Retirement Insights

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Retirement Outlook 2024

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52% of DC participants are concerned about the impact inflation could have on their retirement savings.[2]

In brief

- A higher-for-longer market environment presents challenges and opportunities for sponsors and participants and has sponsors rethinking retirement plan menus.
- Inflation concerns and competing financial priorities have dented retirement confidence but also provide an opportunity for sponsors to clearly define their plan objectives.
- Several SECURE 2.0 provisions come into effect in 2024 and present plan sponsors with some key decisions.
- With yield at the highest levels in years, fixed income will be in focus for 2024, particularly its role in target date strategies.
- In a changing market environment, some companies are reevaluating how they provide retirement benefits in ways we have not seen in years.

In this piece, we discuss key considerations for retirement plan sponsors in 2024, including where markets may be headed, how sponsors can address declining retirement confidence, trends in regulation, legislation and litigation, and the road forward for defined benefit (DB) plans.

What's in store for markets in 2024?

Interest rates continued to dominate headlines in 2023, with the US Federal Reserve raising rates four times to cool inflation. Fixed income had a volatile year, with rising rates driving the broad US fixed income market to negative returns through October, but subsequent falling rates resulted in positive year-to-date returns of 1.6% through November. Equity markets were volatile, but major indices saw positive returns, with US and global equities returning 20.8% and 16.6%, respectively, through November.[1]

Investors are hopeful that central bank policy will be effective in engineering the elusive soft landing to avert recession. However, questions abound as to the long-term impact of a higher-for-longer market regime characterized by higher and more volatile interest rates and inflation. In this new regime, the cost of capital will be higher for most companies, which will make it difficult for those that are not fundamentally sound to consistently grow earnings at the same pace as in the past.

Our MFS® Long-Term Capital Market Expectations for January 2024 estimates equity returns will likely be lower than those seen over the past decade; however, with yields at the highest level in decades, fixed income may present opportunities. Sponsors and participants should revisit their asset allocations and consider any changes that could better help them attain their objectives.

79% of plan sponsors say participants competing financial priorities have a major to moderate impact on their ability to save for retirement.[4]

Inflation + competing financial priorities = declining retirement confidence

The 2023 MFS Global Retirement Survey highlighted inflation as a top concern for DC participants, with 60% indicating the recent increase in inflation has them thinking differently about retirement.[2] As a result, 61% have become more conservative with their investments, 75% feel the need to save more and 58% expect to work longer than planned. Thus retirement confidence is declining, with only 34% of participants confident they will be able to retire at the age they want.

For many participants, competing financial priorities get in the way of saving adequately for retirement, further eroding retirement confidence. Exhibit 1 shows that while financial obligations affect retirement outcomes for all, there is an increased burden for the younger generations.

Exhibit 1: Participants have competing financial priorities

	Millennial Ages 26–41	Gen X Ages 42–57	Baby Boomer Ages 58–77
Financial obligations get in the way of saving adequately for retirement*	89%	77%	63%
Saving for emergencies	41%	31%	25%
Saving for education	28%	26%	3%
Student loan payments	25%	10%	4%
Live paycheck to paycheck	26%	19%	14%

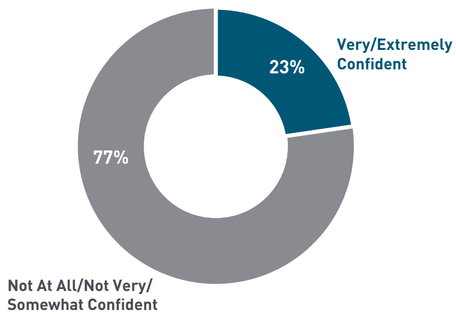
Source: MFS 2023 Global Retirement Survey, US respondents. Q: Do you feel you have competing financial priorities that are preventing you from adequately saving for retirement? Percentages represent the sum of respondents who selected each option. *Percentage of respondents who did not select "I do not have competing financial priorities."

Uncertainty over retirement is not just a problem for participants, it can also have implications for the sponsor. Studies have shown that financial stress can lead to lower productivity as well as increased turnover.[3] And the uncertainty can make it difficult for employers to manage the overall workforce, potentially limiting opportunities for younger workers. Recent legislation has provided some flexibility to help participants address some of these challenges (more on this below), and sponsors should think about the issues facing their unique workforce and if there are policies or programs that could be employed to help ease these challenges.

