Retirement in America: Time to rethink and retool

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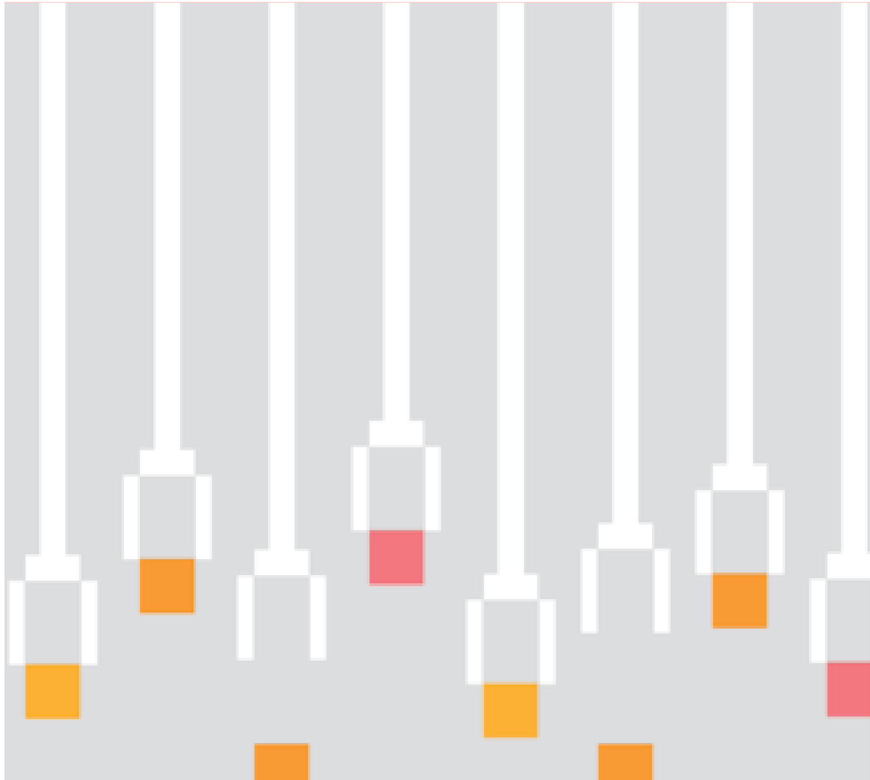


Executive summary

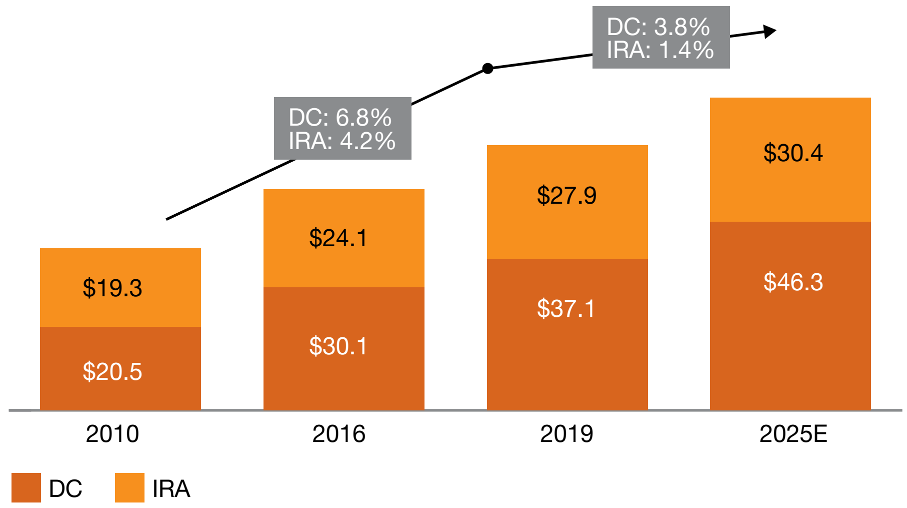
This article is based on research conducted by the PwC Market Research Center. It's part of a series of thought leadership pieces that explore the intensifying pressures surrounding the US retirement industry and the convergence between investment management, insurance and banking to address the changing needs of retirement participants.

[Access US Retirement Industry Overview here](#)

A range of factors have put intensifying pressures on the US retirement system in recent years, leaving the industry facing a decelerating revenue growth outlook. A number of these challenges — fee pressure, underfunded retirement plans, an aging population — are structural and unlikely to ease.

