PGIM

DC SOLUTIONS

AS 401(K) PLANS ADVANCE, WILL THE KEY DECISION MAKERS EVOLVE?

June 2023

INTRODUCTION

AS 401(K) PLANS ADVANCE, WILL THE KEY DECISION MAKERS EVOLVE?

401(k) plans are changing in terms of their roles, importance, and structures. Along with these shifts, we are seeing the emergence of different governance models – engaging an Outsourced Chief Investment Officer (or OCIO) to manage 401(k) investments continues to see growth in the US, and with the passage of the SECURE Act in 2019, the emergence of Pooled Employer Plans (PEPs) introduces an additional governance model for DC plan sponsors to consider.[1]

Given this evolving landscape, PGIM partnered with Coalition Greenwich and Curcio Webb to research changes in DC plan governance models, with a special focus on the OCIO landscape. We surveyed both DC plan sponsors and DC OCIO providers to compare views and trends.[2]

The DC plan sponsor survey includes 155 plan sponsors with at least one 401(k) plan and a minimum of $100 million in 401(k) assets, of which 31 plan sponsors (20%) use an OCIO provider. The OCIO provider survey includes 18 OCIO providers, representing $7.2 trillion in total DC assets (AUM and AUA) of which $505 billion is DC OCIO assets.

1 OCIO, in the context of a DC plan is where a third-party provider exercises discretion across the plan's investment program. Often referred to as a 3(38) manager, an OCIO provider can assume discretion over some or all of a DC plan's investment program.
2 Curcio Webb is an independent employee benefits advisor.

CHAPTER 1

IS YOUR GOVERNANCE MODEL OPTIMAL?

01

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IS YOUR GOVERNANCE MODEL OPTIMAL?

WHAT'S NEW

Today's most common governance model continues to be the plan sponsor assuming full fiduciary responsibility for their 401(k) plan investments. However, how these fiduciaries operate differs by organization:

- 7 in 10 plan sponsors have a single retirement committee whereas 3 in 10 401(k) plans are overseen by two or more committees (e.g., an investment committee and an administrative committee).[1]
- Responsibilities within committees vary – 50% of committees are still responsible for both 401(k) and pension plans, whereas 16% have separate 401(k) and DB committees, and 34% focus solely on the 401(k) plan (don't offer a pension plan).[1]
- The average size of a 401(k) committee is seven members, with senior management and treasury/finance individuals holding a majority of seats.[1]

WHY IT MATTERS

As plan sponsors evolve their DC plans to provide more holistic financial services and solutions, having an effective decision-making body where key stakeholders are all involved, will be an important step in the process. This includes a collaborative relationship between investments and administration, and leveraging external expertise, such as consultants, recordkeepers, investment managers, and legal counsel.

Don't Miss the Opportunity to Retain Pension Expertise

Any internal expertise overseeing an organization's pension plan(s) will be increasingly important to carry over to the DC plan(s) as they grow in size and importance. This includes employing institutional investment practices, such as a thoughtful mix of active and passive management, using diversifying asset classes including alternative investments, selecting best in class investment managers, and offering tools and solutions that can help participants achieve their retirement goals.

1 PGIM 2022 Plan Sponsor Research – See Research Methodology

It's time to expand the lens and think more holistically

As pension benefits decrease, DC plans must transition from merely savings vehicles to true retirement plans, and plan fiduciaries will need to re-examine the role of the DC plan. For some, the DC plan is still a supplement to a pension plan and Social Security benefits, but for many, DC plans will be a primary source of retirement income alongside Social Security. Plan sponsors have an opportunity to use data (e.g., known participant retirement income sources, participant demographics and asset allocations, etc.) to help make more informed decisions about plan and investment design.

Retirement income requires both investments and administration

Investments and administration will need to work together to successfully bring retirement income solutions to DC plan participants as it will likely require a combination of plan design changes, education and communications, investments, and access to lifetime income solutions.