Surprisingly, plan sponsors are even less confident than participants. Our 2023 MFS Plan Sponsor Survey asked sponsors for their insights on key retirement issues and found only 23% were confident their participants will be able to retire at the age they want.[4] Sponsors said that the rate of employee contributions and level of participant engagement are key factors contributing to their lack of confidence.

Exhibit 2: Factors contributing to lack of plan sponsor confidence

How confident are you that your plan participants will be able to retire at the age they want to?



Factors Contributing to Lack of Confidence

	Not Confident
Contributions	71%
Engagement	57%
Tools and Services	30%
Economy	56%

Source: MFS 2023 DC Plan Sponsor Survey. Left Q: How confident are you that your plan participants will be able to retire at the age they want to? Right Q: What factors contribute to your confidence (or lack thereof) that your plan participants will be able to retire at the age they want to?

Digging deeper on plan sponsor views, our survey found the following:

86% are concerned about their participants' retirement

89% offer retirement income planning tools to participants

40% actively encourage participants to remain in their plan after retirement

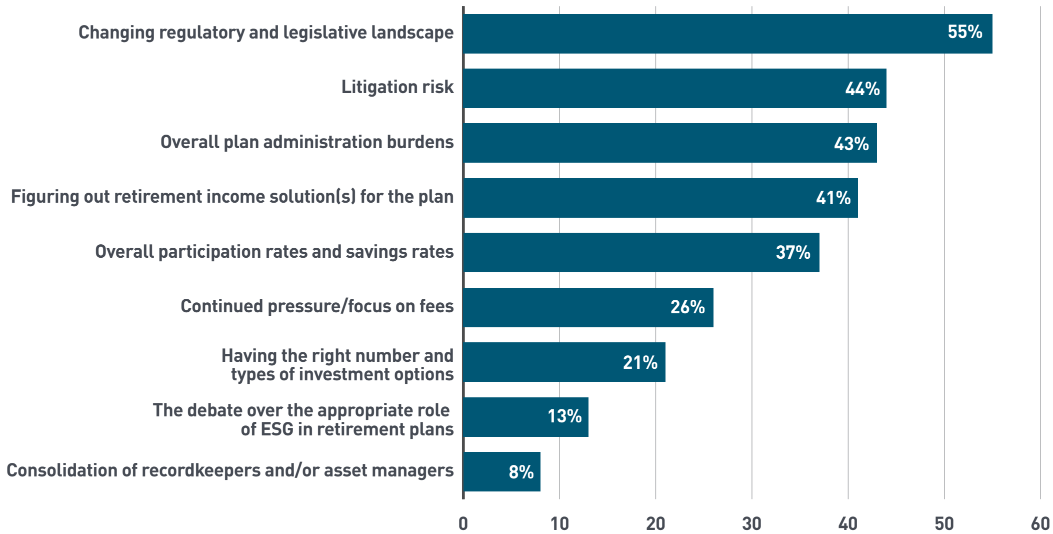
63% offer decumulation options beyond lump sum distributions

As sponsors continue to explore retirement income solutions, we encourage them to clearly define their intentions for the plan: Is it an *acccumulation* plan, in which participants accumulate assets and roll out of the plan upon retirement or termination? Or is it a *destination* plan, in which retirees are encouraged to stay in their plan and draw down their savings through retirement? As discussed in The Retirement Income Dilemma, sponsors should periodically revisit and refine their strategy as plan demographics, business needs or the retirement income landscape change over time.

Regulatory, legislative and litigation developments for 2024

Our sponsor survey asked respondents what keeps them up at night, and topping the list was the changing regulatory and legislative landscape, followed by litigation risk.

Exhibit 3: What keeps you up at night?



Source: MFS 2023 DC Plan Sponsor Survey. Q: What are you worried about/what keeps you up at night? Select only your top 3 areas of focus.

