Retirement Insights

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Retirement Outlook 2025

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What's in store for markets in 2025

After months of anticipation, the US Federal Reserve finally began its rate-cutting cycle in late 2024, lowering the federal funds rate by 75 basis points in two cuts in September and November, with the market expecting further cuts in 2025. The Fed's action came in response to cooling US inflation and job market data, which have indicated that the elusive soft landing is still within reach. Fixed income markets were volatile, with rates on a rollercoaster ride through the year, featuring returns of 2.9% through November. Major equity indices saw double-digit returns, sparked by a post-election rally, with US and global equities returning 28.1% and 20.3%, respectively, through November.[1]

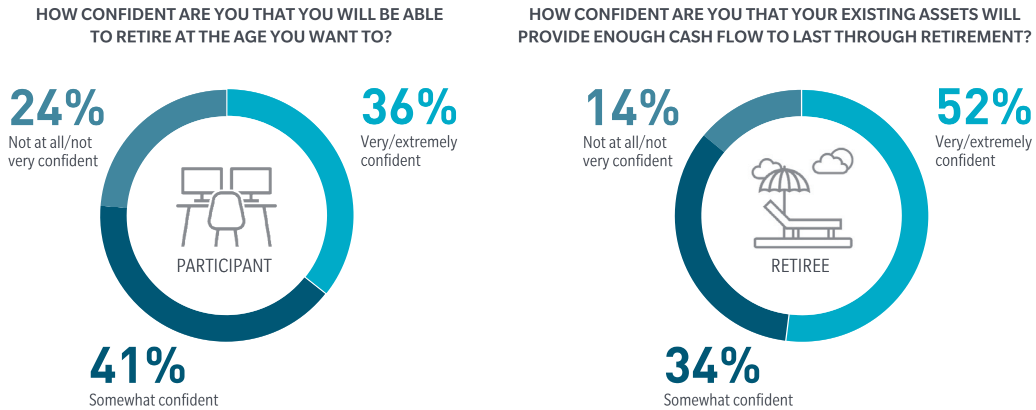
Our "MFS Key Themes for 2025" covers several areas for investors to focus on in the coming year, including the impact of the election on markets, the risk of a "no landing" scenario and the challenges and opportunities for the global economy. Considering these changing dynamics, sponsors and participants should revisit their asset allocations and consider any changes that could better help them attain their objectives.

Participant expectations versus retirement realities

The 2024 MFS Global Retirement Survey[2] probed participant and retiree opinions on a variety of topics and found that while participants are concerned about their retirement prospects, there is a lot they can learn from retirees, providing reasons to be optimistic about the future.

Consider Exhibit 1. It shows that only 36% of participants are very or extremely confident in their ability to retire at the age they want to; however, retirees have a higher level of confidence that their assets will last through retirement.

Exhibit 1: Participant vs. retiree confidence

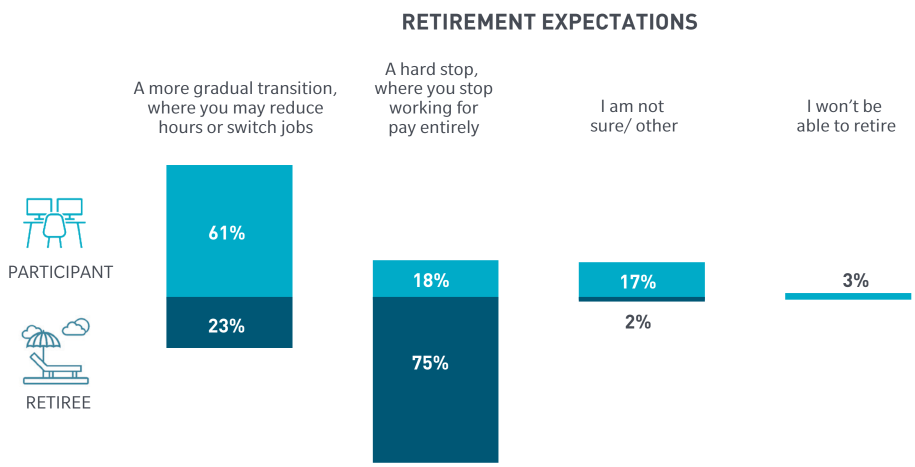


Source: MFS 2024 Global Retirement Survey, US participant & retiree respondents. Left Q: (Participants) How confident are you that you will be able to retire at the age you want to? Right Q: (Retirees) How confident are you that your existing assets will provide enough cash flow/income to last throughout your retirement?