Many retirement players have been unable to outrun even one of these factors: fee pressure. Rising industry-wide fee pressure is placing constraints on the profitability of US retirement firms with average 401(k) expense ratios falling by a third over the last ten years. The fee pressure phenomenon is not limited to asset managers. According to PwC analysis, recordkeeping fees are also on a downward trajectory, declining by 8% between 2015 and 2019 alone.

Defined contribution and IRA revenue
$ in billions, % CAGR:



Sources: PwC Market Research Centre analysis based on ICI data

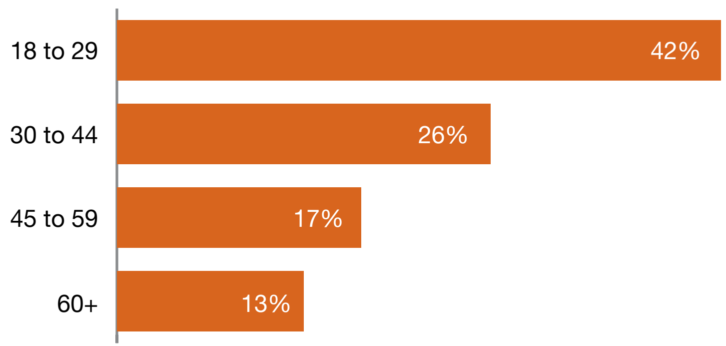
While these pressures have forced some retirement firms to consolidate or exit, there's an opportunity hiding in plain sight. Firms that focus on the evolving needs of participants by addressing individual challenges with new benefit offerings and holistic advice can increase participation. Access to retirement programs can also improve through lower cost turnkey programs specifically designed for small business which, in total, we estimate can unlock an additional $5 trillion in retirement assets.

The call to action is now. There are too many signs suggesting the population is unprepared. A quarter of US adults have no retirement savings and only 36% feel their retirement planning is on track.[1] Even for those who are saving, many will likely come up short. We estimate the median retirement savings account of $120,000 for those approaching retirement (age cohort 55 to 64) will likely provide less than $1,000 per month over a 15-year retirement span. That's hardly enough even without factoring in rising life expectancies and increasing healthcare costs.

$5 trillion

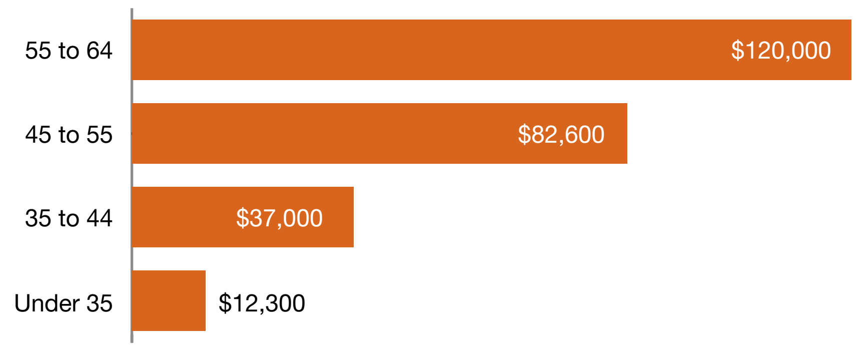
in retirement assets capture opportunity through expanded participation and access.

Percent of Americans who have no retirement savings by age cohort



Sources: PwC Market Research Centre, US Federal Reserve data

Median retirement savings account balance by age cohort



Sources: PwC Market Research Centre, US Federal Reserve data

[1] US Federal Reserve, Report on the Economic Well-Being of U.S. Households in 2018, Last Update: January 27, 2020.

Where the industry stands today

In response to these challenges, retirement firms are matching fee pressure with cost reductions while several firms have opted to consolidate. However, continuous consolidation has further reinforced price competition, with some firms relying on drastic price modifications to attract new business.

While thin margins are a threat for the entire industry, smaller firms face even greater headwinds. The ability to excel in today's environment is closely tied to the extent to which firms can generate scale for distribution, innovate with new technologies and expand benefit offerings to help address gaps in the market — such as a need for supplemental lifetime income. Consolidation has been one approach that helps generates efficiencies needed to reinvest around these opportunities

Still, the significant constraint on profitability restricts how institutions can adapt. Firms that are unable to challenge their status quo are likely to find it harder to gain market share and face eroding competitive differentiation as their offerings become commoditized.