CHAPTER 2

OCIO GAINS WITHIN THE DC SPACE

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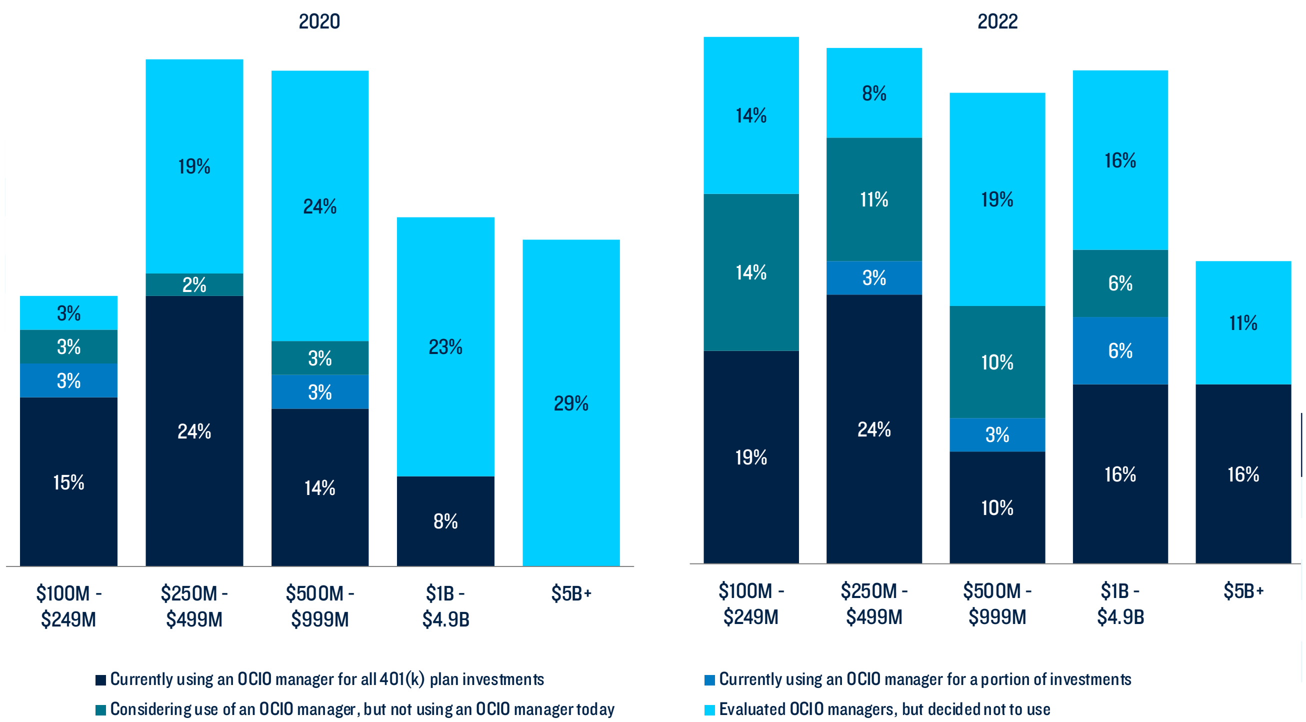
OCIO GAINS WITHIN THE DC SPACE

WHAT'S NEW

- OCIO interest and usage continues to increase in DC plans. Plans with assets less than $500M tend to be the biggest users of OCIO providers[1], but in the last two years there has been greater growth in larger DC plans ($1B+) using OCIO providers.[2] In fact, 50% of the DC OCIO searches conducted by Curcio Webb within the past 18 months that were either for OCIO only or explored both traditional and OCIO service models were for plans with assets over $1B.[3]
- According to a recent Cerulli Associates report, total US OCIO AUM for corporate DC plans has grown from $232 billion in 2018 to $419 billion in 2021, and they are projecting AUM to reach $610 billion by 2026 – the second largest OCIO market in the US behind corporate DB plans.[4]