These results may in part reflect participants underestimating the importance of Social Security. Over 40% of pre-retirees think that less than 25% of their retirement income will come from Social Security, but current retirees indicate over 40% of their monthly income comes from Social Security.

We also see a disconnect between participants' retirement expectations and actual retiree experiences around retirement age. As shown in Exhibit 2, most participants would like to gradually transition into retirement, but retirees tend to come to a "hard stop" where they stop working for pay, often for reasons beyond their control, such as health issues, layoffs or meeting family needs.

Exhibit 2: What will retirement look like?

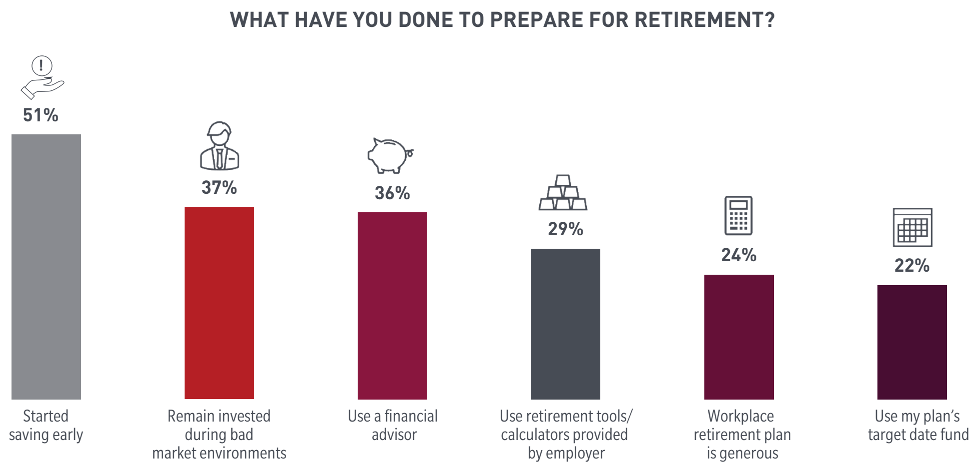


Source: MFS 2024 Global Retirement Survey, US participant & retiree respondents Q: (Participant) Do you expect your retirement to be... Q: (Retiree) When you retired, was it...

In a tight job market with talent at a premium, employers may want to consider policies that could keep some of these older participants in the workforce longer. In our MFS 2024 DC Plan Sponsor Survey,[3] sponsors tell us that only 22% currently have programs in place that allow employees to have a more gradual transition into retirement, with an additional 19% considering such programs.

Despite low participant confidence, we are seeing encouraging signs that participants are taking steps to better prepare for retirement, as shown in Exhibit 3.

Exhibit 3: Participants have taken positive steps to prepare for retirement



Source: MFS 2024 Global Retirement Survey, US participants. Q: Please select the statements that apply to you regarding your retirement preparedness.