The SECURE 2.0 Act of 2022 is now a year old, allowing us to assess the wide variety of retirement-related provisions covering three key areas:

1. Participation and access
2. Retirement income and distributions
3. Financial wellness

In 2023, industry stakeholders leaned in to better understand the implications of various provisions, especially those effective immediately, including a change in the required minimum distribution age from 72 to 73 (which will change to 75 in 2033).

In 2024, several mandatory provisions will become effective. These include an increase in the mandatory cash-out limit of $7,000 (increased from $5,000), allowing employers to transfer former employees' accounts below that threshold to an IRA without consent. This change should help ease the burden on sponsors for continuing to maintain accounts with small balances, many of which are at high-risk for becoming lost participants. Also effective in 2024 will be new rules allowing employees who complete 500 hours of service in three consecutive years to contribute to 401(k) plans.

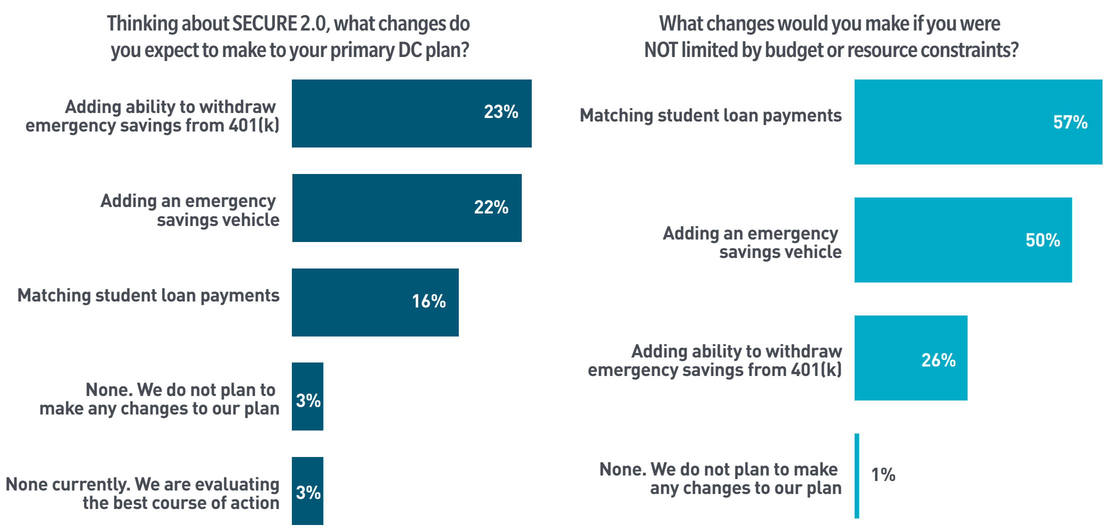
Perhaps most discussed were changes to catch-up contributions. Under the new rules, participants with compensation exceeding $145,000 would only be allowed to make catch-up contributions on a Roth after-tax basis. This was originally effective for 2024, which would require plans to be amended to allow for Roth contributions. Adding to the confusion was a technical drafting error that removed catch-up contributions entirely in the year 2024. In response to industry concerns, the IRS delayed the effective date of this provision by two years, allowing sponsors to begin administering this provision in 2024 if desired but permitted them to delay implementation until January 1, 2026 if more time is needed.

Widely discussed but optional provisions related to emergency savings and student loans are also set to go into effect in 2024, although the IRS has not yet issued guidance. The new rules allow student loan payments to be treated as elective employee contributions for the purpose of matching contributions. This provision should assist savers in being able to take advantage of their employer matching contributions even if their student loan payment obligations impact their ability to make contributions to the retirement plan. SECURE 2.0 also includes two approaches with respect to emergency savings:

1. Allowing participants to take a $1,000 distribution from their account once every three years without being subject to a distribution tax
2. Allowing withdrawals up to $2,500 from a separate emergency savings account subject to numerous conditions

We asked sponsors which of these provisions they planned to implement and found a combined 45% plan to add emergency savings features. However, when asked what changes they would make if they were not limited by budget or resource constraints, the answers change considerably, with 57% indicating they would match student loan payments, and a combined 76% indicating they would create a vehicle for or provide access to 401(k) assets for emergency savings.