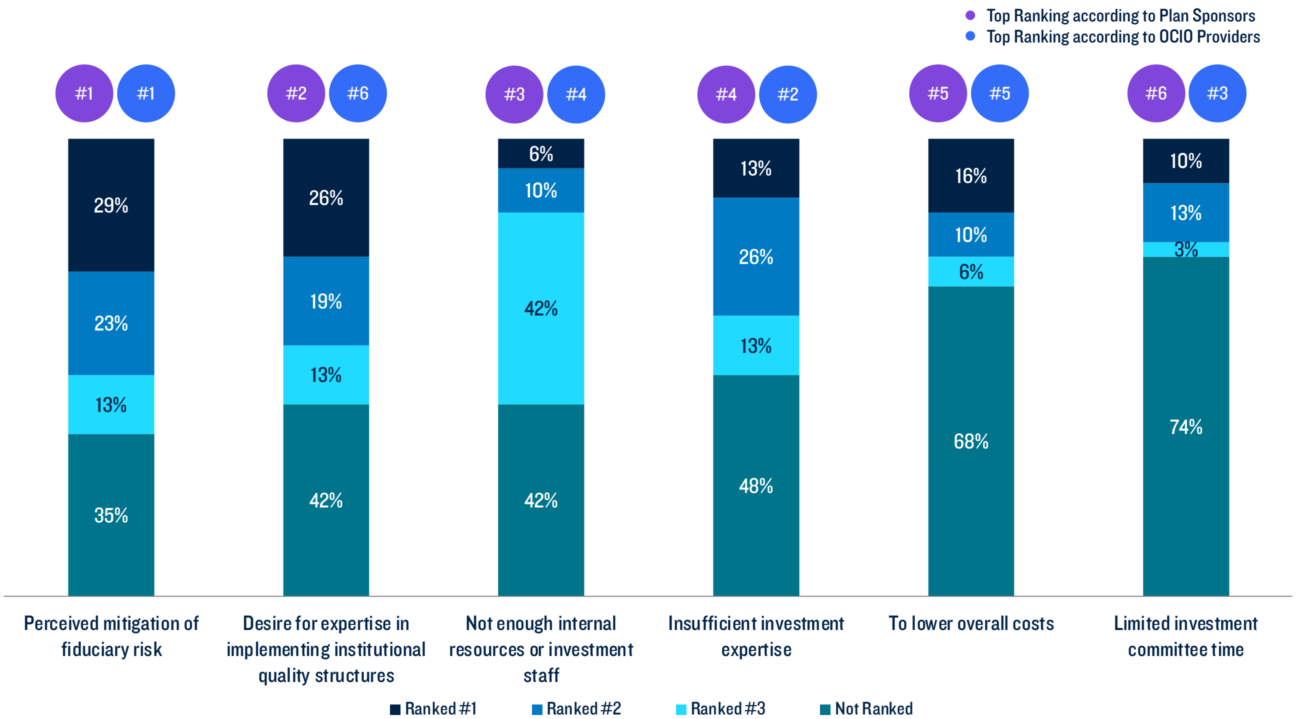
Status of Using an OCIO for the 401(k) Plan



Sources: 2022 and 2020 PGIM Plan Sponsor Research

1 PGIM 2020 Plan Sponsor Research – See Research Methodology
2 PGIM 2022 Plan Sponsor Research – See Research Methodology
3 Curcio Webb
4 Cerulli Associates, *U.S. Outsourced Chief Investment Officer Function 2022: Industry Efforts for Standardization Kick Into High Gear*

Top Reasons Plan Sponsors Hire OCIO Managers



Sources: 2022 PGIM Plan Sponsor Research and Curcio Webb PGIM 2022 OCIO Research

- Agreement exists between plan sponsors and OCIO providers as to the primary reason an OCIO provider is typically hired - *perceived fiduciary risk mitigation*. But a disconnect exists on the remaining top reasons plan sponsors hire OCIO providers.
- The second most cited reason by plan sponsors is a *desire for expertise in implementing institutional quality investment structures*[5] (which was ranked #1 in 2020)[6]. However, in 2020[7] and 2022[8], OCIO providers ranked this reason last (#6) as to why they believe plan sponsors hire them. This could suggest that OCIO providers may be overemphasizing their role as risk mitigators and underemphasizing their role and capabilities to enhance DC plans in a way plan sponsors want to but can't do on their own.

WHY IT MATTERS

- Plan sponsors should periodically evaluate their current DC staffing and governance models to ensure they can deliver the type of plan they want to and meet the needs of the organization and participants. This includes evaluating whether to adjust their internal committees or to outsource certain functions that may be in the best interest of plan participants. Regardless of the outcome of a review, going through an evaluation process is prudent. Curcio Webb has seen the percentage of plan sponsors looking at both non-discretionary and discretionary consulting engagements increase dramatically from 0% in 2018 to 30% of total DC provider searches in 2022-2023 YTD.[9]
- For plan sponsors pursuing an OCIO model, it's important to communicate your goals and objectives as to why you are pursing this model and what you expect from an OCIO provider so they can best tailor an offering to meet your needs.

