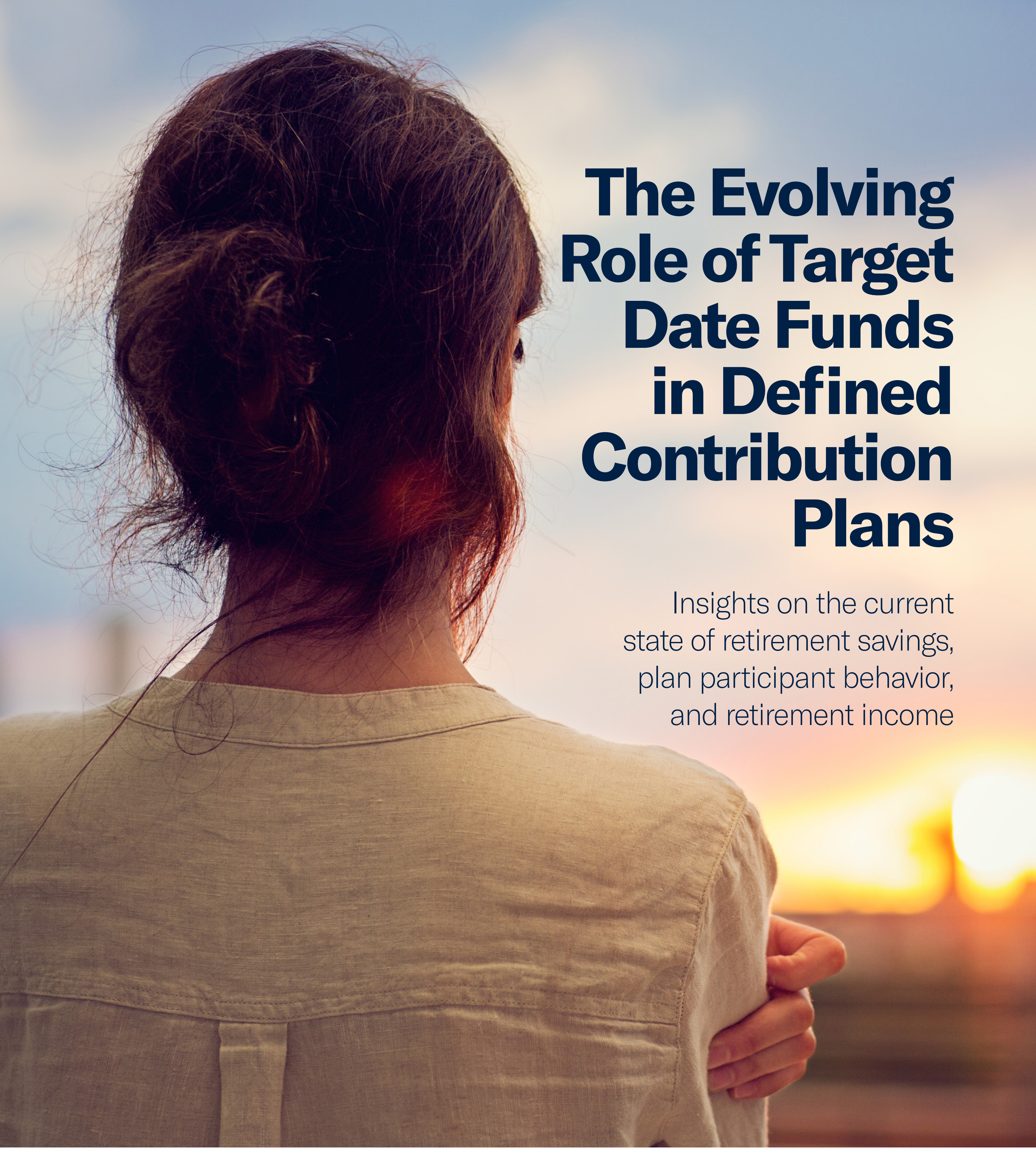


The Evolving Role of Target Date Funds in Defined Contribution Plans

Insights on the current state of retirement savings, plan participant behavior, and retirement income

II Thought Leadership Studio

PGIM INVESTMENTS

Contents

Executive Summary and Key Findings 2
The State of the U.S. Retirement System 4
The State of DC Plan Participant Behavior 8
Role of Target Date Funds 14
A Focus on Retirement Income 20
Key Takeaways 22
About this research 23

Executive Summary

Defined contribution (DC) plan sponsors and advisors feel that target date funds (TDFs) have helped to address many of the major challenges they face regarding plan participation, particularly those based on concerns participants have about what to invest in and how to protect their investments. Overall, plan sponsors and advisors view the health of the U.S. retirement system in a more positive light than was the case in 2016. According to a survey of 250 DC plan sponsors (senior finance and HR/benefits leaders) and 250 DC plan advisors, 42% in each cohort believe the U.S. retirement system is healthy and provides an opportunity for workers to successfully retire. A similar survey in 2016 revealed that only 18% of plan sponsors and 11% of plan advisors held a comparable view.[1]

Overall, the 500 participants in this 2019 edition of the survey represent a broad range of industries and plan sizes. They express a positive view of their own plans, consider the current accumulation side of the retirement equation as largely effective, and display limited anxiety about economic and market dynamics. They do express concern, however, around plan participants' (especially younger participants) failure to save enough money to maximize the utility and potential of DC plans in their post-retirement lives.

In a 2016 survey, only 18% of plans sponsors and 11% of plan advisors said the U.S. retirement system was healthy and provided an opportunity for workers to successfully retire. Three years later, 42% in each of those cohorts feel good about the health of the system and the opportunity it provides for successful retirements.

[1] "DC Plans at a Crossroads: Building a Holistic Retirement Model in a Time of Sweeping Change," Institutional Investor, Prudential.

Key Findings

Overall, DC plan sponsors and advisors feel good about the momentum of their plans and the utility of TDFs. However, they acknowledge there is still much work to be done and progress to be made, particularly in the area of retirement income.

DC plan sponsors and advisors see the U.S. retirement system and their own plans as healthy.

- This marks a noted shift from 2016, when DC plan sponsors and advisors were less certain of the vitality of the system. Today, 42% of each group rate the system healthy and a good retirement platform for employees to retire successfully.

- Plan sponsors have a favorable overall view of their DC offerings, and in particular the quality of investments offered and the contribution matching provisions. This level of satisfaction is on par with sentiments expressed in the 2016 survey. Plan advisors also feel good about their clients' plans overall, if slightly less so — a finding and small gap in sponsor and advisor views that aligns with 2016 results.

Plan sponsors and advisors believe market volatility and interest rates are the macro trends most likely to affect their DC plans over the next three years.

- In the 2016 survey, these same two trends were among the least worrisome, and changing regulatory environment and demographics were the top concerns. Three years later, respondents express concern that the long-running bull market and low interest rate environment won't last forever, while the regulatory climate is more stable.

Plan participant behavior is a major concern for sponsors and advisors.

- Nearly 40% of DC plan sponsors and advisors believe that many of their plans' participants who are closest to typical retirement age are at risk of a delayed actual retirement due to a savings shortfall. This is a conundrum for all involved, as experienced employees do bring value to a business, but their continued employment beyond anticipated retirement comes with hard costs. One study found that a one-year increase in average retirement age results in an incremental cost of over $50,000 for a single employee whose retirement is delayed.[2]

DC plan sponsors and advisors express concern regarding plan participants' contributions.

- In particular, it is felt that early- and mid-career plan participants — that is, those under age 35 and those age 35-55, respectively — should increase their contributions to effectively prepare for a successful retirement. In addition, there is a strong perception that plan participants fail to make the maximum allowable contribution to their plan, and that they don't take full advantage of contribution matching.

A majority of plan sponsors and advisors agree on the efficacy of target date funds (TDFs).

- A majority of sponsors and advisors believe target date funds can work as the sole investment vehicle amid high market volatility and downturns.

- TDFs are also seen as offering a strong value proposition to plan participants — notably by providing peace of mind with their dynamic asset allocation, risk management, and downside protection.

Plan advisors foresee game-changing evolutions in DC plan investment options.

- Potential game-changers include the potential for alternative investments, personalization and individual glide path solutions, and dynamic qualified default investment alternatives.

Income is seen as a priority for retirees.

- Plan sponsors and advisors believe plan participants in the retirement phase should focus on steady income over maximizing returns as the top strategic investment goal.

- In interviews, many plan advisors expressed the opinion that DC plans should be specifically constructed to address a plan sponsor's preference that participants either exit the plan at retirement, or stay in the plan beyond retirement.

[2] "Why Employers Should Care About the Cost of Delayed Retirements," Prudential, 2019. Represents the difference between the workforce costs of a retiree vs. and entry-level employee. It is assumed that when an employee retires, and advancement opportunity is created such that all employees progress through the workforce (i.e. "move up a notch"), and an entry-level employee is hired.

