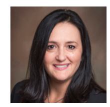
Three questions today—an improved DC plan tomorrow.

Your answers could have a long-term impact on your participants.

April 2019



Lorie Latham, CFA
Senior Defined Contribution Strategist

KEY INSIGHTS

- Plan sponsors should gain a deep understanding of their workforce demographics and use that knowledge to determine the role their specific defined contribution (DC) plan should play in their participants' retirement journeys.
- While there are multiple forms of risk within the DC system, the major risk many plan sponsors are trying to confront is longevity risk.[1]
- 39% of plan sponsors prefer to retain retired participants' assets in the plan, while 37% have no preference.[2] We believe plan sponsors should have a point of view.

To some, it may seem that treading water in the ever-changing DC system is a challenge. The complexity of fiduciary requirements, an increasingly litigious operating environment, service provider consolidation, and a steady stream of legislative and regulatory actions can be a constant battle for plan sponsors.

To help overcome these challenges, we have identified three questions that each plan sponsor should answer about their plan—all of which go beyond uncontrollable external influences and focus on situations where plan sponsors have control. Proactively and honestly answering these questions can help maximize participants' chances for retirement success and enhance the effectiveness of plan sponsors' decision-making processes for DC plan governance.

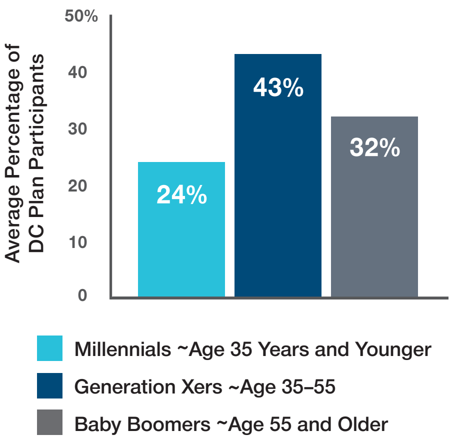
DC Question #1: Who are you solving for?

Plan sponsors should gain a deep understanding of their workforce demographics and use that knowledge to determine the role they would like their plan to play in their participants' retirement journeys. Anchoring decision-making frameworks around workforce needs helps plan sponsors set meaningful plan objectives—and may better position their participants for successful retirement outcomes.

Generations in focus

T. Rowe Price recently completed a study that enabled us to look more closely at the generational profiles of participants in the DC system today.

What Percent of Your DC Plan Population Falls Into the Following Categories?[2,3]



The three active generations in DC plans today—millennials, Generation Xers, and baby boomers—are distinct in their financial journey and future retirement needs. They are distinct if for no other reason than where DC fits into their retirement journey planning. To date, baby boomers have had our industry's full attention given the sheer size of the boomer group. Generation X is very well represented among the current actively working DC plan population, and millennials are right behind them in the retirement queue. If you have not already, this is an opportune time to start thinking more holistically regarding the financial and retirement journey of these two generations. For instance, with these generations, plan sponsors should consider making a concerted effort to "meet them where they are." One approach is to employ digital first, and personalized, communications programs. Using strategies that are timely, relevant and actionable can advance engagement.

Also, these generations are likely to benefit from assistance in solving shorter-term financial hurdles, such as student loan repayment, in addition to (and possibly before) being urged to increase their retirement contributions. Plan sponsors should take the needs of these generations into consideration when developing financial wellness and other engagement programs designed to holistically help participants with their savings goals.

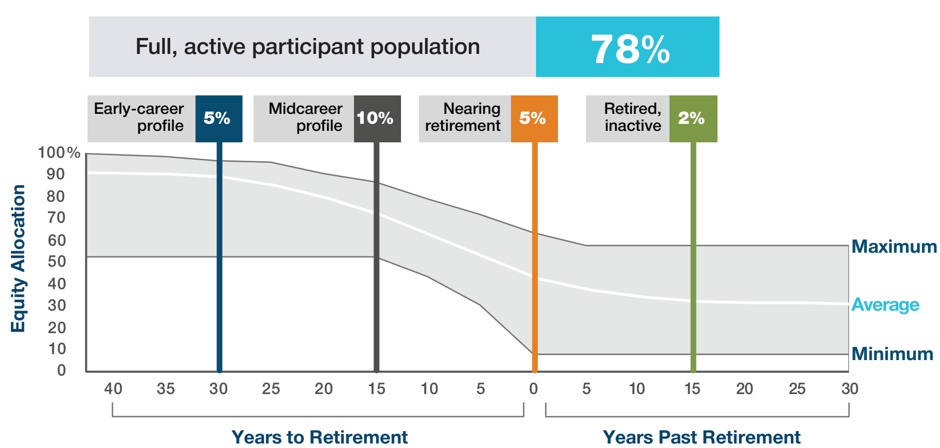
Making asset allocation decisions for the plan