5 PGIM 2022 Plan Sponsor Research – See Research Methodology
6 PGIM 2020 Plan Sponsor Research – See Research Methodology
7 Curcio Webb PGIM 2020 OCIO Research – See Research Methodology
8 Curcio Webb PGIM 2022 OCIO Research – See Research Methodology
9 Curcio Webb

CHAPTER 3

OCIO: A LANDSCAPE OF DIFFERING VIEWS AND PRACTICES

03

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OCIO: A LANDSCAPE OF DIFFERING VIEWS AND PRACTICES

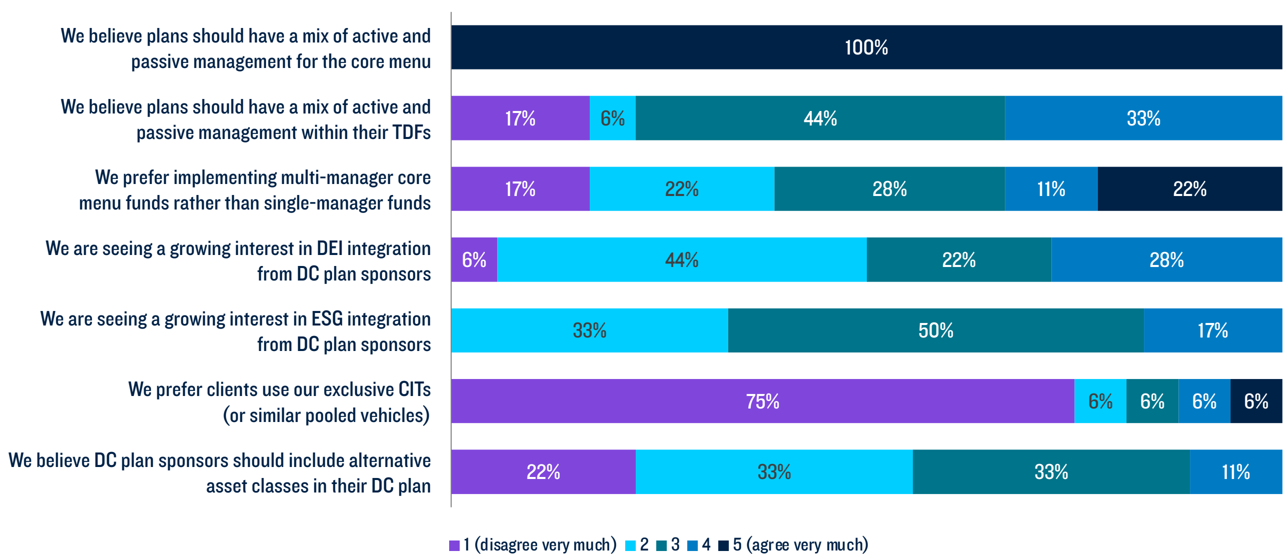
WHAT'S NEW

OCIO providers universally agree that DC plans should have a mix of active and passive management on the core menu. Beyond that, OCIO views differ substantially as it relates to other investment decisions.

- Close to 45% of OCIOs were neutral on implementing an active/passive blend for target date funds (TDFs), whereas 33% agreed, and 23% disagreed. Close to 40% of OCIOs prefer single-manager funds, whereas 33% prefer using multi-manager funds.[1]
- More than half of OCIOs don't agree with the belief that DC plans should incorporate alternative investments, despite these types of investments often being used in other types of institutional pools managed by OCIOs.[1]
- While still a small percentage, OCIOs are seeing greater interest in DEI integration over ESG integration from plan sponsors.[1]

45% of OCIOs were neutral on implementing an active/passive blend for target date funds.

Level of Agreement about Investment Options



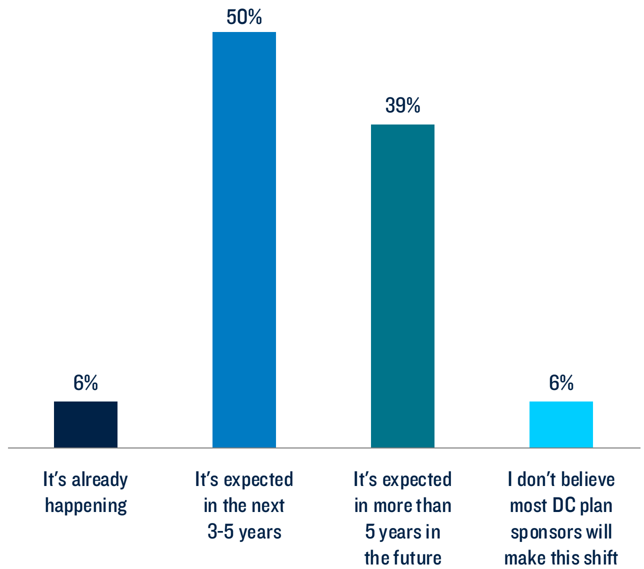
Source: Curcio Webb PGIM 2022 OCIO Research

1 Curcio Webb PGIM 2022 OCIO Research – See Research Methodology

Retirement income is on the horizon, but the majority may still just watch the sunset.