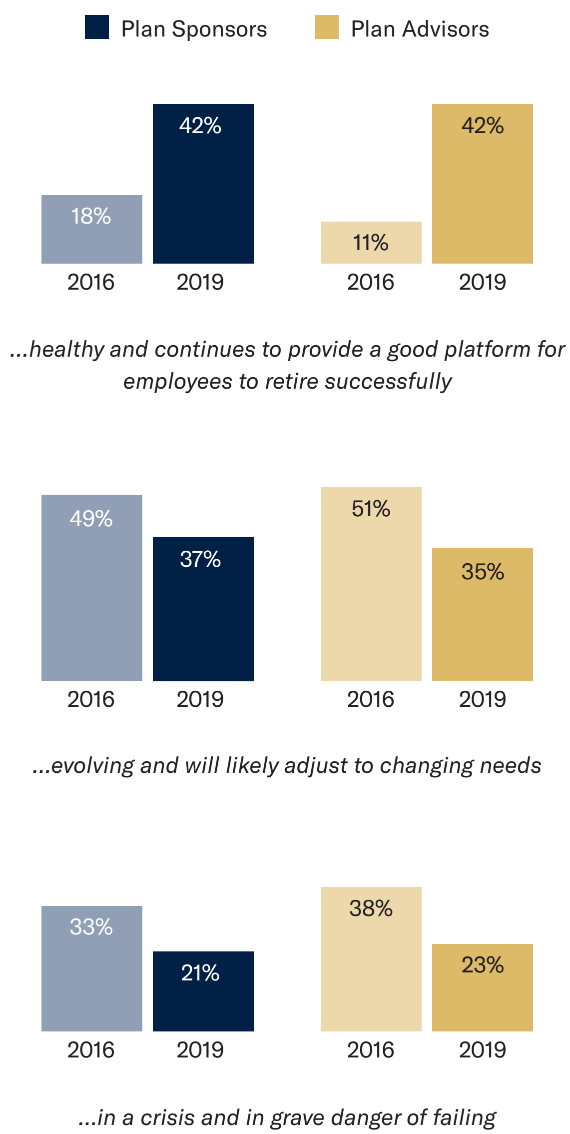
1

The State of the U.S. Retirement System

Defined contribution (DC) plan sponsors and advisors agree regarding the U.S. retirement system's overall health. Forty-two percent of each group rated the system healthy and a good retirement platform for employees to retire successfully (see figure 1), an uptick from a similar study conducted in 2016, a year that saw the markets experience a rocky start.

Figure 1. Both sponsors and advisors see the U.S. retirement system as healthy

The U.S. retirement system is...



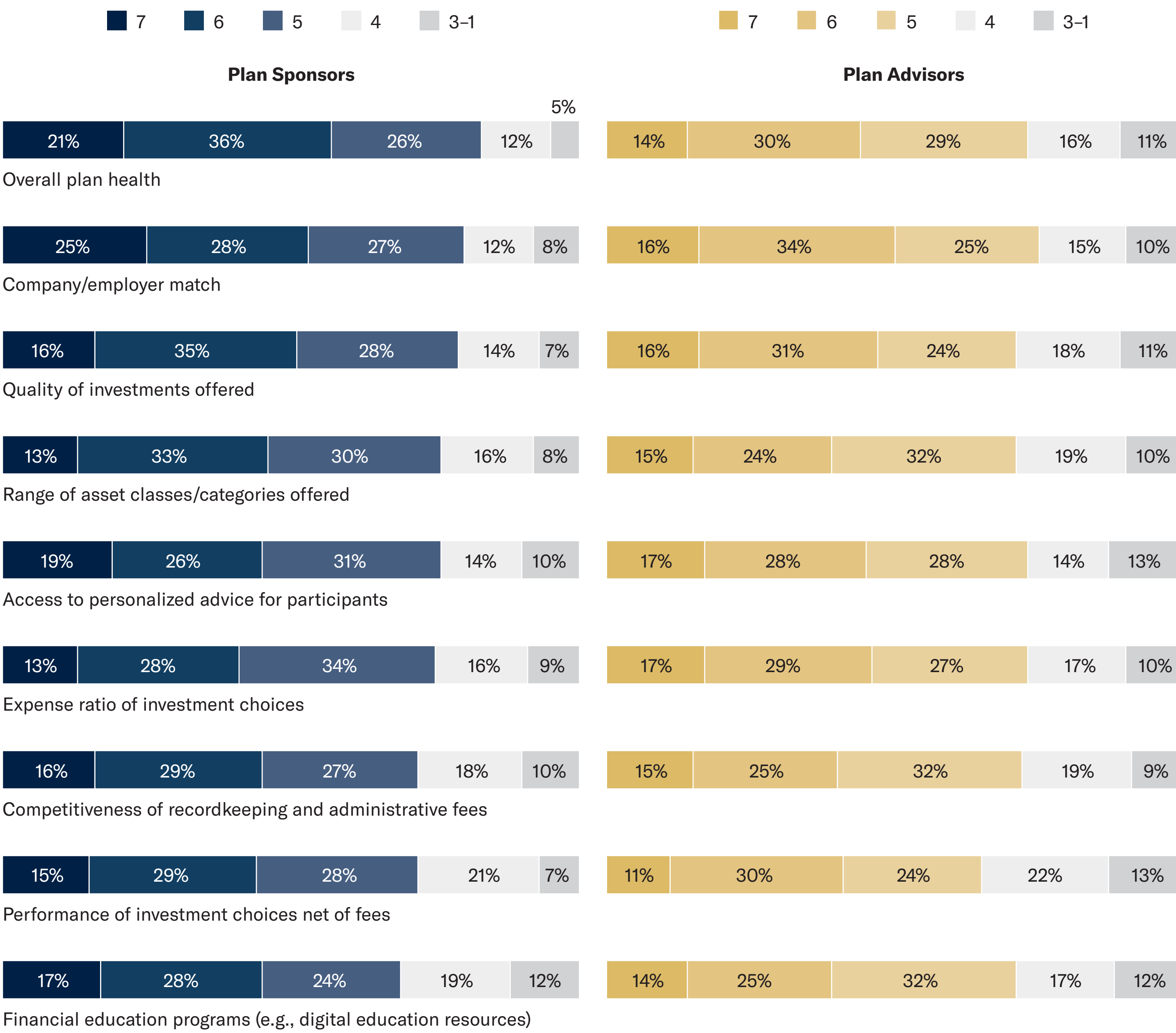
At the other end of the spectrum, pessimism is in noticeable retreat. Less than a quarter of plan sponsors and advisors graded the system as in crisis, a double-digit decline from three years ago.

"The overall system isn't perfect, but we all benefit from the DC mindset that people have to take responsibility for their retirement benefits," says an advisor.

"We think that DC plans are generally well-managed," adds another advisor, "especially in our world of large- and mega-sized companies."

Figure 2. Majority of sponsors rate their plans, matching arrangements, and investments choices favorably

How do you rate your DC plan in each of the following areas? (7 = Excellent / 1 = Poor)



DC professionals believe they are doing a good job

Plan sponsors are largely content with their endeavors to provide for their employees' retirements. On a scale of 1-7 (poor to excellent), 4 out of 5 sponsors graded themselves a 5 or above in the context of overall plan health, company/employer match, and quality of investments offered (see figure 2). Plan advisors' self-assessments are in line with this, with at least 7 in 10 offering the same appraisal.

Some headwinds expected

The current healthy economy and robust stock market would be expected to set minds more at ease, but as they look ahead two years DC plan sponsors and advisors do have some concerns about market volatility as a headwind from a macro perspective. Among plan advisors, 63% believe that in two years equity market volatility will be higher to some degree (see figure 3). Both plan sponsors and advisors are somewhat anxious about inflation and fixed income returns, too.

Related to their DC plans specifically, sponsors and advisors believe the volatility they anticipate in financial markets could have the most significant effect on their plan over the next three years. Respondents are nearly equally concerned about the effect interest rates could have on their plans over the same time period (see figure 4), a sentiment that aligns with their worries regarding inflation and fixed income returns.

Figure 3. Limited anxiety about economic and market dynamics

How much lower or higher do you think the following economic and market metrics will be two years from now? (7 = Higher / 1 = Lower)