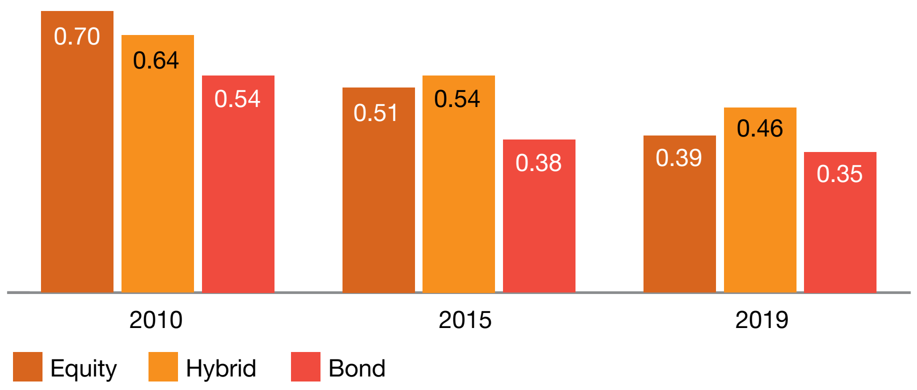
For firms both large and small, the challenges are widespread. How can firms sidestep financial pressures to reinvest for growth? How can they reframe the experience or innovate to foster higher levels of plan participation?

A call to action

The retirement ecosystem — investment managers, record keepers, platform providers and institutional consultants that serve plan sponsors — recognize that endless cost reductions will likely hamper long-term growth objectives. But given the industry-wide pressures, it's important to separate actions that are in your control from structural problems that are not. For example, fee pressure will likely continue to challenge the revenue pool but the ability to meet changing participant needs with new financial and wellness products or expand plan access with instruments such as pooled employer plans (PEP) can help meet some of today's challenges.

Other opportunities exist within your participant coverage. Our research suggests a 17-point gap between access and participation rates for defined contribution plans — 3.5x that of a defined benefit plan. Competing priorities and the lack of financial wellness programs or advice tends to have a direct impact on whether employees forgo participation.

DC management fees have seen constant pressure
401(k) asset-weighted average expense ratios



Sources: PwC Market Research Centre analysis based on ICI data

There are no shortages of challenges facing participants in the retirement industry. But we see four paths to help your firm remain relevant and kick-start growth in an increasingly challenging industry.

1. **Adapt to changing participant needs:** Social inflationary trends such as rising life expectancies and the changing goals of participants dictate that retirement firms will likely need to offer new products and services in new ways in order to find and meet the differing needs of participants. New benefit offerings such as debt repayment programs or decumulation strategies and new access points such as PEP plans will likely be key factors in engaging with new participants earlier, expanding the addressable market by increasing access and growing the overall pie of retiree assets.

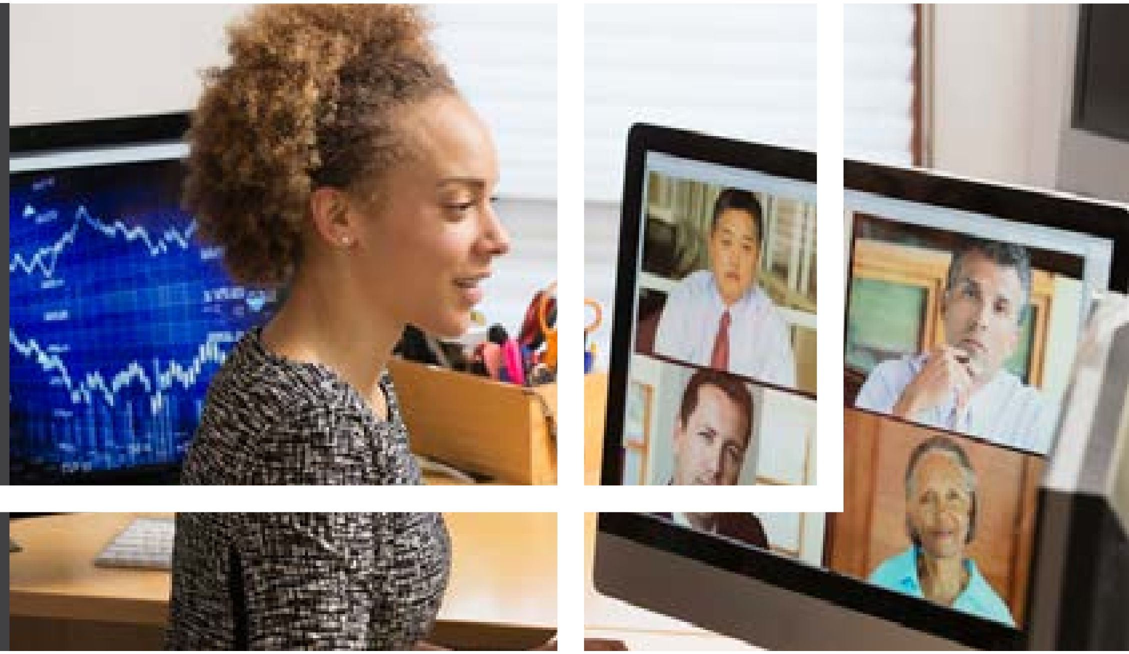
2. **Diversify revenue sources:** Retirement planning is evolving into an ecosystem of benefits that cross financial planning, health, wellness and financial literacy. Firms that can extend beyond the current playing field — which is typically limited to the defined contribution plan — can be more effective at retaining assets over time. Multi-product, cradle-to-grave benefit offerings allow consumers to find and adopt different products as their needs evolve.