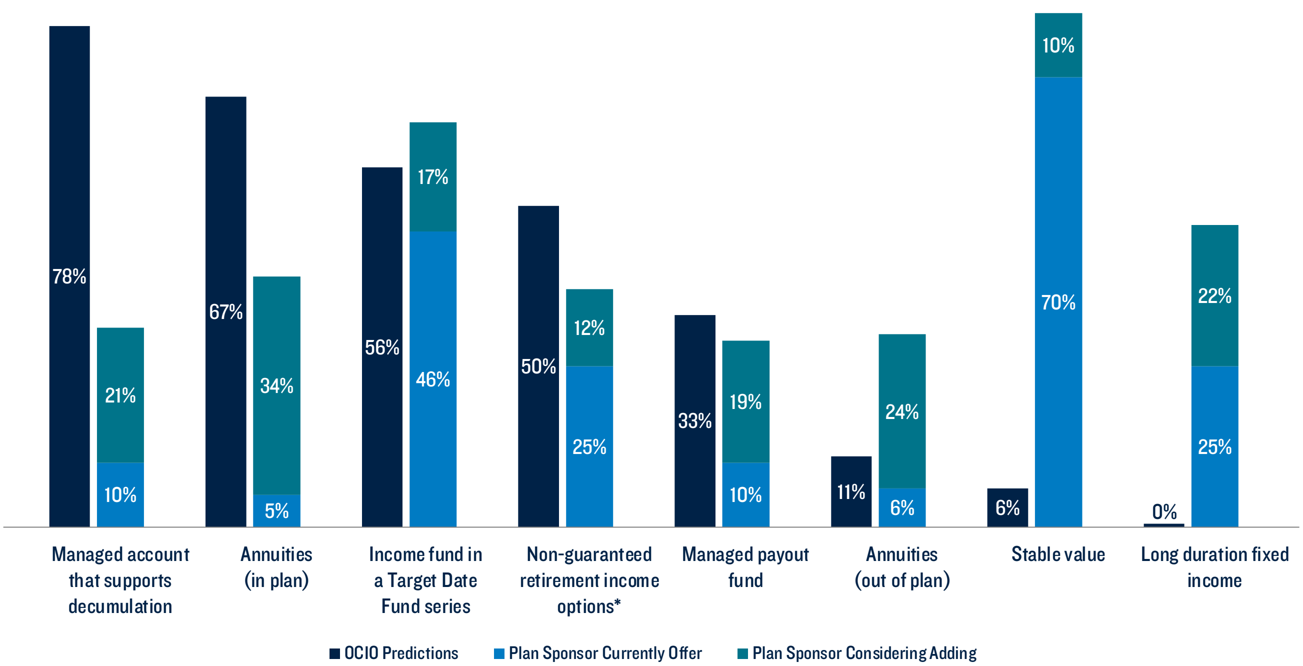
- With 1 in 4 plan sponsors reporting retirement income as a priority for them in the next 12 months[2], OCIOs also see a modest shift happening. Most believe DC plans will provide lifetime income in the next 3-5 years or beyond.[3]
- There is partial consensus between plan sponsors and DC OCIO providers on the top areas of interest with regards to retirement income solutions. Managed accounts and in-plan annuities are high on the list, whereas annuities (out of plan) and LDI fixed income are highly ranked for plan sponsors relative to the solutions that OCIO providers believe will gain traction in the next 5 years.[4 5]

OCIOs: When DC Plans Will Provide Lifetime Income



Source: Curcio Webb PGIM 2022 OCIO Research

Plan Sponsor vs. OCIO Provider Retirement Income Solutions Views



*(e.g., target duration funds, risk-based funds)
Sources: 2022 PGIM Plan Sponsor Research and Curcio Webb PGIM 2022 OCIO research.