Exhibit 4: How plan sponsors are thinking about SECURE 2.0 provisions



Source: MFS 2023 DC Plan Sponsor Survey. Left Q: Thinking about SECURE 2.0, what changes do you expect to make to your primary DC plan? Please select all that apply. Right Q: Thinking about SECURE 2.0, if you were NOT limited by budget or resource constraints, what changes would you make to your primary DC plan? Please select all that apply.

This demonstrates that sponsors recognize their participants could benefit from these features, and we will see in 2024 how the market responds when these features become permissible in DC plans.

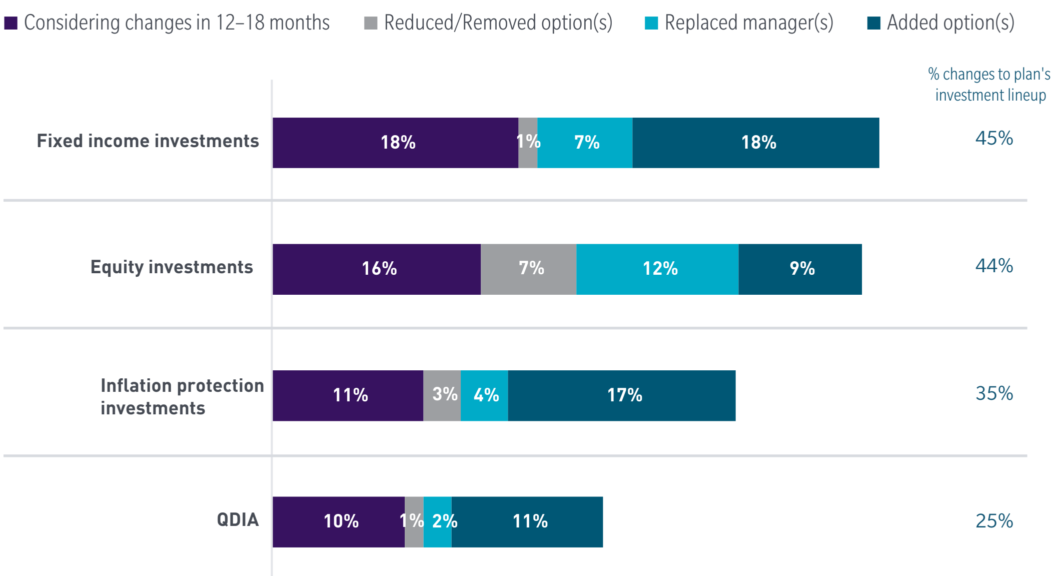
In addition to the SECURE 2.0 implementation issues noted above, the US Department of Labor proposed the Retirement Security Rule in late 2023 to update the definition of investment fiduciary advice, which is sure to keep the industry busy in 2024. These changes highlight how challenging it can be for sponsors to focus on improving participant outcomes in a constantly changing regulatory and legislative landscape. As we look ahead to next year, besides effective dates under SECURE 2.0, we believe that how the fiduciary rule develops will be the most important consideration for the retirement industry.

There was a silver lining on the ERISA litigation front, with a decline in activity as compared to 2022.[5] Although litigation was down for the year, 70% of survey respondents indicated they use ERISA litigation as an input into their decision-making processes. The question is, will litigation continue to decline in 2024 or is it poised to return? While sponsors cannot control the pace of litigation, the best protection is to have processes in place and to document the decision making in those processes.

Revisiting the investment lineup with a focus on retirement income

Our plan sponsor survey found that in a volatile market environment, sponsors either have made or are considering making changes to investment lineups, as shown in Exhibit 5.

Exhibit 5: Plan investment lineup changes

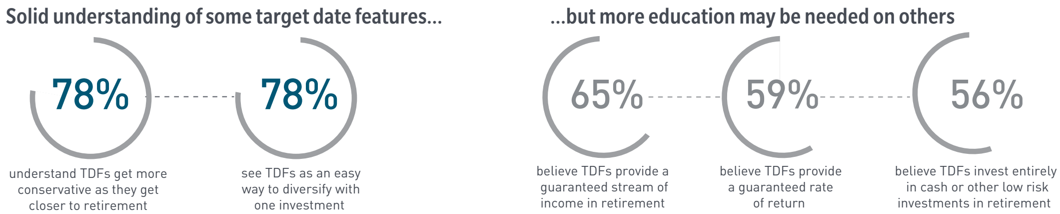


Source: MFS 2023 DC Plan Sponsor Survey Q: What changes have been made or are being considered to the plan's investment lineup?