3. **Reevaluate how you run your business:** Firms that participate in retirement plans are conducting a careful reevaluation of where and how they participate given industry consolidation and product commoditization. For example, record keeping — typically a higher cost function given what are often legacy, aging systems — has been upended by lower cost technology and industry concentration. For sub-scale firms to remain competitive, they should determine where to participate and how to scale in a cost-effective manner.

4. **Digitize your business:** To be competitive in tomorrow's retirement industry, record keepers and platform providers must be able to streamline their operations in order to differentiate with effective customer engagement. With advancements in technologies, there are more opportunities to automate tasks and lower maintenance costs to drive down expenses while freeing up reinvestment in order to deliver more beneficial participant experiences.

> **"Several industries are converging to reimagine what the retirement industry will look like**

Adapt to changing participant needs



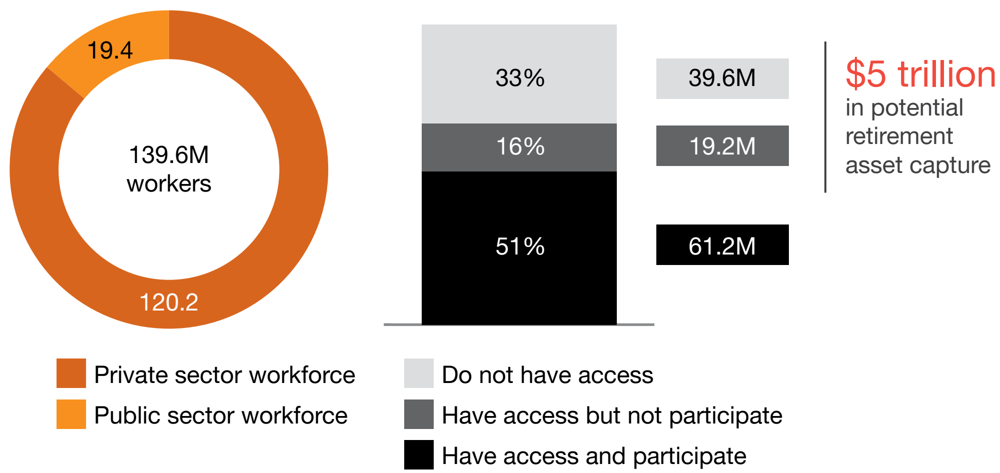
What matters

According to estimates, just 36% of the US workforce thinks their retirement savings plan is on track.[1] Tack onto this rising life expectancy and increasing healthcare costs — both of which further call into question how prepared US households are for retirement.

The list of pressures isn't limited to individuals. Sustained fee pressure will likely lead to slower revenue growth over the next five years. This could make it even more complicated for the industry to address a growing retirement savings gap.

The upshot: For firms that adapt, there's room to grow. Firms that can successfully adjust to the changing needs of retirement plan participants with new offerings can carve out space for growth in an increasingly contested and commoditized marketplace. For example, offering new benefit options such as debt repayment programs or decumulation strategies of expanding market access with new small market PEP plans could have a direct impact on providing access to retirement planning and participation rates — which we estimate could unlock an additional $5 trillion in retirement assets.