2 PGIM 2022 Plan Sponsor Research – See Research Methodology
3 Curcio Webb PGIM 2022 OCIO Research – See Research Methodology
4 PGIM 2022 Plan Sponsor Research – See Research Methodology
5 Curcio Webb PGIM 2022 OCIO Research – See Research Methodology

WHY IT MATTERS

- Between DC OCIO providers and DC plan sponsors, two areas are emerging as retirement income front runners – personalized asset allocation solutions that can facilitate regular distributions (managed accounts), and lifetime income solutions that can address longevity risks. But the data also doesn't suggest any consensus in the marketplace yet. Over half of DC OCIO providers also see the income fund of a target date fund and non-guaranteed retirement income options as viable options to meet retiree needs.[6]
- For plan sponsors who are evaluating OCIO providers, it is important to understand each providers' investment views, approach, and philosophy, and ensure there is alignment before moving forward with an engagement. To help with this process, many plan sponsors end up engaging a third-party evaluator.

6 Curcio Webb PGIM 2022 OCIO Research – See Research Methodology

CHAPTER 4

TRENDS IN OCIO SERVICES

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CHAPTER 4

TRENDS IN OCIO SERVICES

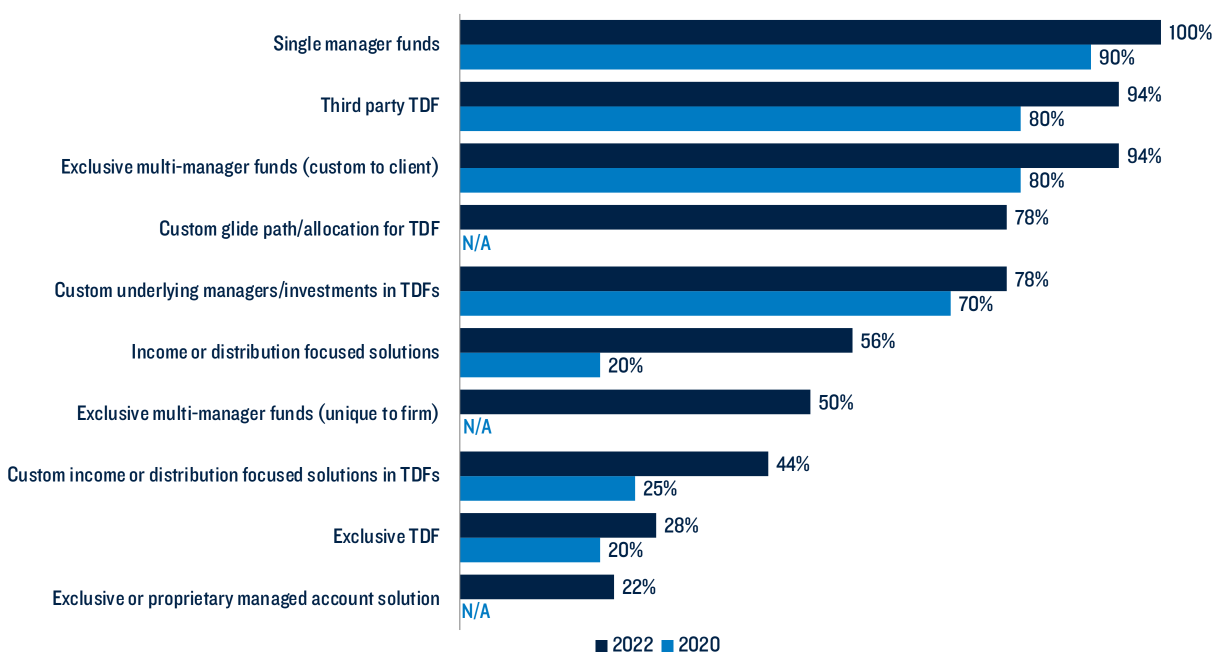
WHAT'S NEW

DC OCIO providers are expanding the services and capabilities they offer.

- Selection of single manager funds and off-the-shelf target-date funds continue to be the highest services OCIO providers are saying they offer; however, over the last couple of years, we're seeing an increase in income or distribution-focused solutions and custom fund management solutions being offered.[1]
- 6 in 10 plan sponsors tell us they use an OCIO provider for off-the-shelf target date fund selection, whereas 3 in 10 plan sponsors have hired an OCIO for that firms exclusive TDF offering or a custom glide path/asset allocation service, respectively.[2]

6 in 10 plan sponsors tell us they use an OCIO provider for off-the-shelf target date fund selection.

