PGIM

PART 3

THE EVOLVING DEFINED CONTRIBUTION LANDSCAPE

THE HOLY GRAIL OF DC: INCOME IN RETIREMENT

RETIREMENT INCOME TAKES CENTER STAGE

Even prior to the devastating impact of COVID-19, one of the greatest financial challenges facing workers was generating an adequate amount of income in retirement. The increased use of target date funds (TDFs), advice tools and financial wellness programs is helping retirement savers, but the coronavirus pandemic further highlighted how much risk has been shifted to individuals with the move from defined benefit (DB) programs to defined contribution (DC) plans. As a result, retirement-income solutions are increasingly becoming more relevant and necessary.

But while retirement savings plans have undergone significant evolutions over the last four decades, they still fall short in providing workers with lifetime retirement security – a significant gap given DC plans are a primary source of most participants' retirement income.

To better understand the current retirement-income landscape within the DC space, PGIM recently completed a survey of more than 130 plan sponsors that have at least one 401(k) plan and a minimum of $100 million in 401(k) assets. You can also view **Part 1** and **Part 2** of our research connected to this survey, examining the expanding role of outsourced chief investment officers (OCIOs) and the use of Alternatives and ESG investments.

How we conducted our research

PGIM canvassed more than 130 DC plan sponsors to learn about the current trends in the DC market. The research was conducted by Greenwich Associates using an online, quantitative approach with DC plan sponsors who have at least one 401(k) plan and a minimum of $100 million in 401(k) assets. See an explanation of our methodology at the conclusion of this report.

> "Historically, DC plans have focused on helping participants accumulate retirement savings, not on converting those savings into a steady stream of income in retirement."

RETIREES AS RISK MANAGERS?

For the private sector, most retirement plans today are DC plans, such as 401(k)s, rather than the DB pension plans that were common through much of the 20th century. Historically, DC plans have focused on helping participants accumulate retirement savings, not on converting those savings into a steady stream of income in retirement. Such a structure leaves retirees with limited options for leveraging the institutional benefits of their DC plan as they are tasked with managing the risks that were once managed by DB plans — namely, longevity risk, market risk, inflation risk, interest rate risk, and sequence of returns risk. Because the most common distribution type is a lump-sum payout, this can also leave retirees exposed to drawdown risk. With so many variables to manage, many retirees end up seeking help from outside of the DC plan, spending down their balances too quickly, or not spending as much during their retirement as they could have.

Longevity risk

As lifespans increase, so does the possibility of outliving your savings.

Market risk

Plan participants are directly exposed to the chance of a financial-market downturn.

Inflation risk

The impact of rising prices can erode your purchasing power in retirement.

Interest rate risk

Changes in interest rates can impact the cost for an individual to secure lifetime income, both through non-guaranteed investments and the purchase of guaranteed income.

Sequence of returns risk

The timing of withdrawals from retirement savings accounts can have a dramatic result on overall returns.

Drawdown risk

Drawdown risk is the amount of time for a portfolio to recover its losses.

This is the third in a three-part series from PGIM exploring income in retirement. Previous research took a deep dive into key trends in the DC space.

TOP STEPS CURRENTLY TAKEN TO FACILITATE & INCREASE EMPLOYEE UNDERSTANDING OF RETIREMENT READINESS

89%
Offer tools & advice on how to meet retirement readiness goals & how to spend down assets in retirement

66%
Communicate account balances to participants in terms of the projected retirement income they will generate

49%
Allow participants to take systematic withdrawals from plans in addition to lump-sum withdrawals

35%
Set retirement readiness objectives for participants in the plan & measure results

THE STATE OF "RETIREMENT READINESS"

Our proprietary research shows that the number-one step plan sponsors have taken to increase employee understanding of retirement readiness continues to be tools and advice on how to spend down in retirement, with 89% of total respondents saying that was their primary mechanism. The next-highest-ranked response was communicating account balances to participants in terms of projected retirement income, with 66% of overall respondents choosing this option.