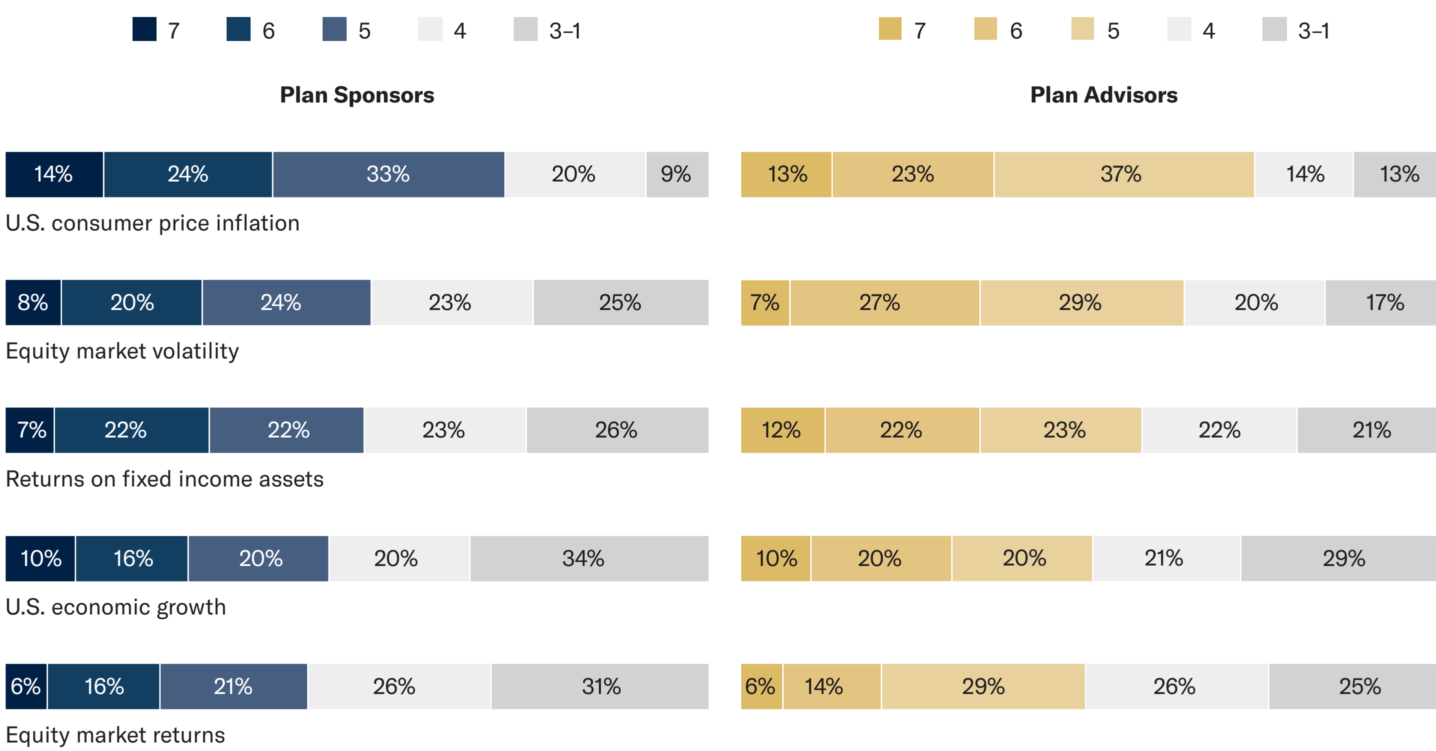
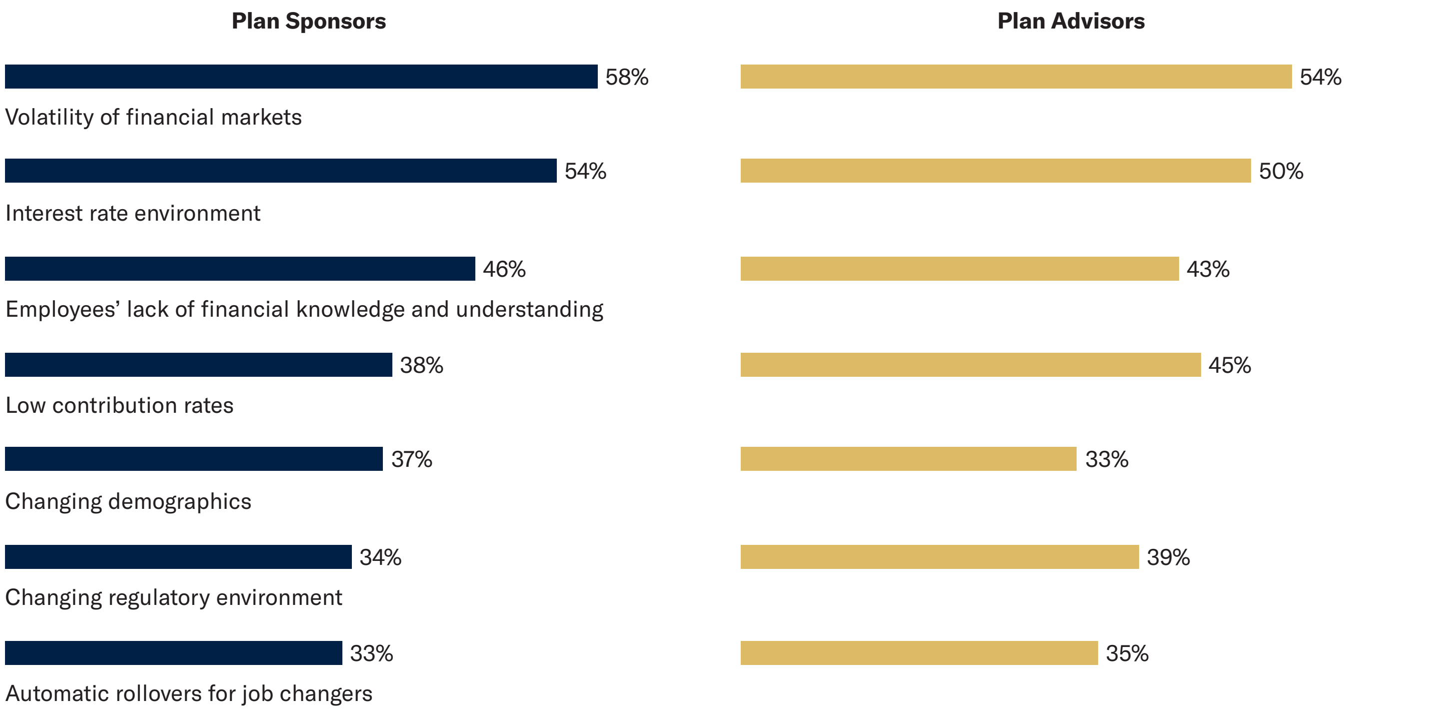


Figure 4. Market volatility and interest rates are most likely to affect DC plans

Which of the following trends do you believe will have the greatest impact on your DC plan in the next three years?



Advisor Viewpoint: Momentum toward accumulation

"The industry has largely figured out the accumulation aspect," says an advisor. "We are big proponents of everything auto — auto-enrollment, auto-escalation, auto-rebalance. The important caveat with something like auto-escalation is that you make that an opt-out feature. If we know anything about DC plans, it's that inertia is an incredibly strong behavioral characteristic. The likelihood of the vast majority of individuals going in and checking that auto-increase box isn't very high." She believes re-enrollment is also key. "If a plan sponsor, their consultant, or advisor holds the belief that the vast majority of the plan's participants would be well-served by a target date strategy versus do-it-yourself, for example, it can implement a re-enrollment. If participants don't make an active investment election by XYZ date, their balance and contributions going forward will be moved to the target date fund. That's one way to help ensure proper diversification."

It's an article of faith among advisors that auto-enrollment and auto-escalation should be a given; one advisor calls these protocols "mandatory to success." He likewise deemed institutional share classes that eliminate revenue sharing "fundamental to success."

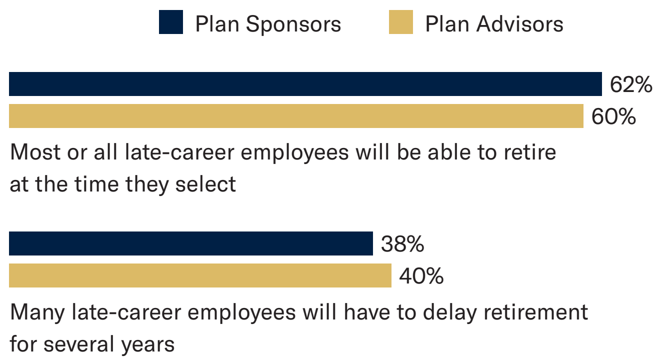
2

The State of DC Plan Participant Behavior

DC plan sponsors and advisors feel good about the job they're doing and the tools at their disposal, but they express concern about plan participants, and in particular those nearing retirement (age 55 and over). Approximately 40% of survey respondents believe that late-career employees risk delaying their retirement (see figure 5).

Figure 5. Approximately 40% of plan sponsors and plan advisors say late-career employees risk a delayed retirement

Which statement best reflects your view on the outlook for employees who are closest to retirement?



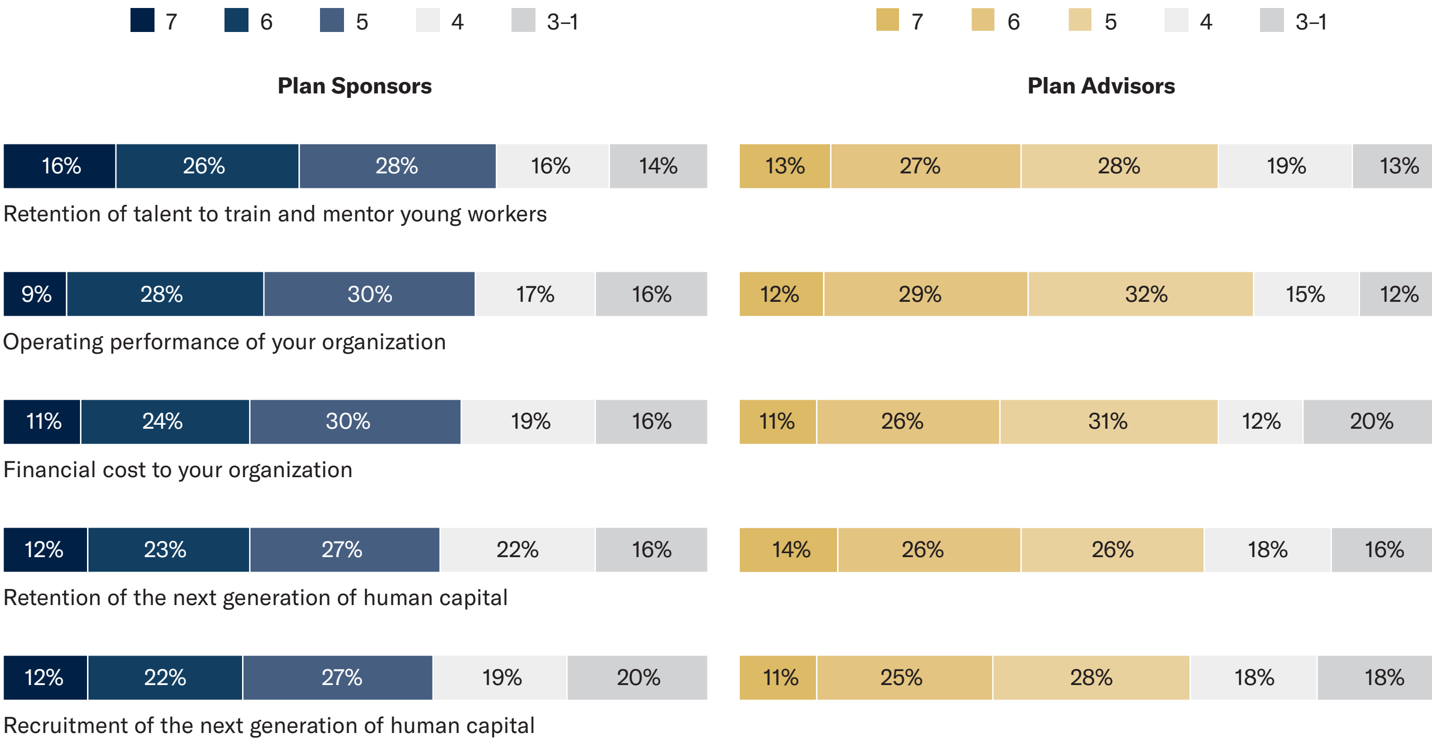
The effects of this savings shortfall among late-career employees are likely felt differently by plan sponsors and the employees themselves. Employees who continue to work beyond their expected retirement age are valued by employers to some degree (see figure 6), also hopefully continue to contribute to their retirement plan. However, delayed retirements come at a concrete cost to employers, as healthcare and other benefits are typically more expensive for older employees. For example, annual healthcare costs of a worker 65 or older are twice those of a worker between the ages of 45 and 54.[3] In addition, not knowing when an employee might retire creates workforce management challenges, such as recruiting and retaining top talent.