US workforce participation and access



Sources: PwC Market Research Centre analysis based on US Bureau of Labor Statistics data
Note: Percent of workers that do not have access or do not participate apply to private sector workers

[1] US Federal Reserve, Report on the Economic Well-Being of U.S. Households in 2018, Last Update: January 27, 2020.

Why now

The US market is more dependent than ever on defined contribution plans (DC). In fact, over 60% of total US retirement assets are now held in such plans, representing a wide scale shift in investment risk from the corporate sector toward employees.[2]

Yet needs remain unmet. As we start to see the first generation retire solely on an employee managed DC plan, the need for higher levels of supplemental retirement income is on the rise. Our research shows the median retirement account balance for those approaching retirement would likely generate less than $1,000 per month over a 15-year retirement span. That's hardly enough for individuals whose financial security is dependent on this savings, not to mention a participant base that is living longer.

The need for broader types of benefit offerings such as debt paydown, supplemental income and managed advice is on the rise. In addition to addressing a potential savings gap, retirement paths are more diverse than in the past: Some people want to retire earlier, others plan to work reduced hours and still others want to continue working but in new endeavors.

Plan sponsors should also look toward new approaches to help increase plan participation. In the US alone, about half the workforce, about 63 million individuals, do not have access to or participate in an employer-sponsored retirement program. We believe state-sponsored retirement savings programs such as CalSavers and New Jersey Secure Choice could gain scale in the coming years and provide a pathway for financial providers to offer investment product options. Alternatively, pooled employer plans (PEP) present an opportunity for retirement firms to work directly with small and mid-size companies to help increase retirement participation.

Now more than ever, firms need to provide different retirement vehicles for different retirement paths to reaccelerate their growth trajectory.

> **More than savings is required to meet participant needs**

[2] 60% of total US retirement assets held in DC plans includes both IRA and DC plan assets.

Steps to take

Expand the benefit offering. The longer the road to retirement, the more difficult it is to enroll and retain plan participants. For example, 42% of individuals between 18 and 29 have no retirement savings versus 13% for those over 60, as seen on page 4. Providers can help younger participants get on the road early and stay the course by understanding the reasons for non participation and expanding benefits to better serve more diverse needs.

To attract and retain participants throughout their careers, we recommend that plan providers add offerings that serve their near-term needs as well as their ultimate retirement goals. Offering a student loan paydown program alongside a 401(k), for instance, might prompt younger workers to enroll earlier than they otherwise would have and, at the same time, help provide a bridge to full retirement savings participation as debt is reduced.

Providers might also consider adding new financial wellness modules that extend beyond just education to also include advisor-led or digital advice. Throughout the pandemic, we've seen wide adoption of virtual advice models. Among other benefits, the technology-driven shift provides plan participants with a larger pool of advisors to choose from as well as potentially lower fees due to the reduction in displacement costs, which can help increase participation. For service providers, remote advice has the potential to help increase opportunities for sales, which could help relieve margin pressure.

By meeting different participant needs or rethinking advice approaches, providers can make sure that their efforts to engage earlier and expand wellness programs produce results.

Adapt product offerings. Plan sponsors should also adapt their product offerings to meet the differing needs of participants in effort to help increase participation and increase access.

First, plan providers can tap the fast-emerging ranks of DC plan-only retirees by expanding their retirement income options. For example, guaranteed income, through in-plan annuities and other options, can play a big role to combat social inflationary trends. Incorporating annuities into a common DC plan could help remove the negative connotation of the product and extend retirement spending power alongside rising life expectancy.

In any case, a diverse set of product offerings is probably key in addressing new and varying needs of participants. In PwC's 2020 Financial Wellness Survey, 56% of surveyed baby boomers told us they would continue to work after retirement either out of willingness or due to financial necessity — far higher than previous generations. Plan providers that have decumulation strategies and alpha-oriented products will be better positioned to be more engaged and meet the needs of these future retirees while keeping assets in plan.

Second, look to the underserved small business market. About 40 million individuals don't have access to an employer-sponsored plan largely due to the cost burden for a small business to offer a plan or the unique needs of self-employed individuals. With the Secure Act of 2019 allowing unrelated employers to create a single plan, known as PEP, costs are shared unlocking a new growth opportunity. According to a Transamerica Center for Retirement Studies survey, 29% of companies that don't offer DC plans would consider a MEP if the costs were reasonable.[3]

Reframe the participant experience. To foster higher levels of participant retention, we believe retirement players should consider ways to build greater convenience and personalization into their offerings. According to our 2018 Future of CX survey, positive experiences influence decision-making the most in healthcare and financial services — two cornerstone industries for retirement.