With the 2019 Setting Every Community Up for Retirement Enhancement Act (the SECURE Act) including a provision that will require a Lifetime Income Disclosure on participant statements by the end of 2021, we should see projected retirement income become a standard metric for participants in DC plans in the future.

The research also suggests there is an opportunity for sponsors to review their plan's available distribution types. Systematic withdrawals, as opposed to a single lump-sum distribution, allow participants to set up a process to automatically withdraw portions of their DC plan balance over time. This plan design feature is a great step in providing more distribution flexibility to retirees and may allow them to set up an automated retirement paycheck. Less than 50% of plans with assets between $100 million and $1 billion allow systematic withdrawals, while about a third of plans greater than $1 billion still don't allow systematic withdrawals.

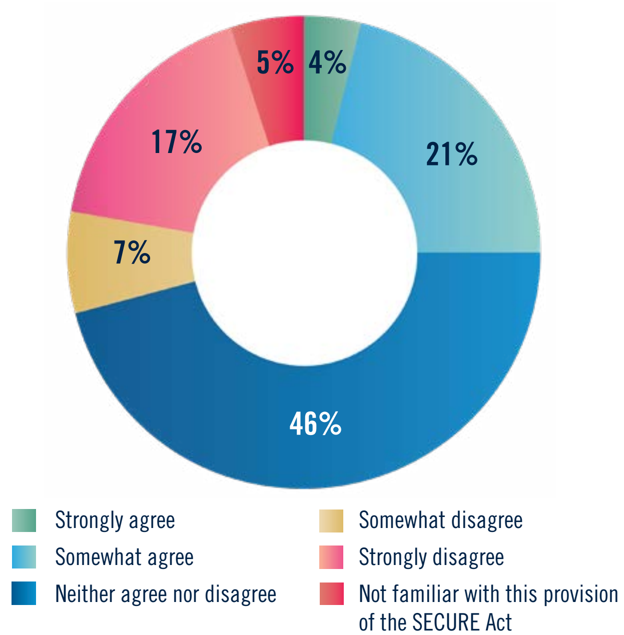
THE SECURE ACT AND ANNUITIES

The SECURE Act has created a more defined path for plan sponsors to offer in-plan guaranteed retirement income solutions. The passage of the Act brings with it some important implications, including a greater ability to protect workers against longevity and investment risks by making it easier for them to convert savings to guaranteed income in retirement.

More specifically, the SECURE Act created a new safe harbor easing liability concerns that have often proven to be one of the barriers for plan sponsors in offering annuities within a DC plan. It also brings more certainty and clarity to how a plan sponsor can satisfy its fiduciary duties when selecting an annuity provider and offers efficiency and cost savings to the annuity-provider selection process.

With more clarity and protections to offer annuities as an investment solution within a DC plan, our survey shows that a quarter of DC plan sponsors indicate they have increased interest in doing so. Plans with $250 million to $499 million showed the most appetite for offering annuities (a total of 36% either strongly agreed or somewhat agreed), followed by those with $1 billion to $5 billion (31%). Interestingly, plan sponsors at the larger end of the market (plans with >$5B)[1] seem to be undecided at this time (71%), and 33% of the smallest plan sponsors somewhat or strongly disagree that the SECURE Act has increased their desire to offer annuities in their 401(k) plans.