"For individuals who are getting close to retirement, a lot depends on what their savings pattern has been throughout their career, and where they are in relation to their financial wellness goals," says an advisor. "Many people are behind their targets."

[3] Employee Benefit Research Institute, "The 2014 Retirement Confidence Survey: Confidence Rebounds – for Those with Retirement Plans," March 2014.

Figure 6. Respondents see value in late-career employees

To what extent would the prospect of postponed retirement affect the following dimensions of your organization's performance? (7 = Positive / 1 = Negative)



Advisor Viewpoint: Financial wellness

Plan participants' every dollar is pulled in many directions, not simply toward investment and retirement programs. Accordingly, plan sponsors and participants increasingly focus on financial wellness. If participants don't have their hands around their near-term financial realities, it's difficult to convince them to focus on what they need to do long-term for retirement. "If you have a financially stressed employee, their productivity level is going down," says one plan sponsor. "It's in the company's best interest to encourage employees to save, and even to help them with student loans and other financial responsibilities they have."

"That's the part of DC that's not working well, and that's where the future focus should be," an advisor says. "Beyond just building a great DC program, it's vital to empower potential participants to utilize it."

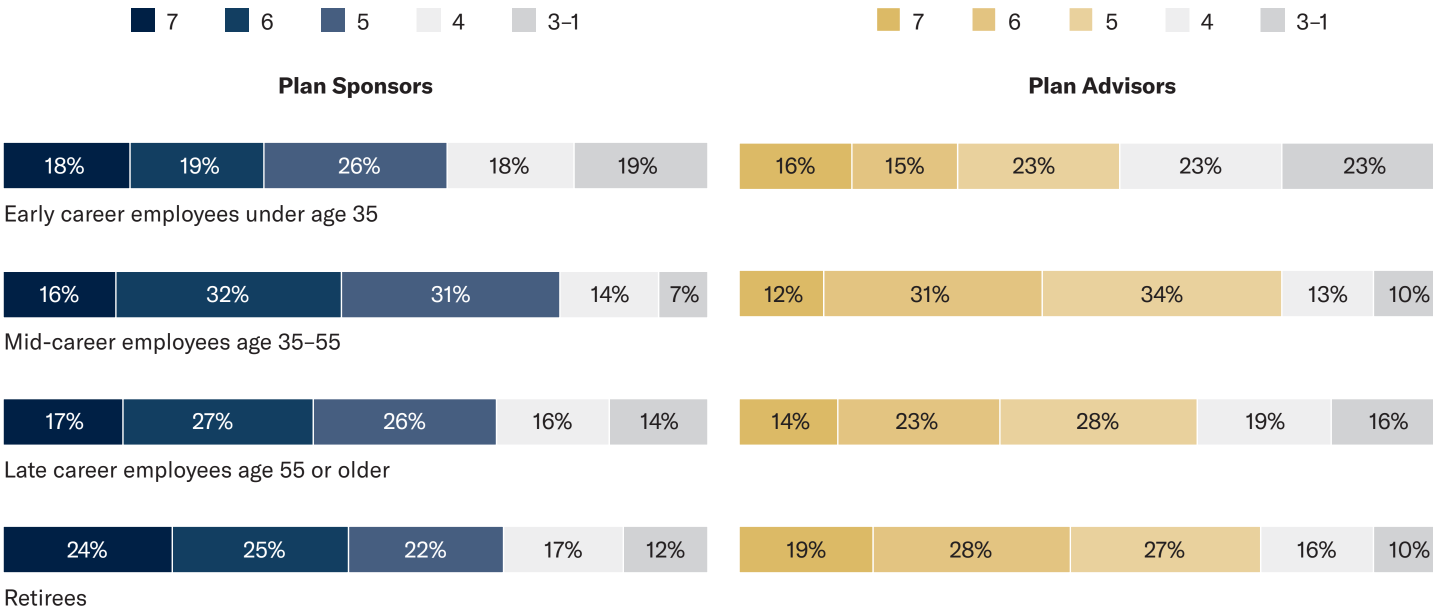
Utilization, she believes, boils down to tools and features available on the recordkeeping platform or via other financial wellness vendors. Ideally, such tools make using one's investment plan as simple as restocking your paper towels on Amazon Prime, i.e. DC plans become as easy to understand and manage as online shopping.

Though room for improvement exists on the data front to provide the best retirement outcomes and to know if DC programs are being properly utilized, one advisor very much likes what he currently sees.

"Structurally, the companies that provide recordkeeping services are evolving really well," he says. "They're taking financial wellness into account, and are able to bring in data from different sources, and present a holistic picture of pensions, social security, and other assets."

Figure 7 . Lower confidence in plans' ability to meet the needs of the youngest employees

How confident are you in your plan's ability to meet the long-term retirement needs of the following groups of employees at your organization? (7 = High confidence / 1 = Low confidence)



Early career employees at risk, too

Sponsors and advisors alike also report doubts about meeting the eventual retirement needs of early-career employees, and with good reason — according to analysis by The Pew Charitable Trusts, workers aged 18-31 had limited improvement in their DC plan savings' benchmarks from 1998 to 2012.[4] Among plan sponsors and advisors surveyed for this report, approximately 1 in 5 expressed a lack confidence in their plan's ability to meet the needs of their youngest employees (see figure 7). These concerns arise principally from an overall lack of early, disciplined saving, which about three-quarters of sponsors and advisors agree is impactful (see Figure 8). Some in the industry and Congress now seek to address this.

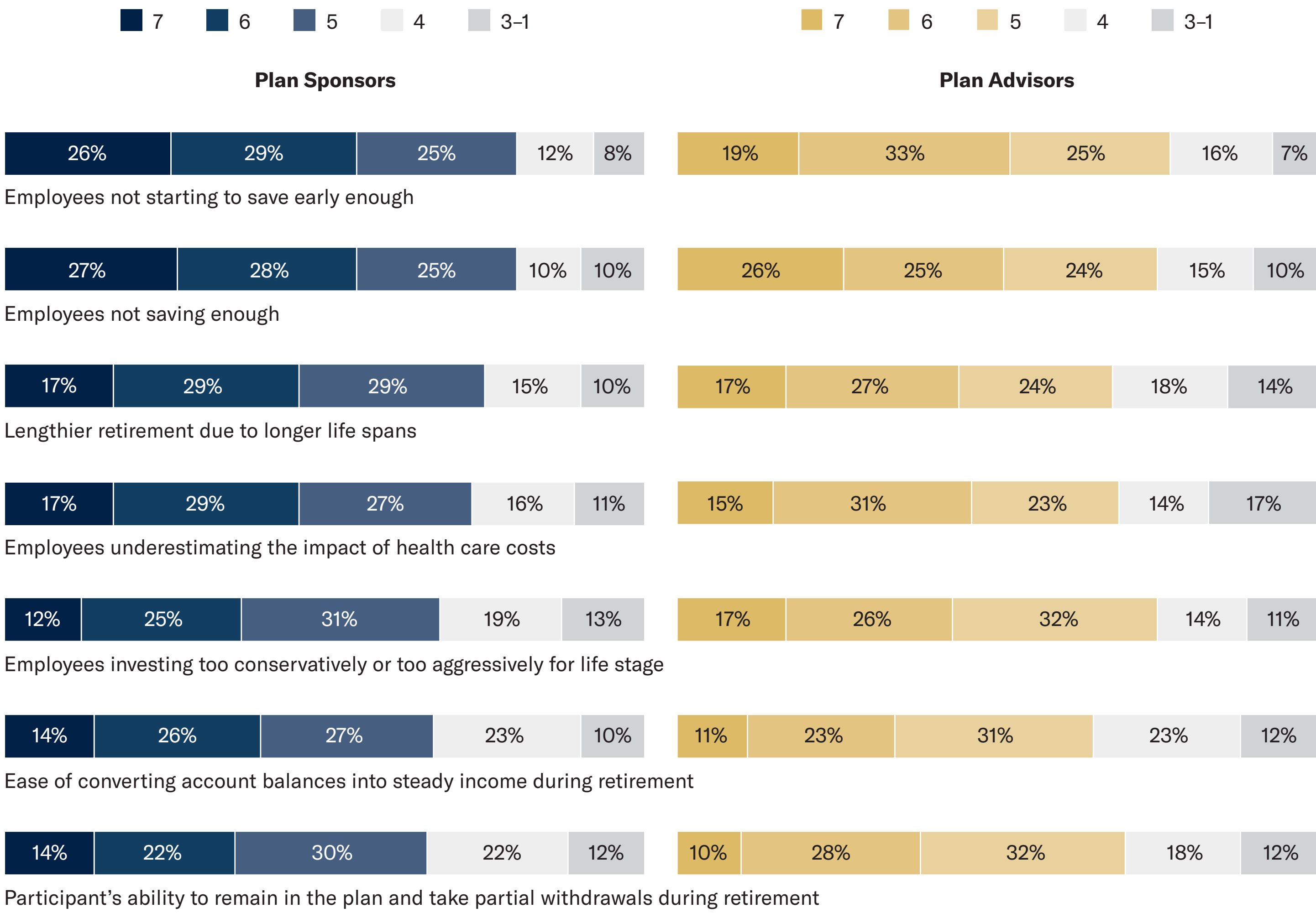
"I think we have a functional and very good DC practice around the country," says one advisor. "But it's vital to get people into the plan early in their careers. Among the plans we work with, participation rates for plans that do not auto-enroll is 68%. For those that use auto-enrollment, the participation rate is 90%. That's a huge difference, and it tends to hold."

"Financial literacy isn't taught in schools," says an advisor. "People take on loads of debt to go to college, and they go to their first employer and say, 'I can't afford to save for retirement.' It's the job of everyone in our industry to help them see they can't not afford to save for retirement."