Sponsors have been more likely to add fixed income and inflation protection options than equity options and are more likely to replace equity managers than fixed income managers. With compelling fixed income yields and higher levels of inflation than in the recent past, we expect to see more activity from sponsors evaluating and potentially expanding fixed income and inflation protection options on their menus in 2024.

Turning to target date funds (TDF's), our participant survey exposed knowledge gaps among participants regarding key features of TDFs, as shown in Exhibit 6.

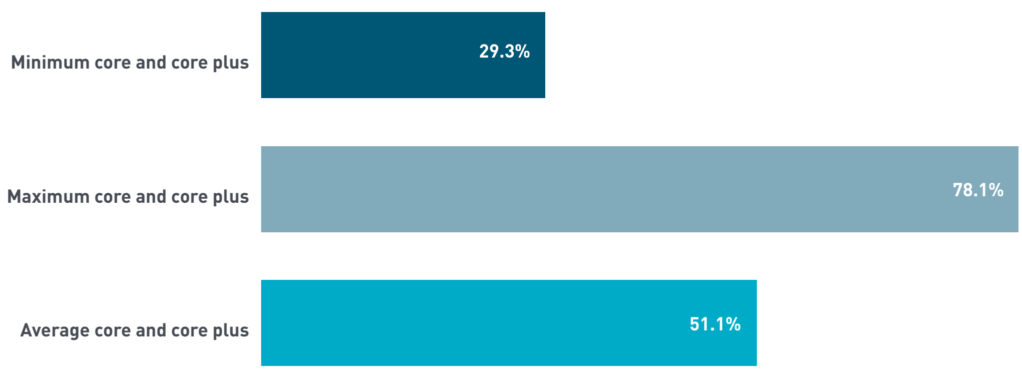
Exhibit 6: How well do participants understand target date funds?



Source: MFS 2023 Global Retirement Survey, US respondents. Q: Please indicate the extent to which you agree with each of the statements about TDFs. Percentages represent the sum of respondents that chose strongly agree or agree with each statement. This question was posed to respondents that answered they are invested in a TDF. A target date fund is a fund whose allocation to stocks and bonds is designed to become more conservative as you near retirement or reach a certain age.

While participants may not fully understand the attributes of TDFs, especially in retirement, sponsors may be underestimating the level of fixed income diversification in their TDFs. Exhibit 7 shows that many of the largest TDF managers rely predominantly on core bond allocations, especially in near-dated vintages.

Exhibit 7: How diversified are fixed income allocations within target date funds?



Source: MFS Investment Management. Analysis based on the 25 largest target date mutual fund series by assets under management as of 31 December 2022, as provided by Morningstar Direct. Fixed income allocation includes dedicated fixed income strategies, fixed income within asset allocation funds and including cash. Core bonds includes the following categories: US Fund Intermediate Core Bond, US Fund Intermediate Core Plus Bond and US Fund Intermediate Government. Please see Revisiting the Role of Fixed Income Along the Retirement Savings Journey paper for a list of these fund series.

Revisiting the Role of Fixed Income Along the Retirement Savings Journey found the number of underlying fixed income strategies employed in 2025 TDF vintages ranged from two to 13. Furthermore, 11 out of the 25 largest TDF managers reviewed had more than half their total fixed income exposure in core bond strategies. Participants with high allocations to core bonds are potentially missing out on the diversification that could be attained through broader access to fixed income building blocks. We encourage sponsors to take a fresh look at the fixed income exposure in their TDFs to ensure they are appropriately diversified and to consider how the fixed income allocation evolves along the glide path when selecting and monitoring a TDF.