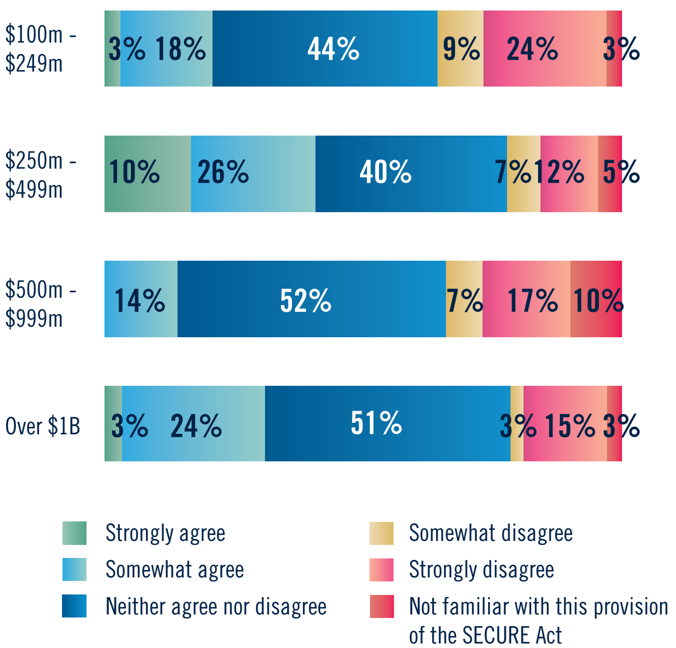
THE PASSAGE OF THE SECURE ACT HAS INCREASED OUR INTEREST IN CONSIDERING OFFERING ANNUITIES IN OUR 401(K).



1 See Figure A2 in appendix for full data.

We asked, "To what extent do you agree with the following statement. The passage of the SECURE Act has increased our interest in considering offering annuities in our 401(k)"

BY TOTAL AUM IN 401(K) PLAN



See Figure A2 in appendix for full data.

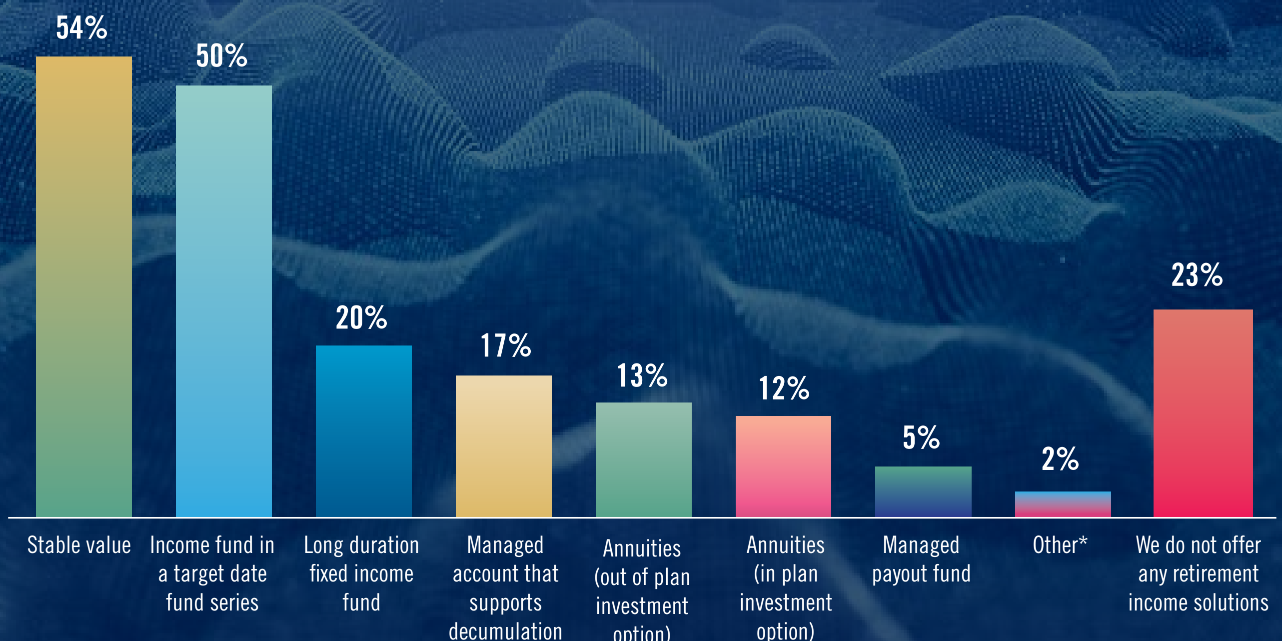
TODAY'S RETIREMENT-INCOME SOLUTIONS

Plan sponsors (along with asset managers, recordkeepers and consultants) continue to develop solutions to help participants achieve a more secure retirement. We believe there isn't going to be a one-size-fits-all approach, but there are many steps plan sponsors can take to support their employees' retirement-income objectives – including evaluating plan design enhancements, educational tools and resources, investment and distribution advice, enhanced administrative functionalities, and investment solutions designed to provide income throughout retirement.