[4] "Are Today's Young Workers Better Able to Save for Retirement," The Pew Charitable Trusts, 2018

Figure 8. Respondents call again for early, disciplined savings

Please rate how you believe the following factors will affect the financial health and retirement security of employees in your DC plan. (7 = High Impact / 1 = Low Impact)



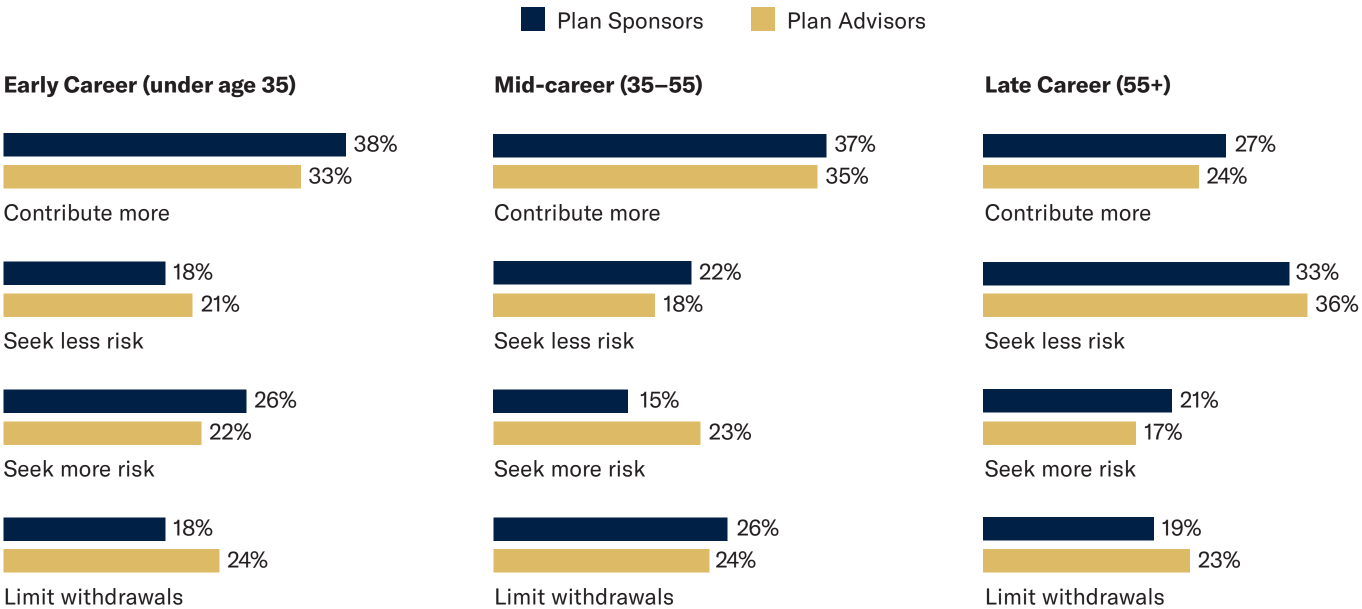
Others agree that the retirement system itself is healthy — but that participants don't receive enough financial education, and don't pursue financial literacy on their own.

"Financial literacy isn't taught in schools," says an advisor. "People take on loads of debt to go to college, and they go to their first employer and say, 'I can't afford to save for retirement.' It's the job of everyone in our industry to help them see they can't not afford to save for retirement."

One plan sponsor believes he and his peers can do better when it comes to demonstrating the logic of saving to early career employees. "As plan sponsors, we have not done a good enough job at helping employees understand how to live within their means, budget monthly expenses, and manage your money appropriately," he says. "That's all part of young people seeing their way clear to saving."

Figure 9. Consistent calls to contribute more and adjust risk/return

Please select the one step that would help the most in preparing each group of employees for retirement



Investment strategy evolves according to career stage

Saving more money in DC plans is clearly step one in preparing for successful retirement, and it follows that the next step is how to invest those assets as they accumulate. And, like the amount saved itself, the goals of investment choices should change over time.

Plan sponsors and advisors agree that increasing contributions is the top tactic for early-career plan participants to travel the road toward successful retirement (see figure 9). In addition, more than one-quarter of plan sponsors and more than one-fifth of plan advisors think early career employees are positioned to take on greater risk exposure and, it follows, the potential for higher returns that come with it.

At the mid-career asset accumulation point, plan advisors are a bit more bullish on how much risk participants should take on, but DC plan sponsors and advisors agree strongly that less risk is better for late-career plan participants.

Advisor Viewpoint: Fewer, Better Choices

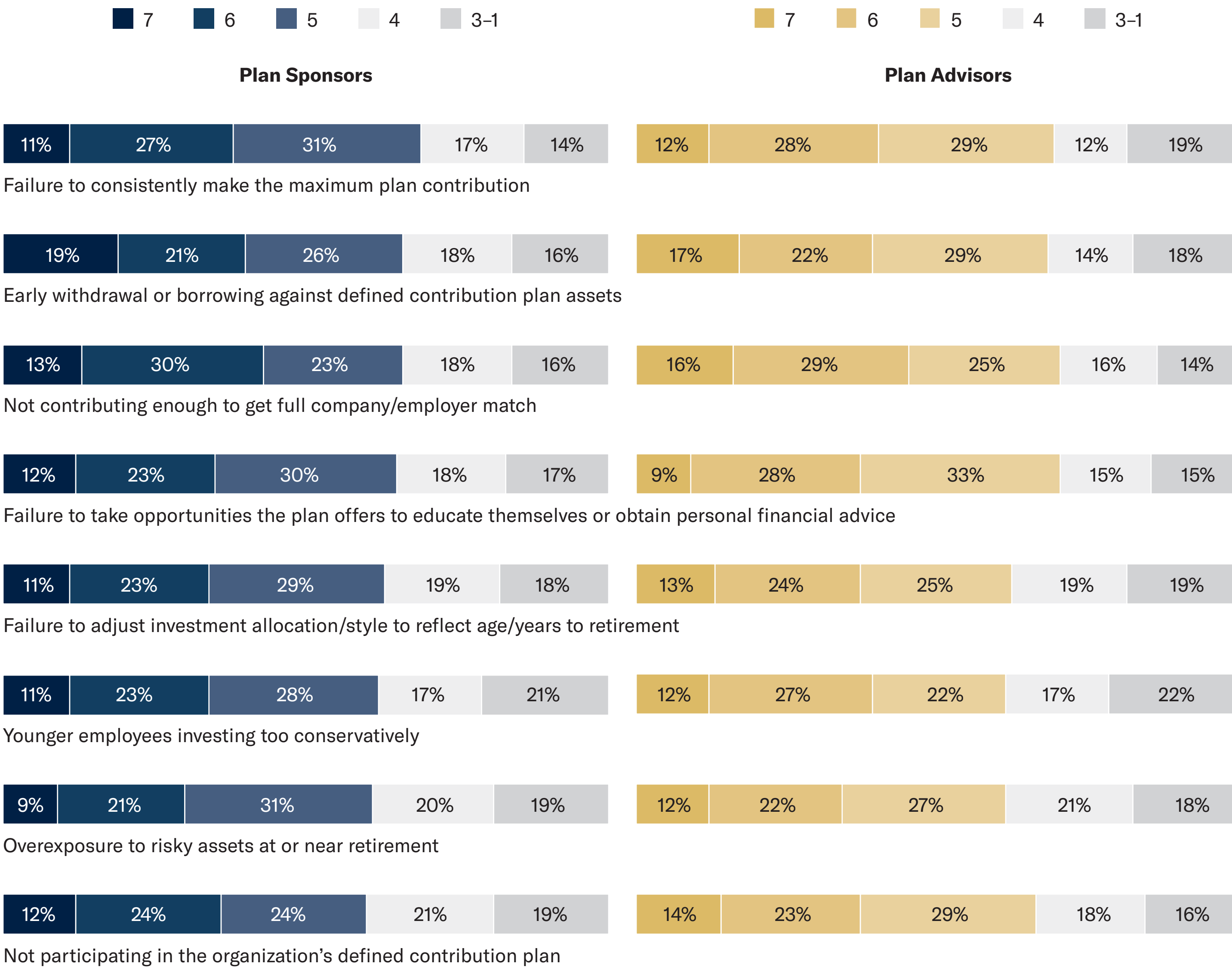
DC plan sponsors and advisors believe that automatic features in plans help increase participation and contributions. When it comes to participants understanding their investment options, the perception among advisors is the same — keep it simple.

"Decision-making tools for participants should be as simple as possible," says an advisor. "In our industry, we're always overthinking, and a decision tree quickly grows into a forest. But people don't have time for forests."

The consensus among DC professionals is that uptake is modest at best when plan participants are offered investment opportunities beyond the default selections made by the plan and its advisors. "We have a brokerage window as one of the investment options in our plan," says one advisor. "Less than 1% of people participate in that."

Figure 10. Concern over participant behavior

How great a problem are the following behaviors among employees in your plan? (7 = Acute problem / 1 = Not a problem)



Across the board — from failure to consistently make the maximum plan contribution, not contributing sufficiently to get the full employer match, to simply not participating in the organization's DC plan at all — more than half of sponsors and advisors see participant behavior they deem problematic (see figure 10). Data backs up these concerns. For example, it's estimated that U.S. employees leave an estimated $24 billion on the table annually by not saving enough to reach their full employer 401(k) match.[5]

[5] "Missing Out: How Much Employer 401(k) Matching Contributions Do Employees Leave on the Table?", Financial Engines, May 2015, based on analysis of savings records of 4.4 million active DC plan participants.