Recent T. Rowe Price research showed a high degree of consensus among plan sponsors regarding their focus on the full active participant population when choosing an asset allocation solution (e.g., target date solution or other qualified default investment alternative (QDIA)).[1] For illustrative purposes, in the figure below, we plotted the respondent results along an average glide-path structure to emphasize where on the path a cohort may be considered most relevant.

In our respondent profile, only 22% of plan sponsors indicated that they target a specific participant population cohort when making asset allocation decisions. In fact, a clear majority (78%) focus on the full active population.[1] While this may seem intuitive, the devil is in the details. Often, asset allocation evaluation and selection exercises such as evaluating target date suites start out with excellent strategic direction (e.g., identify the solution best suited for the full active participant

> "Only 22% of plan sponsors indicated that they target a specific participant population cohort.

When Choosing an Asset Allocation Solution, on Which Demographic Cohort Do You Primarily Focus?[1]



Considerations for DC Question #1

1. Consider how to meet the unique needs of the various generations in your plan.
2. Set plan objectives to support your preferred approach to meeting participant needs.
3. Understand if one participant cohort informs the way you assess and select your QDIA.
4. Evaluate the trade-offs of any selection relative to the whole population.
5. Determine if you want your plan options to align to participant needs pre- and postretirement.

population) only to subsequently lose focus on the big picture.

There are trade-offs to every decision, and they should be evaluated with care. The drive to identify a solution best positioned for the full active participant population while also accounting for the wide demographic mix of most DC plan populations can easily get lost during the analysis. Overemphasizing one single cohort or disproportionately weighting static analytics doesn't serve the whole population well—and may be detrimental to identifying a solution best designed for long-term retirement goals. A focus on the full population calls for tools to address a diverse set of needs, solutions based on robust methodology, and a long-term view.

The generational data show that plan sponsors should be mindful of the newer generations moving through the system and the ways in which they may impact plan decisions.

THINGS TO WATCH OUT FOR

Don't let a narrow focus on one participant cohort drive broader decisions. This most frequently happens with a disproportionate focus on downside volatility for participants at or nearing retirement (commonly referred to as the "red zone"). This approach not only diminishes the importance of the broader generational profiles involved, but may also fall short for participants nearing retirement. Retiree longevity may span multiple decades. Moving to a more conservative "at retirement" equity allocation too soon in the retirement cycle may actually result in a shortfall for these retirees.

DC Question #2: How do you define and prioritize risk to deliver better retirement outcomes?

As the U.S. DC system has grown and assets have accumulated, the definition of "risk" has expanded. A recent survey of DC plan sponsors conducted by T. Rowe Price provides a fresh perspective on the connections between long-term plan objectives, plan sponsor perceptions of risk, and the evaluation and selection of target date strategies and other QDIAs. We have divided risk into five main categories—market, fiduciary, inflation, behavioral, and longevity.

Defining risk

DC plans have historically been viewed as supplemental retirement pools, and risk was primarily thought of in terms of *market-oriented risk*, or emphasis on benchmark-relative results and corresponding volatility. For many years, this view of risk and the corresponding approach to monitoring DC plans was a common, and understandably accepted, practice. Currently, benchmark-relative results remain an important mechanism for investment monitoring; however, they fall woefully short of revealing the full range of risks associated with DC plans.

Fiduciary risk was next to capture everyone's attention in the DC industry. Fiduciary risk has been a topic of more extensive discussion as of late due to the more litigious environment, often with a myopic focus on performance and fees. The frenzy associated with these concerns has moderated a bit as we have learned more about the importance of process and documentation to more soundly support fiduciaries' choices.

Participant *behavioral risk* is also on the minds of plan sponsors. We have grown more attuned to the importance of participant behavior and their choices as an area that can have positive results (proper savings and investment behaviors for individual circumstances).

> 42% of plan sponsors are most concerned with longevity risk in the context of a QDIA.