In our survey, we asked plan sponsors what types of retirement-income solutions they currently offer on their DC plan menu. Stable value and income funds in a TDF series are considered the most common retirement income solutions, at 54% and 50%, respectively.

The results aren't too surprising, as stable value and TDFs have been offered in 401(k) plans for years, but are these the optimal solutions for retirees trying to create a reliable income stream in retirement? The survey also suggests that annuities – whether offered in plan or out of plan – have not seen much traction to date. Will this change with the passage of the SECURE Act? We believe the retirement income solutions space will continue to evolve in the coming years as more innovative and creative solutions are introduced to the market.

RETIREMENT INCOME SOLUTIONS/POST-RETIREMENT SOLUTIONS OFFERED ON INVESTMENT MENU FOR 401(K) PLAN



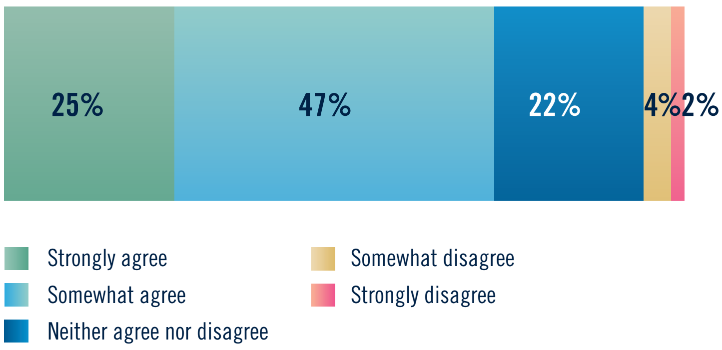
*Other includes installments and systematic withdrawals

HOW TECHNOLOGY CAN HELP DRIVE INNOVATION

Enhancements to DC plans that better support retirement income will come in small steps. There are several ways sponsors can further the process of providing opportunities for income in retirement, and one of those is leveraging the power of technology to provide more tailored advice and investment solutions.

Our survey found that there is a strong belief around a need to offer retirement income solutions through a technology-enabled customized solution for pre-retirees and retirees. Indeed, 72% of our respondents said they strongly agree or somewhat agree that there will be a need for such solutions, while just 2% strongly disagreed. The most support came from the plans with $1 billion to $5 billion in assets, followed by plans with more than $5 billion.

We asked, "To what extent do you agree with the following statement. I believe there will be a need to offer retirement income solutions through a technology-enabled customized solution for pre-retirees and retirees."