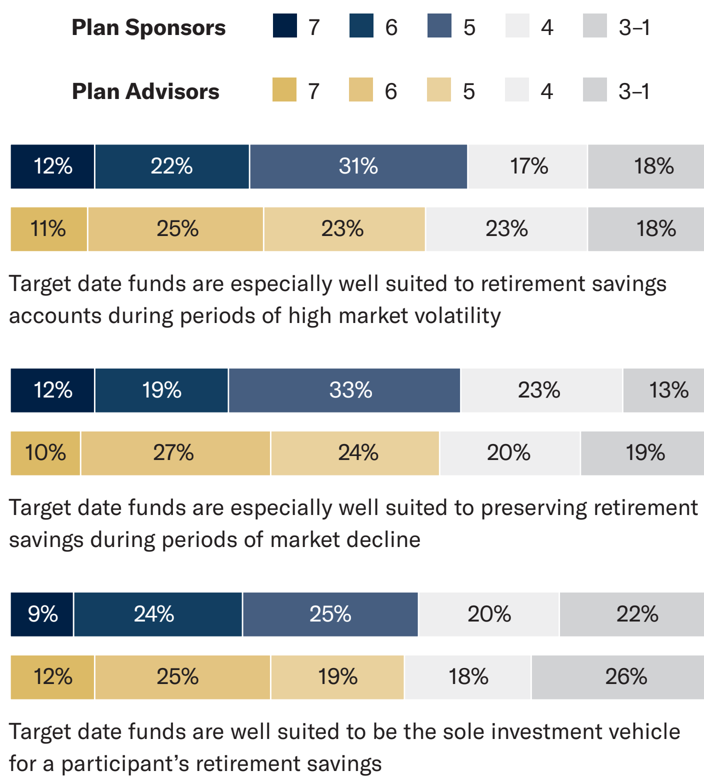
3

Role of Target Date Funds

Target date funds play an important role in DC plans, with up to 92 cents of every dollar flowing into DC plans going into a target date fund. Up to 92 cents of every dollar flowing into DC plans now goes into a target date fund.[6] This evolution of TDFs into a mainstay of DC plans can be explained, at least in part, by the belief of more than half of sponsors and advisors that TDFs are well suited to periods of high market volatility, and for capital preservation during market downturns (Figure 11) — a belief they likely pass along to plan participants.

Figure 11. Majority of plan sponsors and advisors view TDFs as well-suited to be the sole investment vehicle amid market uncertainty

To what extent do you agree with the following statements about target date funds? (7 = Agree strongly / 1 = Disagree strongly)



[6] Callan DC Index, 6/30/2018

"Our view of target date funds remains incredibly positive," says an advisor. "It is the best solution for the vast majority of people. There's a lot of discussion in the industry about how managed accounts might ultimately replace target date funds, but we're not there yet. We still believe that the target date funds should continue to be the cornerstone of DC programs. They've been a very effective tool for the American worker."

Plan sponsors proved especially supportive of messaging on TDFs' value proposition. From financial peace of mind to improving investment decisions, better diversification to more appropriate risk-related choices, more than two-thirds of sponsors agreed that TDFs led to better outcomes in all of these aspects (see figure 12).

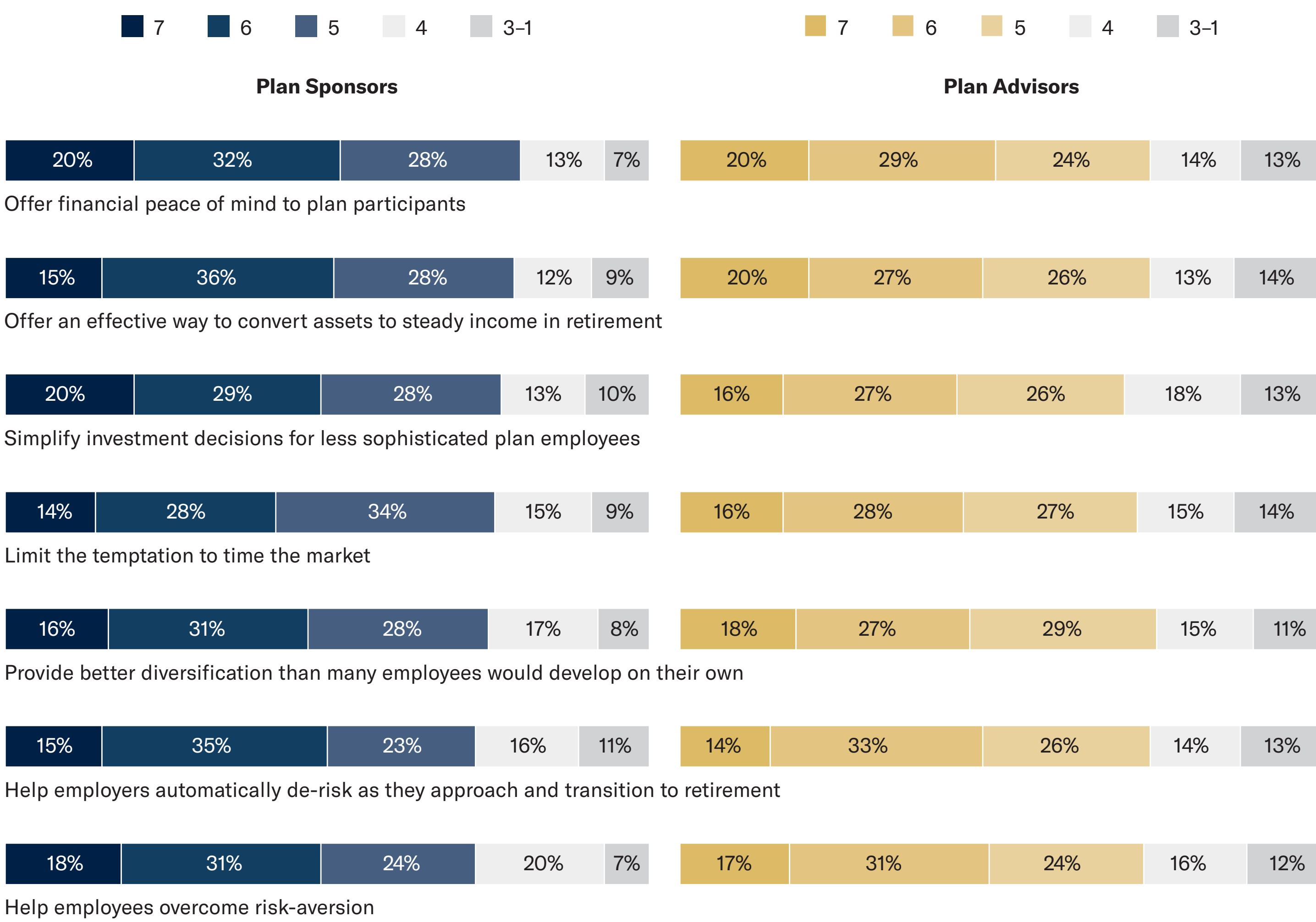
Reviews on the horizon

Because TDFs have become the bedrock of DC plans, it's not surprising that sponsors and advisors plan to review TDF offerings within the next two years, with 42% of both cohorts saying it's very likely they'll do so.

How will TDF performance be evaluated? Ask three sponsors or advisors that question and you're likely to get three different responses — "total return net of all fees," "risk adjusted return net of all fees," and "it depends on the fund's position on its glide path." Indeed, respondents split nearly in thirds on the question.

Figure 12. Sponsors and advisors agree on top messages of target date fund value proposition

To what extent do you agree with the following statements about target date funds? (7 = Strongly Agree / 1 = Strongly Disagree)



One advisor believes that risk-adjusted returns are what people are buying, and that focusing on those returns prevents loss aversion meltdowns.

"People will see that XYZ target date was up 13%, and another one was up only 11% — but how much risk did they take to get that 13% versus the 11%?" he says. "Clients rarely complain when you were up 14% and another firm was up 15%, but they scream when you were down 15% and the other firm was only down 8%."

"At a high level, absolutely you should be looking at things on a risk-and-return basis," says another advisor. "When we work with sponsors, we'll show the expected return, and we'll show the downside results. Sponsors and participants need to understand the objectives of the funds, and understand that to get higher returns, you basically have to take higher risk. You should always be looking at the full distribution of outcomes."

"Returns, risk-adjusted returns, standard deviation, alpha, Sharpe ratio — all those things are a part of the examination of performance," says yet another advisor.

"The target date landscape a decade ago looked very different in terms of the types of solutions that were available. Ten years from now, target date funds will and should look different than they do today."

Advisor Viewpoint: Continuing Evolution of Investment Options

Advisors see no shortage of new investment options for DC plan participants either just arriving or on the near horizon. For example, many advisors see a continuation of the trend toward more active-passive hybrid strategies.

"Evolution is natural," says one advisor. "The target date landscape a decade ago looked very different in terms of the types of solutions that were available. Ten years from now, target date funds will and should look different than they do today."

Here are some examples of what DC plan advisors anticipate might be game changers.

Alternative assets in TDFs

The stability of cash flows in DC TDFs makes the prospect of alternative assets found in other institutional pools more likely, says an advisor, who sees value in higher levels of diversification when hedge funds, private equity, private real estate, for a few examples, being added to the mix more often. "These things can really move the needle," he says. "We think that's potentially likely, if the sponsor already has experience with those types of strategies – such as a sponsor that already has a defined-benefit plan."

Personalization and individual glide path solutions

"Amazon and Google use data about you to personalize your experience," says one advisor. "Why wouldn't that hit the retirement industry as well? As technology progresses, we're going to see more innovation around personalization within the target date space."

"Funds use one factor — age," another advisor says. "But we have much more data. We know things like participants' savings rates, their marital status, whether they have a defined benefit plan. We're taking all this additional data, and allowing the participant to update it as well, to find the asset allocation that works, and revise it over time."

It's a concept another advisor calls "an individual glide path solution."

"The perfect scenario is that every individual has their own glide path based on their own unique personal situation," says the advisor. "That's what managed accounts are trying to do, but there are a lot of impediments, ranging from product availability to infrastructure, the nuts-and-bolts of record-keeping systems, and so on. At some point we will get to a more individualized experience, but that's years away."

Dynamic QDIAs

"When you're 22, everyone has the same set of needs," says an advisor. "But when you get to 50, needs are much more personalized than they were in our younger years." Dynamic qualified default investment alternatives (QDIAs) treats employees the same early, on but later migrate them to a managed account structure for greater customization. "I'm not sure the right product is in the marketplace yet," says the advisor, "but there are a lot of very bright people working on it. I expect that to become the norm in the next 5-10 years."