Longevity Risk: Why Outcomes Matter[5]

- **Discretionary spending power in retirement**
- **Money for retirement health care costs**
- **Contribution to grand-children's college savings**
- **Increase potential to leave a financial legacy**

50 basis points of outperformance results in a

12% greater balance at retirement and

+5 additional years of spending

Conversely, inconsistent attention to these influences could prove devastating to wealth accumulation and planning if poor choices are made (e.g., misallocation of investments, leakage, excessive loans).[1]

Inflation risk can also have a sizable impact on purchasing power in retirement. Inflation as a focal point in DC plans seems to ebb and flow in the consciousness of plan sponsors over time. While inflation remains an important theme that can impact retiree wealth and buying power, our research shows that plan sponsors focus less on this than on other more dominant concerns.

Longevity risk is the risk of a participant having insufficient funds resulting in a shortfall in retirement. Longevity is linked to a growing focus on retirement readiness as a plan objective or a plan sponsor's workforce. Plan sponsors' awareness of longevity risk has increased given the much longer life spans now predicted for retirees. Longevity can be planned for and solved for in a thoughtful manner. This more recent awareness signals that we may have reached a tipping point where DC plans will now truly be recognized as "retirement" plans and no longer simply thought of as "savings" plans.

Prioritizing risk management

We come to the central questions of our survey-based research: What risks are plan sponsors most focused on resolving, and how do they prioritize these varied risks when evaluating and selecting a target date strategy? Do plan sponsors prioritize the mitigation of longevity risk or of investment volatility, given that these can be competing aims? Do they focus on addressing the special needs of near retirees, even if it might undercut the needs of other plan participant cohorts? Furthermore, do they understand the inherent trade-offs involved when making these choices or prioritizing one preference over another? It is essential that plan sponsors define risk and prioritize which risks they would most like to mitigate in order to make sound plan design and investment decisions that align with these risk management goals.

Longevity risk remains the highest concern

As multiple forms and definitions of risk have roiled the DC system through the years, our research shows that longevity risk is first among plan sponsors' concerns. Our work revealed that, when evaluating a QDIA, 42% of plan sponsors are most concerned with longevity risk compared with participant behavioral risk (25%), downside risk (14%), volatility risk (12%), and inflation risk (7%).[1]

Increasingly, growing generations in the DC system today will look to their DC savings to provide a greater share of their retirement income needs. In fact, our research shows that while retirees today only rely on DC plans for 6% of their income needs, Generation X is projected to rely on their DC plan assets to provide one-third of their retirement income, and millennials are indicating a similar projection, at 27%.[4]

Further, we know that the retirement outcomes achieved in the DC plan for individuals will have a substantial impact on retirement success and income adequacy. If participants are saving, let's make certain the assets being saved are working as hard as possible. Solving for longevity risk requires careful assessment of all levers that have the potential to make a substantial impact on outcomes. These levers, including the QDIA's glide path and overall growth trajectory, good active management, and good tactical oversight, can extend the number of years a retirement nest egg will last.

Considerations for DC Question #2

1. Determine how you define and prioritize risk in your DC plan.
2. Identify which risk(s) you are most concerned about for your plan participants.
3. Establish how these views should inform assessment of your QDIA.
4. Prioritize between achieving long-term outcomes or managing shorter-term volatility.
5. Evaluate use of all levers available that impact retirement outcomes in QDIA solutions.

THINGS TO WATCH OUT FOR

Beware of analytics that prompt an overemphasis on a single market cycle or "worst-case scenario" displays that emphasize point-in-time, asset-only valuation risk. Such analytics can cause a plan sponsor to succumb to short-term bias and lose sight of the longer-term trends in market performance and volatility. Exposures, such as equity, that may cause heightened volatility in one cycle may bring greater upside and a higher growth trajectory in long-term market cycles. Performance of the U.S. equity market in 2009 is a good example of the upside potential available after a period of negative outcomes. Those plan sponsors who stayed the course did so to the benefit of their participants. While, of course, less volatility may be preferred to more volatility, the journey goes both ways.

DC Question #3: What role do you want your plan to have in your workforce's retirement journey?

A growing number of plan sponsors can answer this question with ease. However, some may be undecided, or others may not have thought about it at all. Understandably, when DC plans were considered supplemental, knowing the answer to this question was not a priority. However, based on today's circumstances and the evolving role of DC in the retirement planning journey, we believe this is a critical question for plan sponsors to explore.