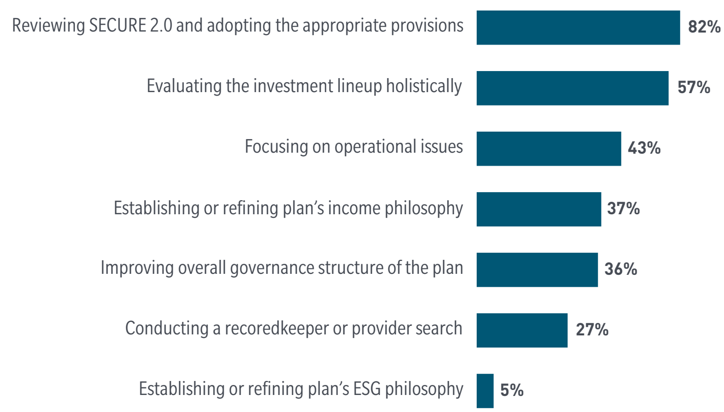
For example, more than half of participants started saving early, and 36% are using a financial advisor to prepare for retirement. Our survey results consistently highlight that participants receive retirement advice from a variety of sources but would also utilize advice offered by their retirement plan sponsors.

This data should compel sponsors to think about the potential impact low retirement confidence may have on their workforce. Sponsors may want to consider how education on retirement and investment issues, along with policies and programs that allow for more retirement flexibility, could help improve overall employee confidence, which could help improve morale and productivity.

Plan sponsor areas of focus for 2025

For the second year in a row, plan sponsors' top priority over the year has been reviewing SECURE 2.0 and adopting relevant provisions. Like last year, sponsors are also focused on evaluating the investment lineup and the day-to-day operations of running the DC plan.

Exhibit 4: Areas of focus over next 12 months



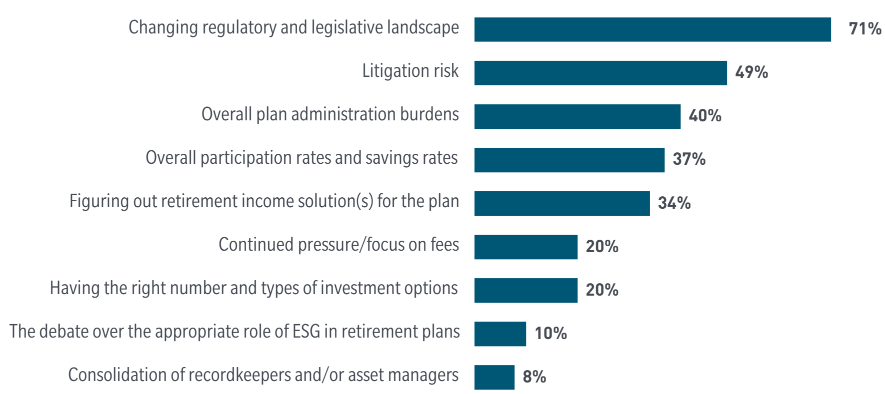
Source: MFS 2024 DC Plan Sponsor Survey. Q: What are your plan's areas of focus over the next 12 months? Select only your top three areas of focus.

The emphasis on ESG-related issues continues to decline for plan sponsors, in part due to the heightened political sensitivity around the issue.

Regulatory, legislative and litigation developments in 2025

Our survey of sponsors asked respondents what keeps them up at night, and topping the list was the changing regulatory and legislative landscape, which increased from 55% in 2023 to 71% in 2024, followed by litigation risk.

Exhibit 5: What keeps you up at night?



Source: MFS 2024 DC Plan Sponsor Survey. Q: What are you worried about/what keeps you up at night? Select only your top three areas of focus.

Various provisions of SECURE 2.0 Act of 2022 will continue to be phased in in 2025, most notably increased contribution limits for those aged 60 to 63, adding a layer of administrative complexity for plans. There were also changes that will require catch-up contributions for participants with compensation exceeding $145,000 to be made on a Roth basis, although the IRS provided a two-year administration transition period through December 31, 2025, to give sponsors time to comply with the new rules.

Other SECURE 2.0 provisions to be aware of for 2025 include mandatory automatic enrollment of new plans, an expansion of part-time work eligibility and a few additional distribution options that provide greater flexibility to participants in taking distributions in certain circumstances. Additionally, we will continue to see if student loan matching and emergency savings provisions grow in both plan sponsor adoption and participant uptake.