The path forward for corporate DB plans

Higher rates improved funded status for many corporate plans in 2023, with the estimated aggregate funded status for the largest plans increasing from 102% at the end of 2022 to 104% through October 2023.[6] Plans engaged in significant risk transfer activity in 2023, with single-premium annuity buyouts of over $22 billion through the end of the second quarter.[7]

However, 2023 also saw significant developments that could breathe life into DB plans. IBM announced that it is replacing their 401(k) match with a DB plan accrual,[8] and defined benefit pensions were a central bargaining point in the United Auto Workers strike, although the settlement ultimately resulted in an enhanced DC contribution.[9] These are signs that in a changing market environment, some companies are reevaluating how they provide retirement benefits in ways we have not seen in years.

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The US faces a significant labor shortage, and for employers in industries in which it is difficult to find workers, restarting a DB plan could help retain experienced employees while also helping to reduce retirement related worries that can impact productivity. This could also enable a more orderly and predictable workforce transition, which could provide opportunities for advancement as older, experienced workers leave the workforce in a more predictable pattern.

Sponsors who benefited from increased funded status in 2022 and 2023 may be able to capitalize on surplus assets that could be used in part or in whole to fund new benefit accruals, as well as cover certain administrative expenses. Sponsors should also consider the savings that could result from higher employee retention rates than might arise in a DB plan.

Our participant survey shows that 75% of respondents ranked "receiving a predictable stream of income payments throughout retirement" as one of the top three elements they want to see in a retirement portfolio.[10] While there has been much effort in the retirement industry to incorporate guaranteed income features within defined contribution plans, the uptake of these solutions has been low, as they can be difficult to understand and present administrative and governance challenges. Accordingly, many sponsors are hesitant to be first movers.

For sponsors who are thinking about the retirement income challenge, frozen or closed DB plans might be part of the answer they are looking for. Defined benefit plans are a time-tested way to provide lifetime income while pooling longevity and investment risk for participants.

In a reopened DB plan, liability driven investing (LDI) will continue to be critical in managing legacy liabilities; however, sponsors should consider whether adjustments to the overall investment strategy are warranted to cover new benefit accruals. With fixed income yields at the highest levels in years, sponsors may want to look at whether there are fixed income asset classes, such as intermediate credit, global bonds or taxable municipals, that could help improve returns while retaining the liability hedging characteristics of the LDI portfolio.

As we reflect on 2023 and contemplate what 2024 might have in store, the one thing we can rely on is that there will be plenty of surprises, so we hope this piece can help you prepare for what will certainly be an eventful year.

Endnotes

[1] FactSet as of November 30, 2023, for the Bloomberg US Aggregate Index, S&P 500 Index and the MSCI All Country World Index.

[2] 2023 MFS Global Retirement Survey, US Results. Methodology: Dynata, an independent third-party research provider, conducted a study among 1,000 Defined Contribution (DC) plan participants in the US on behalf of MFS. MFS was not identified as the sponsor of the study. To qualify, DC plan participants had to be ages 18+, employed at least part-time, actively contributing to a 401(k), 403(b), 457 or 401(a). Data weighted to mirror the age/gender distribution of the workforce. The survey was fielded between March 22 and April 6, 2023.

[3] 2022 PwC Employee Financial Wellness Survey.

[4] 2023 MFS DC Plan Sponsor Survey. Methodology: DCIIA's Retirement Research Center, an independent third-party research provider, conducted a study among 141 plan sponsors in the US on behalf of MFS. MFS was not identified as the sponsor of the study. To qualify, plan sponsors had to offer a 401(k), 403(b), or 457 plan governed under ERISA as their primary plan (they could also offer a DB plan). The survey was fielded between September 5 and October 30, 2023. We define plan sizes as follows: small plans, less than $25 million to $99 million; midsize plans, $100 million to $999 million; larger plans, $1 billion or more.

[5] Euclid Fiduciary, https://www.euclidspecialty.com/2023-mid-year-update-on-excess-fee-and-imprudence-litigation/.

[6] Milliman Pension Funding Index, November 7, 2023.

[7] LIMRA. U.S. Pension Risk Transfer Sales Jump 31% in Second Quarter 2023.

[8] PlanSponsor: "Analysts Agree IBM Pension Thaw Benefits Both Participants and Plan Sponsor," November 20, 2023.

[9] Bloomberg Law News: "UAW's Big 3 Retirement Deal Falls Short of Pension Revival," November 2, 2023.

[10] MFS 2023 Global Retirement Survey.