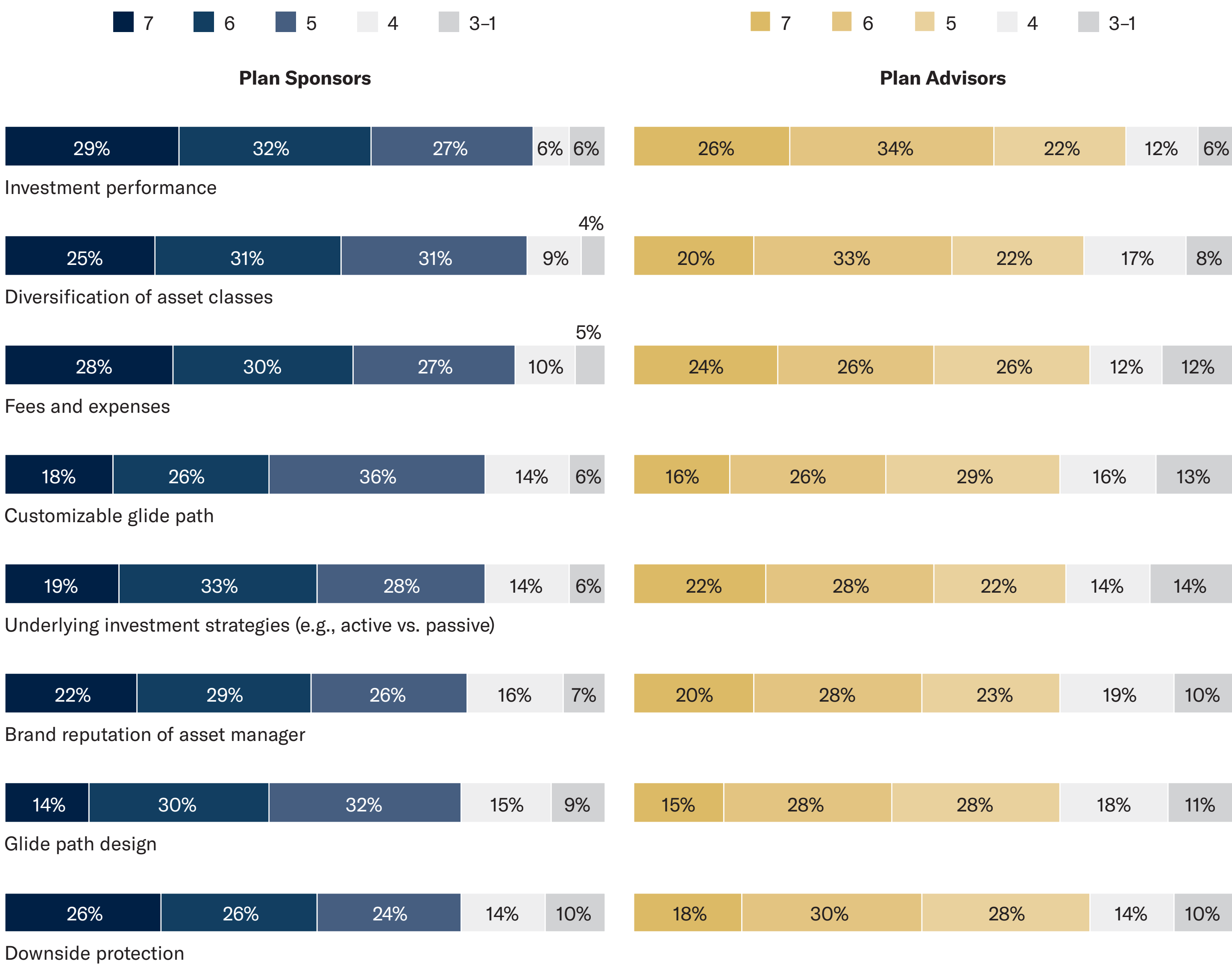
Design vs. performance in TDFs

In the assessment of target date fund offerings, plan sponsors showed a clear preference for investment performance over TDF-specific attributes such as glide-path design: 29% deemed the former very important vs. 14% for the latter (see figure 13). Yet many advisors argue that a focus on performance can cloud strategic, long-term thinking.

"The focus has been on investment metrics," says an advisor. "The view should be the effectiveness of the solutions. You can evaluate things from an investment professional's mindset, but if they're not being used by the participants effectively and appropriately, you're not doing them any favors."

Figure 13. TDF performance is the primary focus, but downside protection matters, too

How important are the following attributes in your assessment of target date fund offerings? (7 = Very important / 1 = Not very important)



Value vs. fees in evaluation discussions

Fees have been top-of-mind in the DC industry and asset management in general for many years now. DC advisors would very much like to see that mindset evolve.

"The industry has gone about as far as it can regarding lower fees, especially in terms of passive off-the-shelf," says an advisor. "Now that we've gotten there, the discussion needs to change to, 'Are participants going to be ready for retirement?'"

No one questions the importance of offering reasonable fees, and lowering them when possible; many, however, believe that the unrelenting fees discussion has gone "a little too far."

Says one advisor, "When you only focus on fees and don't look at the value, you're missing your overall objective."

His suggestion for refreshing sponsor-advisor conversations is to discuss fee budgeting. By increasing the plan's fee budget from five basis points to 15, for example, how might the bigger budget add value?

"That usually leads to some pretty good discussion," he says.

4

A Focus on Retirement Income

At least a third of both DC plan sponsors and advisors believe that the main purpose of any investment strategy for retirees should be to generate steady income (see figure 14). This raises a question of whether the best way for plan participants to achieve steady retirement income is to remain in their DC plan during post-retirement. DC plan sponsors who haven't already had the discussion regarding whether retirees should stay in the plan or exit it should make a point of doing so, says one advisor, because "stay" or "go" has important implications for plan design.

"If a plan sponsor wants to encourage participants to exit the plan upon retirement, the plan should be built accordingly," says the advisor. "If a committee expresses a more paternalistic viewpoint, that has implications for plan design in terms of distribution flexibility, plan rules, and ultimately having that retirement income product mission. It also has implications for investment design in terms of the type of target date fund they're offering, and for other features and services that they might make available, such as managed accounts."

Another advisor says he is seeing a trend toward more sponsors wanting to keep post-retirement participants in the plan, whether to retain scale and pricing power or simply because they feel it is the right thing to do. No matter the motivation, he concurs that "you need a philosophy around that, and then you have to make sure your plan is designed appropriately. As a sponsor, your investment design and plan provisions must be consistent with each other."

TDFs that look like pension funds

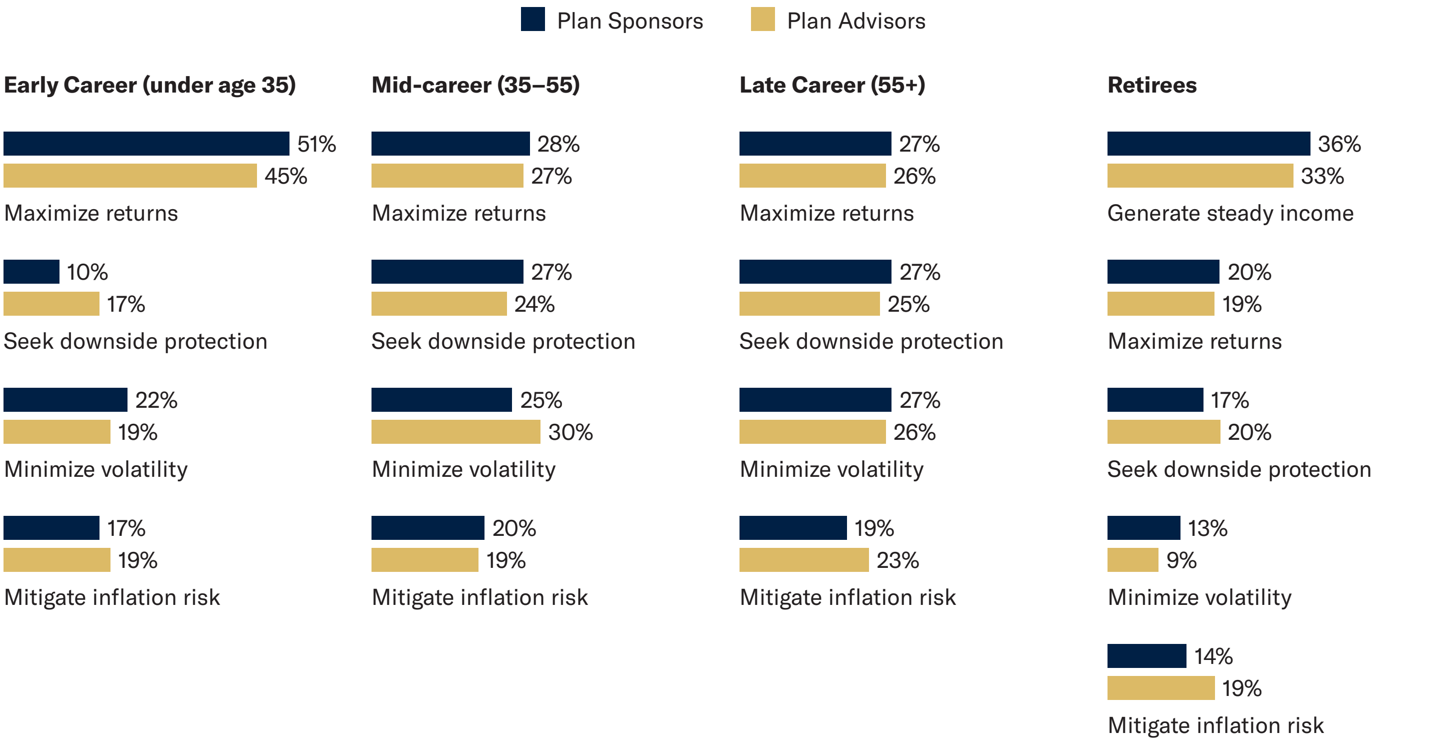
For plan sponsors and participants to see staying in the plan as a "default" option likely requires further evolution in the ability to take regularly scheduled retirement disbursements from an in-plan TDF series.