Changing regulatory landscape and fiduciary rule

Since the new Retirement Security Rule was finalized in April 2024, there have been litigation and legislative efforts to block it. In July, two federal courts issued rulings which together stayed the new rule nationwide,[4] less than two months before its scheduled effective date of September 2024. In the order, the judge said the regulation, "suffers from many of the same problems" as previous DOL rulemaking that was vacated by a federal appeals court. In September, the DOL appealed both stays up to the Fifth Circuit; however, under the new Trump administration, this rule is unlikely to have support.

US Supreme Court implications

The US Supreme Court overturned the 40-year-old "Chevron deference" standard in June.[5] This standard provided that when a statute was ambiguous, the courts were to defer to a regulatory agency's reasonable interpretation. Many believe the decision will result in increased litigation challenging agency interpretations, including challenges to retirement regulation and legislation. For example, a Texas district court will re-hear a challenge to the DOL's ESG rule because of this ruling.

In the upcoming term, the court has agreed to hear a case regarding the burden of proof for prohibited transactions between plan sponsors and service providers under ERISA. If the outcome of this case results in a low bar for plaintiffs to sue plans (and get to the discovery stage), it could make it more expensive to offer and insure retirement plans.

Litigation

Although litigation was down for the year, our 2024 Plan Sponsor Survey finds 10% of respondents have been subject to a class action ERISA lawsuit in the past five years, with an additional 7% reporting being subjected to a lawsuit over five years ago.

There have been a few notable lawsuits filed following major pension risk transfer (PRT) deals in 2024. The lawsuits claim that the chosen insurer invested in lower-quality, higher-risk assets that were potentially lower cost to the employer and higher risk to the retiree.

Another recent litigation trend is around claims that plan sponsors have improperly used forfeited assets. Since the DOL has not issued formal regulatory guidance regarding the use of forfeitures, plaintiffs argue that forfeitures are "plan assets," which ERISA requires to be used exclusively for the benefit of the participants and defraying plan expenses. As these lawsuits have made their way through the courts, rulings have been mixed and many are still pending. Without clarification from the courts, we will likely see additional litigation in this area.

While sponsors can't control the pace of litigation, the best protection is to have clear and consistent processes in place and to document the decision making in those processes.

US election impact

The outcome of the US election will shape the regulatory and legislative environment for retirement plans heading into 2025. With the Republicans controlling both the executive and the legislative branches, there will likely be a shift toward easing regulatory efforts around retirement security and fiduciary responsibilities. We expect to see additional legislative efforts around ESG, such as a likely reversion back to the prior rule and to alternative assets, such as a more accommodative stance on the inclusion of private and digital assets in DC plans.

Election outcomes can have deep political, economic and social implications. Fortunately, power in the United States does not lie solely in the hands of an individual or a party, but rather in a system of distributed power replete with checks and balances. In election years and other times of change, it is important for investors not to let news headlines knock them off course. Maintaining a disciplined investment approach, a long-term time horizon and a sensible rebalancing plan remains a sound approach.

Living to 100: Retirement implications and protecting the core menu

Significant demographic and market forces are at play when we consider the optimal DC plan investment menu for the future. We have longer life expectancies and an evolving concept of retirement, and the average time in retirement has increased while the type of benefit we rely on has shifted responsibility more to the participant, as shown in Exhibit 6.

Exhibit 6: Implications of living longer[6]

	Average retirement age		Life expectancy at retirement		Type of retirement benefit	
	MALE	FEMALE	MALE	FEMALE	DEFINED BENEFIT	DEFINED CONTRIBUTION
Today	**65.2**	**65.3**	**▲ 18.1**	**▲ 21.0**	**▼ 22%**	**▲ 78%**
50 Years ago	63.4	62.9	15.0	19.4	74%	26%
100 years ago	72.0	67.0	8.1	13.6	Virtually none	

With retirement potentially lasting decades, individuals may need to save more to ensure they don't outlive their resources. This may mean saving earlier in life, saving at a higher rate or investing more aggressively while they have a long-time horizon. Plan sponsors should consider the role of automatic enrollment, automatic escalation and encouraging strong deferral rates to help set participants up for success.