Preference over what retirees do with their retirement balances

A recent study revealed that 39% of plan sponsors prefer to retain assets in the plan, and the minority (18%) prefer assets to leave the plan. Furthermore, 6% of plan sponsors indicated they were reconsidering their position, and 37% had no preference.[2,6] Sponsors with no clear preference could be indifferent to which direction a participant takes at retirement, or they may not have fully considered it yet. In either case, this could prove troublesome in making informed plan design decisions. Our conversations with plan sponsors of large plans show that many who haven't formed a view want to do so. And, we believe that not having a view could be detrimental.

The days of accumulation being the only focus of DC plans are behind us. Plan sponsors should make decisions using a more holistic approach that considers both the accumulation and decumulation phases of retirement. Being intentional about the landing point of the retirement journey is necessary to inform several key areas of plan oversight. These areas include:

1. Plan design features and approaches to governing documents.
2. Choices in QDIA glide-path strategy.
3. Assessment of solutions to provide consistent retirement income.
4. The preferred approach to participant education and engagement.

Our research reveals that the clear majority of plan sponsors believe that DC plan design should consider the needs of retired participants as well—and provide solutions for participants' full journeys up to and into retirement.[2]

A recent study we conducted revealed that nearly half of retirees' household assets have originated from DC sources (including rollovers and IRAs). However, only 19% of these assets are currently used to generate retirement income, demonstrating that DC assets make up a large portion of overall household wealth, yet retirees are not converting

What Do Plan Sponsors Prefer Retiring Participants Do?[2]

39% of plan sponsors prefer to retain assets in plan

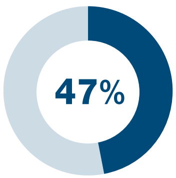
18% of plan sponsors prefer assets to leave the plan

6% of plan sponsors are reconsidering their preference

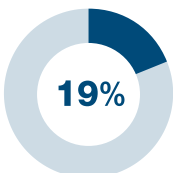
37% of plan sponsors do not have a preference

Current Retirees' Household Income Sources[4]

Among Current Retirees

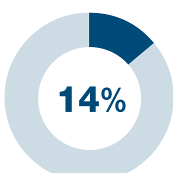


47% of retiree household assets originated from DC sources



Only 19% of current retiree household income is sourced from DC plans or IRAs

Prevalence of Retirees in DC Plans[2]



Retired participants make up 14% of plan sponsors' participant populations

these assets into income as intended. This illustrates the need for plan sponsors to ensure that retirees are educated and equipped with retirement income solutions to assist them in converting a lifetime's worth of savings into an income stream in retirement.

In another study, we learned that 14% of participants in the DC plans profiled are already in retirement.[2] This shows that carrying at least some participants into retirement is unavoidable. "In-plan retirees" will likely persist regardless of whether sponsors are ready for them or have an established preference for whether these assets stay or go. Sponsors must address the question, or they may find themselves making important decisions without a clear plan.

Help needed...and expected

Over the last decade, the growing availability of auto-solutions has likely created "auto-generations" among Generation Xers and millennials. These individuals have been defaulted into DC plans through auto-enrollment, and in a growing number of plans, their deferral is even auto-increased. It's natural that these generations have come to expect a more robust level of support along their financial journey.

Our recent study of participants in DC plans tells us that they look to plan providers and recordkeepers as a preferred source for both retirement and broader financial wellness matters. Specifically, 71% of the participant respondents in our survey indicated a desire for help with saving for retirement through workplace savings plans, and 64% look to their recordkeeper. Further, 70% wanted advice on converting retirement assets into a stream of income for retirement.[4] In addition, many in-plan participants benefit from the controlled environment of a lower-cost investment offering and fiduciary oversight. This puts plan sponsors at the fulcrum of making important decisions regarding financial education, resources, tools, and investment solutions for participants.

A spectrum of solutions

Another finding indicates the need for greater plan sponsor clarity on how to solve for retirement income and drawdown needs. Nearly three-quarters of our plan sponsor respondents believed that accumulation can be solved for with a single solution to build wealth and move into retirement. However, when it comes to retirement income and drawdown, only 12% believe a one-stop offering with an annuity default is the proper solution.[2] This reveals the growing awareness of the heterogenous nature of participant populations, the wide array of participant needs and objectives in retirement, and the corresponding need for a range of solutions to build a retirement-oriented portfolio to meet the various objectives.

