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2021 BEST IDEAS - PART 6

Next Generation Of DC: Taking An Institutional Approach

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NEXT GENERATION OF DC: TAKING AN INSTITUTIONAL APPROACH

It's one of life's most difficult financial challenges: securing enough savings to enjoy a long retirement. But the self-service model of defined contribution (DC) plans often doesn't result in better outcomes for participants. DC plans need to evolve towards prioritizing retirement readiness, and one way to do that is by adopting a more institutional approach to investing.

Individual investors should have access to the same types of investment strategies currently available to institutional investors and high-net-worth individuals. Most DC plan sponsors, however, do not offer access to alternatives or illiquid assets in their investment menu or as part of their target date funds (TDFs). (PGIM's DC team will be releasing findings from our proprietary research on this topic later in the first quarter.)

The good news is that the recent Department of Labor (DOL) information letter on the inclusion of private equity in TDFs gives plan fiduciaries the opportunity to take a more innovative approach. The information letter was not a safe harbor, nor was it a new regulation; the DOL merely stated its view that the inclusion of private equity is not inherently improper. The letter did provide some special considerations a plan sponsor should evaluate given the unique nature of this asset class.

"The letter did specifically address private equity, because that's what was asked of them," said Josh Cohen, PGIM's head of institutional DC. "But I think it's an opportunity to have a broader discussion with plan sponsors about a thoughtful institutional approach looking at myriad assets classes, not just private equity."

Whether it's private equity, other alternative strategies or any investment strategy, a fiduciary should be able to go through a process and rely on their own expertise and the expertise of their advisors to evaluate whether they believe a strategy will benefit their participants. And the DC market is an obvious place to take a more institutional approach, the result of:

- **Fiduciary Oversight:** There is no higher fiduciary standard than ERISA, and participants in a DC plan have a fiduciary that needs to ensure their best interests are served.
- **Institutional Pricing:** Employers can use their scale to bring institutional investments, such as alternatives, to the average American worker at a price they could not have achieved on their own.
- **Professional Management:** In a DC plan, alternatives can be incorporated in professionally managed solutions like TDFs, overseen by knowledgeable investment professionals.
- **Long-Term Time Horizon:** Many alternative investments are illiquid and require a long-term holding period to pay off. Saving for retirement can be a half-century or more proposition, making alts a perfect vehicle for less liquid investments with a longer-term payoff.
- **Broadest Access:** For most middle-income Americans, the bulk of their wealth is in housing and their retirement plans. If we want to provide access to alternative investments to a majority of Americans, DC plans are where this can best happen.

EASING THE BURDEN ON SPONSORS

One of the biggest drivers of the trend toward the "simple" approach in DC plans has been perceived litigation risk by plan sponsors. However, alternative options may actually be beneficial to participants.

There is also a fairness case to be made to democratize investment opportunities and allow more American workers access to the types of strategies that only institutions and wealthy Americans currently utilize. While many plan sponsors have fiduciary concerns in adding these to DC plans, there are similarly fiduciary concerns of not making these investments available given the compelling case to do so.

While there is significant debate as it relates to the appropriate investment approach to help participants build and manage retirement savings, sophisticated investors understand the benefits of unique investment strategies to grow wealth and manage risk. The ongoing evolution of the DC space should focus on how workers saving for their retirement could benefit from plan sponsors implementing a more institutional investment approach that includes alternatives and illiquid assets.

Characteristics of an Institutional Investment Approach	Application Within Defined Contribution Plans
Outcome-oriented investments	Target-date funds, stable value, retirement income solutions, and managed accounts
Broad asset class diversification	Extended credit sectors, private assets, absolute return, and real assets
Best-of-breed investment management	Skilled investment managers that are institutional in nature
Thoughtful mix of active and passive	Hybrid target-date strategies and customized open-architecture funds
Vehicle agnostic	Institutional mutual funds, collective trusts, and separate accounts

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