DC plan investment menus have becoming increasingly influenced by the widespread adoption of target date funds as the default investment option in plans. While this has been a great outcome for disengaged participants who are mapped to an age-appropriate asset allocation, sponsors should consider whether the core menu is meeting the needs of those participants who are engaged and prefer to make their own investment decisions; may display more willingness for active management; and better understand investing principles and may need more tailored strategies, particularly as they approach retirement. A core menu should have the right building blocks of both equity and fixed income investment options, providing both active and passive options for participants.

The good news is that most participants do seem to understand long-term investing, as seen in Exhibit 7. Over half believe that long-term investing means investing over ten years or more, and 83% believe long-term investing means investing over at least 5 years.

Exhibit 7: Most participants understand long-term investing

MEANING OF LONG-TERM FOR RETIREMENT INVESTMENTS

LESS THAN 1 YEAR	1 – 3 YEARS	3 – 5 YEARS	5 – 10 YEARS	10+ YEARS
1%	5%	11%	30%	53%

Source: MFS 2024 Global Retirement Survey, US participants. Q: What does long-term mean to you when thinking about your retirement investments?

Our survey results, along with trends shaping the DC investment menu, highlight the importance of the three *As* of retirement plans: the importance of *accumulation*, providing *active* management opportunities and the role of *advice* when it comes to decumulating those assets.

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The path forward for corporate DB plans

Corporate DB plans continue to be on a solid footing, with the estimated aggregate funded status for the largest plans improving from 98.5% at the end of 2023 to 103.4% through October 2024.[7] Plans have continued to engage in significant risk transfer activity in 2024, with single-premium annuity buyouts of $26 billion through the end of the second quarter.[8]

However, there have been a few notable lawsuits relating to pension risk transfer deals where the plaintiffs have alleged that the insurer taking on the pension liabilities had invested in lower-quality, higher-risk assets that were lower-cost for the employer and higher-risk for the retiree.

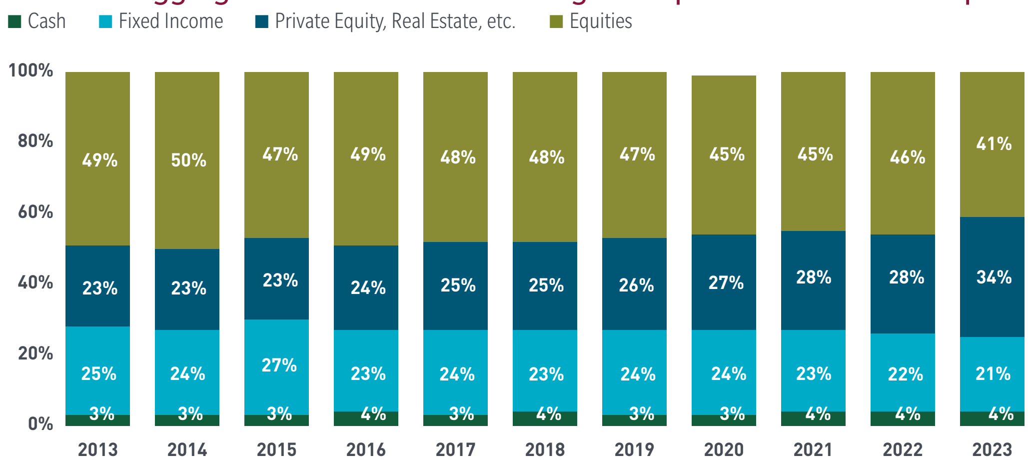
While there has not been much movement in reopening DB plans since the IBM announcement in late 2023,[9] pensions continue to be a hot topic, and were a key negotiation point in the labor dispute between Boeing and their machinists' union, which ultimately settled for an enhanced defined contribution match.[10]

One factor that has driven risk transfer activity and impacted employers' ability to provide DB coverage has been the high cost of Pension Benefit Guaranty Corporation (PBGC) premiums, which have risen steadily over the past decade, despite the PBGC single employer program sitting in a healthy financial position. The American Benefit Council has suggested a proposal that ties premium levels to the PBGC's funded status, which could significantly lower costs for plan sponsors.[11] A key component of this proposal would be to take PBGC premiums off budget, which would not let them be considered as general revenues when Congress does its budget accounting. This will likely be a point of contention as the new administration tries to find revenue sources to pay for various campaign promises.