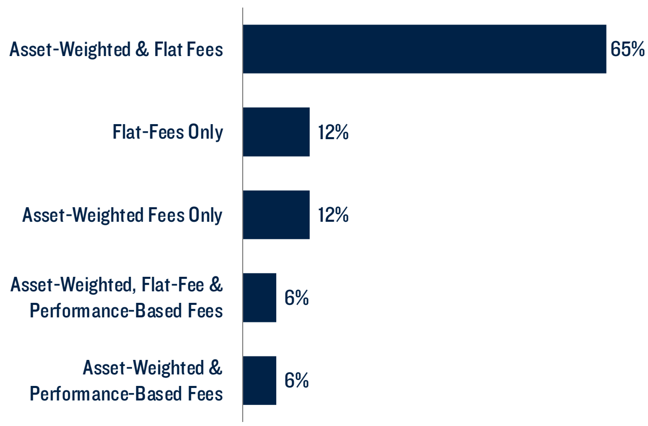
DC OCIO Provider Services



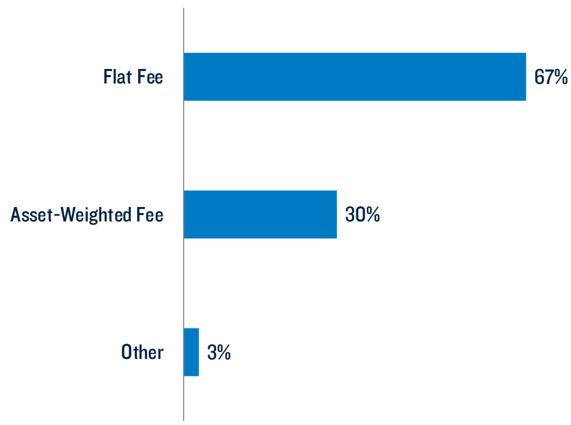
Source: Curcio Webb PGIM 2022 OCIO Research

1 Curcio Webb PGIM 2022 OCIO Research – See Research Methodology
2 PGIM 2022 Plan Sponsor Research – See Research Methodology

OCIO Management Fee Structures Offered



Plan Sponsor Reported OCIO Fee Structures Used



Sources: 2022 PGIM Plan Sponsor Research and Curcio Webb PGIM 2022 OCIO Research

OCIO fees are coalescing around flat-fee arrangements.

- While most DC OCIO providers offer both asset-based and flat-fee arrangements, 67% of plan sponsors reported a flat-fee arrangement with their OCIO provider. This aligns with the trends Curcio Webb has seen in the last 5 years – 100% of their OCIO searches have resulted in flat-fee arrangements. This is primarily because they highly encourage flat fee structures for DC OCIO because of the more limited scope of work and asset growth from factors that have nothing to do with the OCIO provider (e.g., participant contributions).[3]

WHY IT MATTERS

- While the majority of OCIO providers may not believe plan sponsors will adopt lifetime income solutions in the next couple of years, they are expanding their services to include evaluating the retirement income space and bringing their own custom income solutions to market. By expanding their services, OCIO providers can offer more solutions that meet the diverse needs of plan sponsors and participants alike, while aligning these solutions with the evolving DC landscape.
- The popularity of flat-fee structures for DC OCIO services is a divergence from other areas of the OCIO market, where asset-based fees tend to be more commonly employed. For DC plans, flat-fee structures tend to be easier to project, budget and allocate, which is important when these costs are passed along to participants. Flat-fee structures tend to be more attractive to larger DC plans ($1B+), a solution that may result in continued growth and adoption of OCIO services within this plan size cohort.

3 Curcio Webb

CHAPTER 5

A NEW FRONTIER: POOLED EMPLOYER PLANS (PEPs)

05

CHAPTER 5

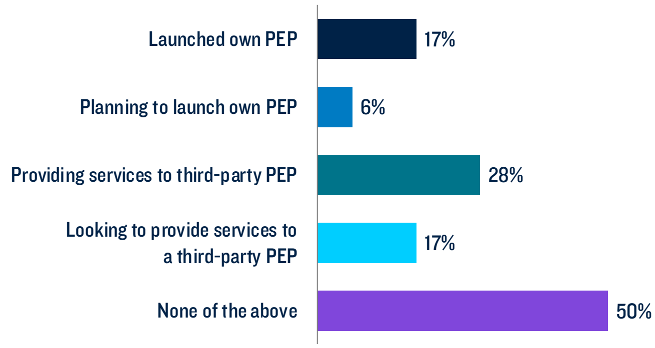
A NEW FRONTIER: POOLED EMPLOYER PLANS (PEPS)

WHAT'S NEW

OCIO providers are responding differently to PEPs following the passage of the 2019 SECURE Act.