Considerations for DC Question #3

1. Explore whether you view your DC plan as a "savings" plan or a "retirement" plan.
2. Identify whether you want participants to remain in your DC plan at retirement or leave.
3. Assess retirement income solutions with your preference in mind.
4. Review your plan governing documents to ensure that they reflect your preferences.
5. Align participant communication to your views.

FINAL THOUGHTS

Every plan sponsor has a different set of circumstances to consider in the oversight of their DC plan. Our objective has been to elevate three straightforward and clearly interconnected questions that we believe merit further examination based on current circumstances. We know that DC plans are evolving to be a critical part of the retirement picture, generational needs are increasingly distinct, and the role of the plan sponsor is now more important than ever.

Plan sponsors who can address the questions of who they are solving for, how they define and prioritize risk in pursuit of better outcomes, and what role they want to have in their participants' retirement journeys will be well positioned to make informed decisions linked to plan objectives. Inviting in these three questions for plan sponsor oversight committees this year could go a long way in refining your overall DC plan in design and choices for today's more complex circumstances.

Footnotes

1 T. Rowe Price. *Advancing the Way We Think About Perceptions of Risk and Achieving Outcomes*. Pulse survey conducted by P&I Content Solutions Group and statistical analysis conducted by Signet Research, Inc., in early 2018. Survey population includes 289 plan sponsor officials.

2 T. Rowe Price. *What DC Plan Sponsors Prefer Retiring Participants Do and Why It Matters*. Pulse survey conducted by P&I Content Solutions Group and statistical analysis conducted by Signet Research, Inc., in September and October 2018. Survey population includes 210 plan sponsor officials. Not all survey respondents completed all survey questions.

3 Results from 188 respondents.

4 T. Rowe Price. *The Retirement Savings & Spending Survey (RSS study)*, 2018. Nationally representative survey conducted by NMG Consulting in July and August 2018. Survey population includes 3,005 adults age 21 and older who have never retired and are currently contributing to a 401(k) plan or are eligible to contribute and have a balance of at least $1,000. The 2018 RSS study also includes a sample of 1,000 retirees who had a Rollover IRA or a left-in-plan 401(k) balance.

5 **Demographic Assumptions**

Starting Balance	0 USD		
Starting Age	25	Retirement Age	65
Starting Salary	30,000 USD	Ending Salary	97,861 USD
Annual Salary Growth Rate	3%	Annual Contribution Rate	9%

Scenario Assumptions	BASELINE	+ 25 BPS	+ 50 BPS
Returns before 65	7.00%	7.25%	7.50%
Returns after 65	5.00%	5.25%	5.50%
Account Balance at 65	845,930 USD	897,859 USD	953,452 USD
Withdrawal (% of ending salary)	50%	50%	50%
Annual Withdrawal Amount	48,931 USD	48,931 USD	48,931 USD
Withdrawal increase	3%	3%	3%

Past performance cannot guarantee future results.
The results shown are hypothetical, do not reflect actual investment results, and are not a guarantee of future results. Hypothetical results were developed with the benefit of hindsight and have inherent limitations. Hypothetical results do not reflect actual trading or the effect of material economic and market factors on the decision-making process. Results do not include the impact of fees, expenses, or taxes. Results have been adjusted to reflect the reinvestment of dividend and capital gains. Actual returns may differ significantly from the results shown. The demographic assumptions, returns, and ending balances are shown for illustrative purposes only and are not intended to provide any assurance or promise of actual returns and outcomes. The +25 bps represents the additional return a participant could earn by investing in a portfolio that beats the market by a quarter of a percent per year. The +50 bps represents the additional return a participant could earn by investing in a portfolio that beats the market by half of a percent per year—when compounded, this could lead to an additional 5 years of spending money in retirement.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

T. Rowe Price®

Important Information

This material is provided for general and educational purposes only and is not intended to provide legal, tax, or investment advice. This material does not provide fiduciary recommendations concerning investments; it is not individualized to the needs of any specific benefit plan or retirement investor, nor is it intended to serve as the primary basis for investment decision-making.

The views contained herein are those of the authors as of April 2019 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

All investments involve risk. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc., Distributor.

C77983ANL
201904-799925