of glidepaths, consider two of Yale's portfolios. The 2060 portfolio fund allocates 11% to the TIAA Traditional guaranteed annuity and the rest to four Vanguard funds: 45% to the Total Stock Market Index, 29% to a Developed Market index fund, 9% to an emerging markets index fund, and 9% to a real estate investment trust (REIT) fund. The portfolio's expense ratio is just six basis points a year. The 2020 portfolio, for those who recently retired or are planning to retire soon, is much more conservative. It allocates 65% of contributions to the annuity, 14% to the Total Stock Market Index fund, 10% to the Developed Market index fund, 8% to a REIT fund 3% to Emerging Markets. Its expense ratio is only four basis points a year.

A bespoke 403(b) plan

To build the plan it wanted, Yale had to work within the rules of non-profit 403(b) plans and conform to the Employee Retirement Income Security Act of 1974 (ERISA).To default new participants into the plan, Yale's main offering needed to meet the requirements of a Qualified Default Investment Alternative (QDIA).

Fitting the TIAA Traditional annuity into a QDIA TD series required using a fully liquid version of the contract. A higher crediting version of the guaranteed annuity has more limited liquidity, but allows for faster growth during the accumulation phase. All versions of the TIAA Traditional have a guaranteed rate of return and an option for lifetime guaranteed income in retirement.

“Income was an important design element for us,” Penney said. “TIAA Traditional when annuitized has no built-in inflation protection, but annual dividends help increase the payout from year to year,” providing a de facto inflation buffer.

Yale’s QDIA TD portfolio uses a fully liquid version of TIAA Traditional. Its returns aren’t as robust as those of a less liquid version, but it meets the QDIA requirements; participants can move money into and out of as they wish. Still, the deferred annuity structure makes it so patently valuable that Yale’s TD series essentially offers no other fixed income investment.

The guaranteed annuity investment also allows Yale participants a vehicle inside their 403(b)for converting their savings to future income, in one or more conversions before, at, or after retirement. To achieve all the elements of this progressive custom design, Yale, TIAA and Aon had to work within a managed account that could hold a TD portfolio and also hold an annuity.

No pressure

Yale likes the idea of annuitization but the decision is up to each participant. “Our studies and analyses showed that retirees feel more security in retirement if part of their income is guaranteed,” Penney said. “We’re very comfortable with having the income option. We think annuitization is beneficial. But annuitization is an individual decision for participants.

“We can design the investments to offer and design a TD with a 60/40 retirement allocation, for instance, at a certain age. But as a plan, we can’t advise people about what to do with their investments, so we must address [the annuitization concept] from an educational perspective,” he added.

Yale’s idea of retirement income planning isn’t very different from the recommendations of Wade Pfau at The American College of Financial Services or the “floor and upside” gospel of the late great Retirement Income Industry Association (whose principles are now absorbed into the adviser education component of the Investment and Wealth Institute).

“Our modeling shows that there’s a sweet spot in the amount that a typical participant might consider to annuitize—either enough to double their Social Security benefit or a quarter of their 403(b) assets. With Social Security and secure lifetime income you likely become a long-term investor with the balance of your portfolio," Penney told *RIJ*. "Many retirees make withdrawals from qualified plans for income, but that technique and its variations don't have the same guaranteed profile as an annuity."

Yale's plan, and the literature on the topic agrees, that most participants are better off using a default retirement savings strategy, designed by experts, than trying to manage their own savings over the decades and through the market's ups and downs.

"Since the advent of the 401(k), plan sponsors have tried to educate participants to become sophisticated investors, but we realized that is not what most participants actually want," Penney said. "When the market tanked last spring, we were curious what people would do. In the past we often saw people sell at the bottom of a dip. This time, almost nobody moved and they came out of it fine."