- 25% of OCIO providers have launched or are planning to launch their own PEP, with 45% reporting they are currently or are looking into, providing services to another organization's PEP.[1]
- For half of DC OCIO providers, they are not getting involved in the PEP space (yet).[1]

OCIO Manager Involvement in Pooled Employer Plans



Source: Curcio Webb PGIM 2022 Research

WHY IT MATTERS

- The concept of pooling assets and participants to gain scale and operational and cost efficiencies is not new – this model has been used by multiple-employer plans for years. The SECURE Act changed the law to allow more employers to use this model as there is no longer a requirement that two employers share a "common nexus" or association.
- It is still too early to tell how impactful PEPs will be on the US DC market. In Australia, Super Annuation Funds, which is a similar concept to a PEP, have grown to significant size and importance, bringing institutional investment best practices and scale to a broad swath of Australians. In the US, the original intent was to help close the retirement coverage gap by offering a turn-key solution for small employers, but there is nothing precluding larger plans to join.
- PEPs are an area to watch over the next 5-10 years.* As this segment grows, there are many questions as to how they will evolve. But there is a huge opportunity for pooled plan providers to bring institutional investment best practices, including retirement income solutions, and the best thinking across technology and participant communications and engagement, to large populations of American workers.
  *For more on PEPs, check out *Season 2 Episode 8: Non-Accidental Plan Sponsors of The Accidental Plan Sponsor Podcast* with host Josh Cohen.

ADDITIONAL THOUGHTS

For more information on different DC governance models, the Defined Contribution Institutional Investment Association (DCIIA) recently released a paper: *DC Plan Governance Structures – A Guide for Plan Sponsors* that may be useful for DC plan sponsors exploring their options.

1 Curcio Webb PGIM 2022 OCIO Research – See Research Methodology

RESEARCH METHODOLOGY

The 2022 DC plan sponsor survey includes 155 plan sponsors with at least one 401(k) plan and a minimum of $100 million in 401(k) assets, of which 31 plan sponsors (20%) use an OCIO provider.

TOTAL AUM IN 401(K) PLAN	
Over $5B	12%
$1-$4.9B	21%
$500m-$999M	20%
$250-499M	24%
$100-$249M	23%
	100%

USE OF OCIO	
Currently using	20%
Considering using/Evaluated, decided not to use	23%
Do no use and never considered using	57%
	100%

The OCIO provider survey includes 18 OCIO providers, representing $7.2 trillion in total DC assets (AUM and AUA) of which $505 billion is DC OCIO assets.

TOTAL FIRM ASSETS: $21,620,248 (MILLIONS)	
Combined Total Firm Ex DC Assets	67%
Combined Total Firm DC Assets	33%
	100%

COMBINED TOTAL FIRM DC ASSETS: $7,218,172 (MILLIONS)	
Combined Total Firm DC Ex-OCIO Assets	93%
Combined Total Firm DC OCIO Assets	7%
	100%

The 2020 DC plan sponsor survey includes 138 plan sponsors with at least one 401(k) plan and a minimum of $100 million in 401(k) assets, of which 17% use an OCIO provider.

TOTAL AUM IN 401(K) PLAN	
Over $5B	5%
$1-$4.9B	19%
$500m-$999M	21%
$250-499M	30%
$100-$249M	25%
	100%

USE OF OCIO	
Currently using	17%
Considering using/Evaluated, decided not to use	19%
Do no use and never considered using	64%
	100%

The 2020 OCIO provider survey includes 20 OCIO providers, representing $16.8 trillion in total assets and $1.2 trillion in OCIO assets (all plan types).

AUTHOR

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PGIM DC Solutions

ABOUT PGIM DC SOLUTIONS*

As the retirement solutions provider of PGIM, we plan to deliver innovative defined contribution solutions founded on market-leading research and capabilities. Our highly-experienced team will partner with our clients on customized solutions to solve for retirement income. As of 03/31/2023, PGIM has $169 billion** DC assets under management.

* PGIM DC Solutions does not establish or operate pension plans.
** Reported data reflects the assets under management by PGIM and its investment adviser affiliates for defined contribution investment purposes only.

NOTES TO DISCLOSURE

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FOR MORE INFORMATION

To learn more about our capabilities, visit www.pgim.com/dc-solutions or contact PGIM DC Solutions at dc@pgim.com.