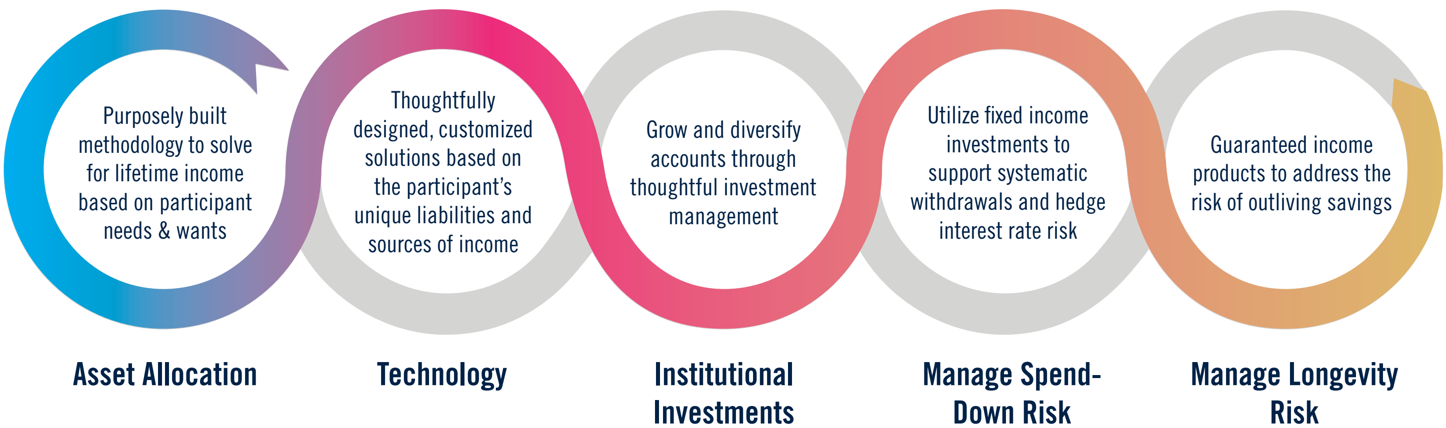
PAVING THE WAY FOR THE FUTURE

It's critical that plan sponsors evolve their DC plans to focus not simply on retirement savings, but also on achieving adequate retirement outcomes. By embracing new technologies, more robust communications about income, customization opportunities, and risk mitigation solutions with both non-guaranteed and guaranteed investments, DC plans have the potential to help workers meet their retirement-income challenges. They also have the potential to help employers, both by mitigating the costs associated with workers staying on the job because they can't afford to retire, and by giving retirees an incentive to stay in their workplace plans.

It's also very clear that there is plenty more work to be done. When asked about the top three priorities over the next 12 months, 38% of sponsors included evaluating retirement income solutions – although only 7% included it as the number-one priority. Most sponsors (62%) did not rank it as a priority, and instead have prioritized evaluating compliance with regulations, incorporating financial wellness programs, and improving participation and savings rates.

We believe the next generation of retirement income solutions will deliver both guaranteed lifetime income as well as non-guaranteed components that leverage asset allocation and asset-structure best practices, liability-driven investing concepts, and institutional investments. With a greater focus on income generation, participants will be able to make better informed decisions about when to retire, secure in the knowledge that they will be able to enjoy a comfortable retirement.

GENERATING THE RETIREMENT INCOME "PAYCHECK"



HIGHEST PRIORITIES REGARDING 401(K) PLAN DURING THE NEXT 12 MONTHS

1. Ensuring compliance with regulations
2. Increasing enrollment, participation & deferral rates
3. Incorporating financial wellness programs
4. Re-evaluating your investment menu
5. Reducing plan costs
6. Evaluating retirement income solutions
7. Re-evaluating your record keeper
8. Re-evaluating your consultant/plan advisor

For more info contact Josh Cohen, Head of Institutional Defined Contribution, PGIM Institutional Relationship Group at josh.cohen@pgim.com or Mikaylee O'Connor, Vice President, Senior Defined Contribution Strategist, PGIM Institutional Relationship Group at mikaylee.oconnor@pgim.com or learn more at pgim.com/dc

APPENDIX

METHODOLOGY

- The research was conducted by Greenwich Associates from March 5 to July 17, 2020, using an online, quantitative approach with DC plan sponsors who have at least one 401(k) plan and at least $100m in 401(k) assets.
- The research was conducted on an unsponsored/blind basis with no mention of PGIM as the study sponsor.
- Participants were incentivized to participate with a summary of the research findings as well as a charitable donation to the American Red Cross or AMEX gift card ($100).

Figure A1: Almost all DC plan sponsors offer their participants tools and advice on how to meet goals and how to spend down assets in retirement

Figure A2: A quarter of DC plan sponsors indicate that the SECURE Act has increased their interest in offering annuities as an investment option

"THE PASSAGE OF THE SECURE ACT HAS INCREASED OUR INTEREST IN CONSIDERING OFFERING ANNUITIES IN OUR 401(K)."

