The Future of DC Plans, Via PIMCO

By Editor Test *Tue, Apr 27, 2010*

A PIMCO executive's new book is an ode to custom target date funds—and offers a glimpse of the Allianz unit's retirement business strategy going forward.

Are custom target-date strategies, where a retirement plan provider or advisor cobbles together "open-architecture" target-date investment options out of a plans' existing funds, the wave of the future in defined contribution plans?

PIMCO, the giant bond manager and unit of Allianz AG, thinks so. That's the gist of a new book by Stacy Schaus (at left), a senior vice president and leader of PIMCO's defined contribution practice and of PIMCO's just-released Fourth Annual Defined Contribution Consulting Support and Trends Survey.

Schaus' book, "Designing Successful Target-Date Strategies for Defined Contribution Plans" (Wiley Finance, 2010), lays out a vision of the DC world of tomorrow—a vision that might also be interpreted as PIMCO's retirement business strategy.

In this vision, made possible by the Pension Protection Act of 2006, millions of new DC participants would be auto-enrolled and defaulted into custom TDFs, which would be held in low cost collective trusts and be institutionally managed. Their contributions would be "auto-escalated" over the years to enhance their nest egg.

At retirement, according to this scenario, participants wouldn't leave their plans. They would roll their assets into in-plan "deemed" IRAs, allocate part of their money one of PIMCO's TIPS payout funds and then cover their longevity risk tail by purchasing an advanced life deferred annuity from PIMCO sibling Allianz Life.

This, of course, isn't the only vision that retirement plan providers are pitching to plan sponsors. Another feature in *RIJ* this week, "Great-West Enters the In-Plan Income Space," describes Great-West Retirement Services' SecureFoundation program, in which participants are encouraged to buy off-the-shelf TDFs and protect them with a lifetime income rider starting ten years before retirement. Prudential Retirement introduced this concept with its IncomeFlex program in 2007.

Both the PIMCO and the SecureFoundation/IncomeFlex strategies will inevitably compete with rival strategies that involve individual income annuities, deferred income annuities, or payout mutual funds. In addition, a wide range of retirement income planning tools offer individualized strategies for financial advisors and their high net worth clients. Given the $15 trillion retirement market, there's likely to be room for many players.

In an interview, Schaus explained the drivers of and philosophy behind PIMCO's strategy. In designing custom TDFs, she said, PIMCO would focus on helping the participant achieve "retirement income adequacy." At the same time, the strategy would reflect the "more conservative" approach to investing that might be expected from a company like PIMCO, with its fixed income roots.

Schaus was asked if PIMCO believes in "to" or "through" TDF "glide-path." In a "to" target date fund, generally speaking, the investor's bond allocation lands at its permanent maximum—perhaps but not necessarily 100%—at his or her retirement date. In a "through" fund, the investor's equity allocation might still be 50% or more at retirement, and the fund won't reach an all-bond allocation for many years, if ever.

"There's no single answer," she told RIJ. "Our philosophy regarding the to/through issue is that the allocations are based on each plan's needs, and the level of certainty that's required." She noted that if the retiree adds a TIPS ladder and longevity insurance to their retirement portfolios, those products would absorb much of the market risk, interest rate risk and longevity risk that would otherwise fall on the target-date funds. In that case, the to/through issue wouldn't be as pressing.

Selected Findings, PIMCO's 2010 Defined Contribution Consulting Support and Trends Survey*

- 60% of consulting firms actively promote custom target-date strategies.
- 100% of firms recommend that clients offer a target date or target risk investment tier.
- 90% consider custom target-date strategies for plans with assets of $500 million or less.
- 66% said "insufficient asset size" and 59% said "difficulty of operational setup" deterred plan sponsors from custom strategies.
- 60% believe collective investment trusts are critical or very important for DC clients.
- 43% believe exchange-traded funds (ETFs) have no place in DC plans beyond availability in a brokerage window.
- 73% expect passive strategies in DC plans to proliferate.
- 82% believed that Treasury inflation-protected securities (TIPS) would bring the most value as an added asset class in DC plans, followed by emerging market equities (57%) and commodities (54%).
- 75% of plan sponsors would like to retain retiring participants assets in their plans, but only 32% try to do so.
- 80% believe it is "somewhat to highly likely" that plan sponsors will add a guaranteed income option to their plans over the next two years, but at a slow pace.
- Fixed annuities, living benefits, and longevity insurance were the retirement income products most likely to interest plan sponsors.
- Hewitt, Mercer, Schwab, Fidelity, JPMorgan and ING are the recordkeepers most supportive of custom strategies.
- 54% recommend an equity allocation at retirement of 30% to 50%, while 29% recommend less than 30%.
- 89% said different demographics among companies should drive unique "glide paths."

*Results are based on responses from 30 U.S. consulting firms serving 2,000 defined contribution plan sponsors with aggregate plan assets of $1.7 trillion.