Liability-driven investing (LDI) continues to be critical in managing legacy liabilities; however, 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.

Positive market returns in 2024 also helped improve public plan funded status, with the largest US public plans estimated to be 82.8% funded at the end of September, up about 4% from year end 2023.[12] While this is encouraging news, many public plans still have a long way to go before they are on solid financial footing. Over the past several years, public plans have steadily increased allocations to illiquid assets, such as private equity and real estate, while holding low levels of fixed income.[13]

Exhibit 8: Aggregate asset allocations for largest US public defined benefit plans



Source: Milliman 2023 Public Pension Funding Study.

This trend has largely been due to plan sponsors looking to generate higher returns in the low-rate environment that they operated in for much of the past decade. However, with higher fixed income yields today, sponsors may have an opportunity to reduce risk, improve liquidity and still generate attractive yields by revisiting their fixed income allocations.

As we consider what 2025 might have in store, we hope this piece can help you prepare for what will certainly be an eventful year.

Endnotes

[1] FactSet as of November 30, 2024, for the Bloomberg US Aggregate Index, S&P 500 Index and the MSCI All Country World Index.

[2] 2024 MFS Global Retirement Survey, US Results. Methodology: Dynata, an independent third-party research provider, conducted a study among 725 Defined Contribution (DC) plan participants and 310 retirees 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). US retirees had to be fully or partially retired and must have had a 401(k), 403(b), 457, or 401(a), DB plan, or SEP/Simple IRA. Data weighted to mirror the age/gender distribution of the workforce. The survey was fielded between March 28 and April 13, 2024.

[3] 2024 MFS DC Plan Sponsor Survey. Methodology: DCIIA's Retirement Research Center, an independent third-party research provider, conducted a study among 166 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), 457 or other defined contribution plan, defined benefit plan or other non-qualified deferred compensation plans. The survey was fielded between September 3 and October 30, 2024.

[4] 2024-07-25_FACC-v-DOL.pdf (millerchevalier.com).

[5] Supreme Court's Chevron deference ruling gives judges more power - and regulators less - to interpret laws that are ambiguous or unclear | Pensions & Investments (pionline.com).

[6] MFS Living to 100: Retirement Implications to Consider. Average retirement age: 100 years ago = US Census Bureau, Age of Gainful Workers, 1930. Average retirement age considered to be when <50% of persons were gainfully employed. 50 years ago = Bureau of Labor Statistics: Retirement Age Declines October 2001, Estimated average age of men and women 1970 to 1975. Today = OECD Average effective age of labor market exit in Pensions at a Glance 2023: OECD and G20 Indicators. Life expectancy based on MFS Analysis of life expectancy at average retirement age shown using relevant mortality tables: 100 years ago = 1932 Combine Annuity Mortality Table with Stark's Extension, Male & Female Combined. Female/male life expectancy increased/decreased by 1.5 years from combined mortality result, 50 years ago = 197 Group Annuity Mortality Table for Males & Females, today = Social Security 2024 Mortality.

[7] Milliman Pension Funding Index, November 7, 2024.

[8] LIMRA. "U.S. Pension Risk Transfer Sales Jump 14% in First Half of 2024."

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

[10] Pensions & Investments: "Boeing union workers ratify contract boosting 401(k) match; DB plan not resurrected." November 5, 2024.

[11] American Benefits Council: "Strengthening defined benefit pension system will enhance retirement security for many." February 28, 2024.

[12] Milliman Public Pension Funding Index, October 2024.

[13] Milliman 2023 Public Pension Funding Study.