Another advisor offers a view. "We have to walk before we can run as it relates to product. The first phase is to make sure we have a planned structure from a features perspective that is accommodating for individuals in retirement regarding how they can access their money. The second phase is making sure that the recordkeeping systems can do what we need them to do from an access perspective. The third phase is evaluating and implementing a product that makes sense."

"We're not there yet, but coming up with a product that almost feels like a pension plan when in retirement is probably the next stage of evolution," says an advisor. "Participants would get a fixed dollar amount every two weeks and wouldn't have a tremendous amount of exposure to the markets, and that provides incentive to stay in a plan post-retirement."

Figure 14. Income viewed as priority for retirees

Which of the following investment strategies do you think is most appropriate for each of these groups of employees at your organization?



This advisor doesn't see that paycheck scenario happening soon, but is optimistic that the groundwork is being laid. In the meantime, he is pained to watch millions of dollars leave his clients' plans for financial advisors who get paid based on assets.

"When I see a participant withdraw from a plan that has an all-in fee of 40 basis points and I know they will go pay 2% plus all-in on the outside, that's painful," says the advisor.

"It seems like there will be some near-term support for retirement income making its way in a more significant way into plan lineups," says another advisor. "There's clearly a need to replace some of the guaranteed income foregone by frozen DB plans, so sponsors should be looking at these things regardless."

A plan sponsor adds "an income-based decumulation phase could have a lot of traction, but participants have to be educated to understand that they've built money up over the 20–25 years of being an employee, and that's the same way you have to decumulate it over the rest of your life."

Advisors note that there are ways to address in-plan retirement income needs without necessarily having to put an annuity into the plan, including managed pay-out, ladder bonds and income-oriented bond funds. One advisor says that movement on the retirement-income front will be less a matter of a single product solution than a holistic approach.

"First, plan sponsors and organizations need to determine what role they want to play for retirees," says an advisor. "If retirees want to stay in the plan, success isn't not going to be around a single product. It's going to involve communication and education, because retirement is the time when people are going to be most engaged. We're going to need to be flexible in the way that they're able to take their money out — lump sum, partial, systematic withdrawals, a paycheck-like experience. And, what kind of investment solutions do we want to provide participants, each of whom is in an individualized situation?"

5

Key Takeaways

TDFs are designed to weather increases in volatility.

More than half of DC plan sponsors and advisors expect an increase in market volatility during the next 24 months — and well over half of both groups expect that volatility to have the biggest impact on their DC plans over the next three years. In addition, a majority of plan sponsors and advisors believe TDFs are especially well suited to best serve plan participants during such periods.

Many of the challenges faced by DC plan participants and sponsors are addressed by TDFs and existing tools.

Auto-enrollment, auto-escalation, and auto-rebalance, for example, are tools that help solve issues around participation and contribution levels. However, TDFs cut the widest swath in addressing the concerns of plan participants, such as what to invest in, how to protect against market volatility and downturns, and at what point in their lives to take on more risk and reduce risk. The value proposition of TDFs speaks to many of the concerns expressed by advisors in this report, too — and many advisors believe TDFs are the best solution for many plan participants.

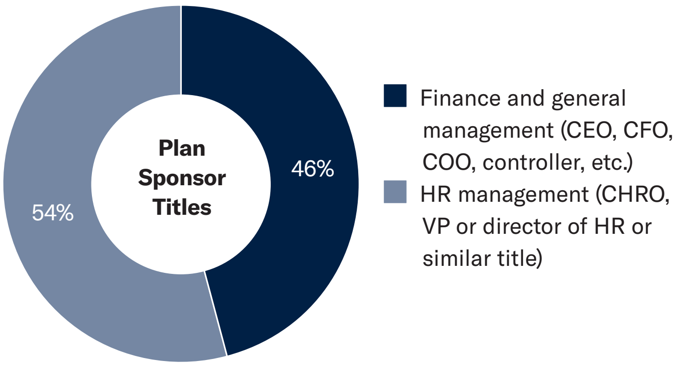
Providing consistent retirement income should be the focus for post-retirement plan participants, according to DC plan sponsors and advisors.

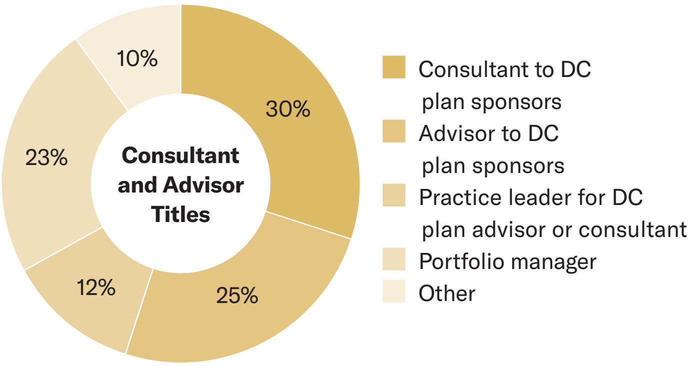
However, according to interviews with plan advisors conducted for this report, if the goal of a plan is to achieve that by having retirees stay in the plan post-retirement, the plan should be constructed for that purpose. If, on the other hand, a sponsor's goal is to have employees exit their plan at retirement, the plan should be constructed with that specific goal in mind.

About this research

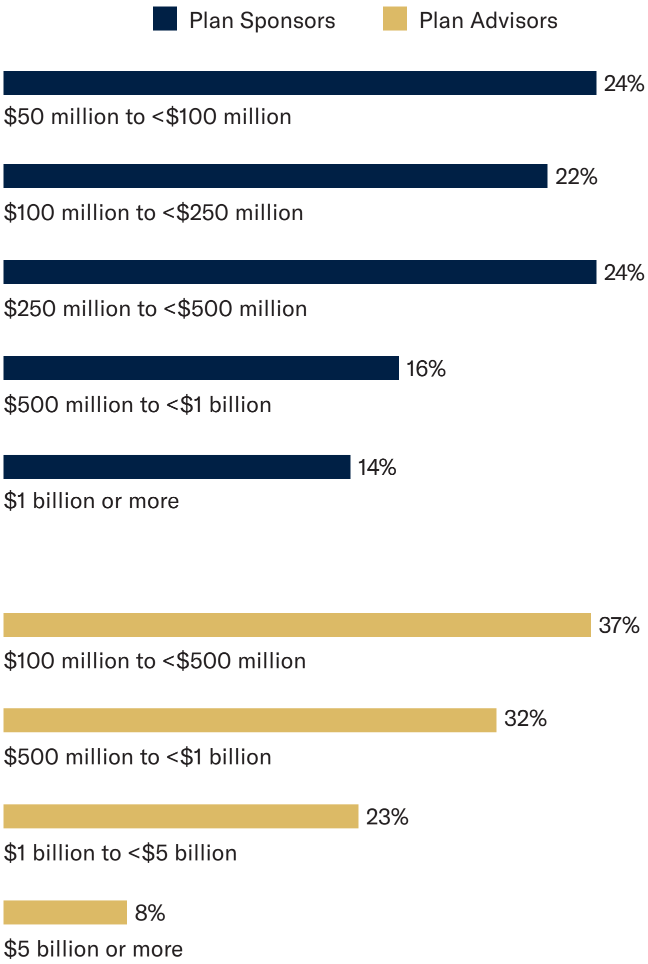
PGIM Investments composed a questionnaire in collaboration with Institutional Investor's Custom Research Lab to examine the views of defined contribution plan sponsors and advisors on what might affect their plans in the next two years, challenges in participant behavior, the role TDFs play in plans, and the question of retirement income. The questionnaire was fielded in December 2018 and includes responses from 250 DC plan sponsors and 250 DC plan advisors in North America. To supplement the survey findings, interviews were conducted with twelve plan sponsors and advisors. Demographic highlights of the survey respondents are below:

Respondents' titles





Survey respondents' DC plan assets



Auto-enrollment is an automatic contribution arrangement that can be used as a feature in a retirement plan allowing employers to enroll employees in the company's plan automatically upon meeting eligibility requirements. **Auto-escalation** is a plan design option that allows a plan sponsor to increase participant deferrals annually by a set increment. A **Qualified Default Investment Alternative (QDIA)** is an investment vehicle to which a fund manager may direct retirement plan contributions in the absence of direction from the plan participant.

Investing involves risk. Some investments are riskier than others. The investment return and principal value will fluctuate; shares, when sold, may be worth more or less than the original cost; and it is possible to lose money. Past performance does not guarantee future results. Asset allocation and diversification do not assure a profit or protect against loss in declining markets.

The target date is the approximate date when investors plan to retire and may begin withdrawing their money. The asset allocation of the target date funds will become more conservative as the target date approaches by lessening the equity exposure and increasing the exposure in fixed income type investments. The principal value of an investment in a target date fund is not guaranteed at any time, including the target date. There is no guarantee that the fund will provide adequate retirement income. A target date fund should not be selected based solely on age or retirement date. Participants should carefully consider the investment objectives, risks, charges and expenses of any fund before investing. Funds are not guaranteed investments and the stated asset allocation may be subject to change. It is possible to lose money by investing in securities, including losses near and following retirement.

This material is being provided for informational or educational purposes only and does not take into account the investment objectives or financial situation of any client or prospective clients. The information is not intended as investment advice and is not a recommendation about managing or investing your retirement savings. Clients seeking information regarding their particular investment needs should contact a financial professional.

1026069-00001-00

Thought
Leadership
Studio

Institutional Investor
1120 Avenue of the Americas, 6th Floor
New York, NY 10036

InstitutionalInvestor.com

PGIM INVESTMENTS

PGIM Investments
(877) 275-9786
www.pgiminvestments.com/DCIO