BY TOTAL AUM IN 401(K) PLAN

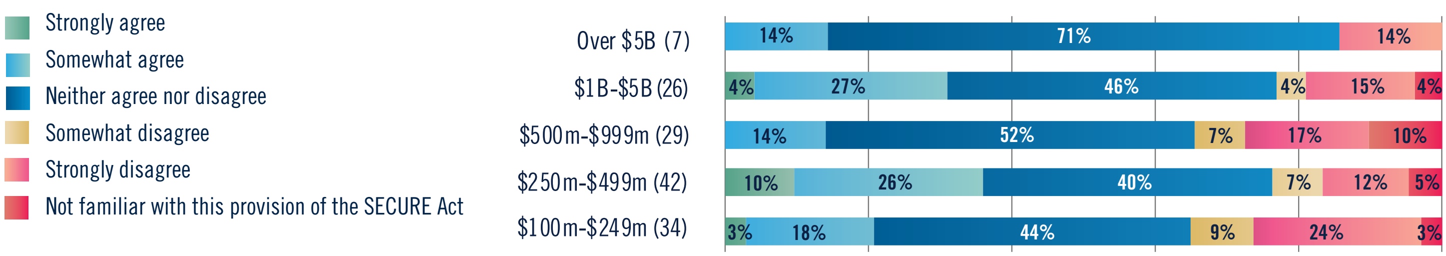
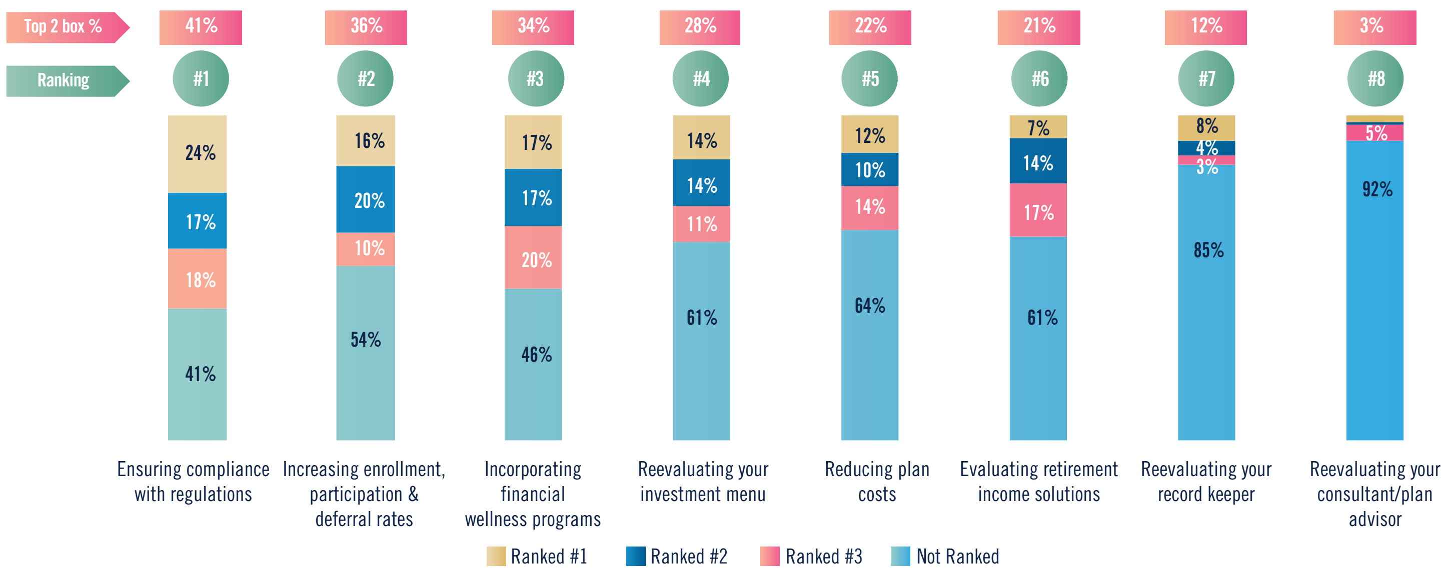


Figure A3: DC plan sponsor top priorities for their 401(k) plan are ensuring compliance with regulations, increasing participation and deferral rates, and incorporating financial wellness programs

HIGHEST PRIORITIES REGARDING 401(K) PLAN DURING THE NEXT 12 MONTHS
TOTAL (138)



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