Plan providers can enhance convenience and make retirement planning less onerous for their participants by integrating tools into their daily routines. Simple steps such as mapping an individual's retirement plan to routine check-ins and measurements can help anticipate needs and make the experience more personal.

When it comes to experience, our CX survey indicates that consumers value efficiency and convenience more than any other factors. Plan providers that focus on participant experience can help meet what participants value while improving retention and engagement.

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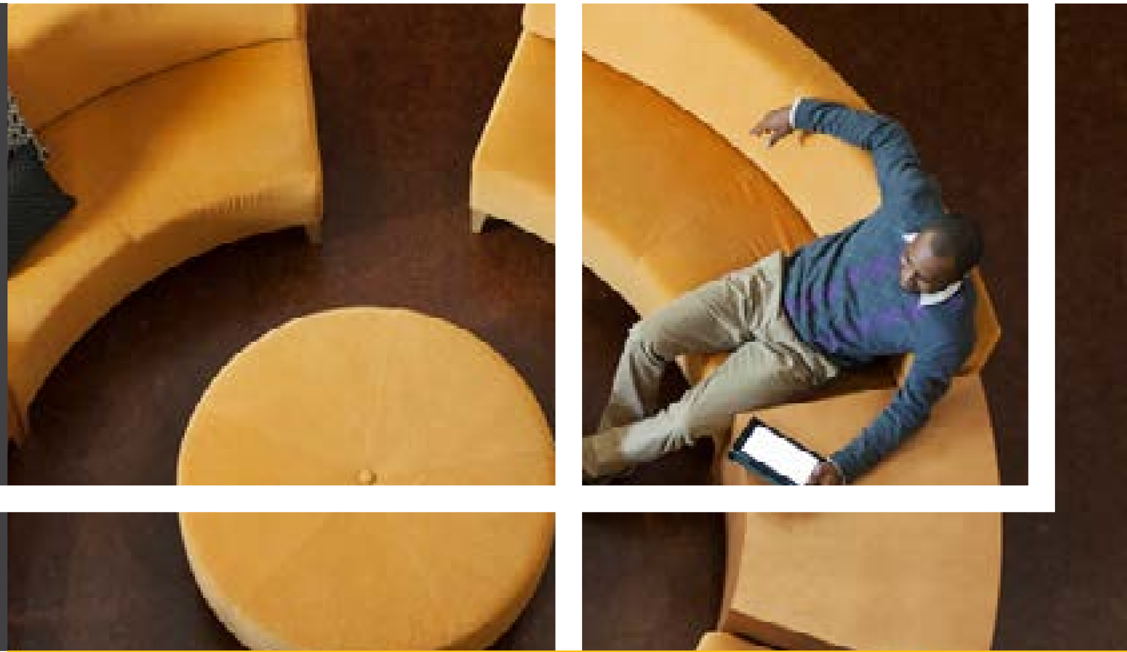
[3] Nonprofit Transamerica Center for Retirement Studies, Pre-Pandemic, U.S. Employer Benefits and Business Practices, December 2020.

Diversify revenue sources



What matters

The retirement industry is at an important inflection point — a number of overarching pressures are mounting, suggesting the likely need to expand boundaries to mitigate these issues.

If firms stick to their knitting, they risk a slow erosion of revenue. Witness the decelerating estimated growth of DC revenue falling from 6.8% annual growth over the last nine years to an expected 3.7% through 2025.[4] This downtick is highlighted by the fact that, as of 2019, mutual funds required twice the assets needed in 2009 to achieve the same level of revenues — putting future revenue pools into question.

On the other hand, diversification offers retirement providers an opportunity to transform their futures, and we believe that those that diversify into multi-product, cradle-to-grave offerings can harness new growth engines and elevate participant retention.

In precedent industry examples, companies have often been able to reaccelerate growth when they looked beyond their current defined market. Rather than trying to gain market share in a shrinking revenue pool, these companies looked to adjacent areas for growth. The retirement industry, in particular, has a cross-sector task involving not only planning and growing wealth but also preparing participants for retirement — and that can create different types of demands and more opportunities. Those that can deliver on these deeper sets of connected interests between financial planning, insurance and healthcare have an opportunity to deliver for their retirement participant, and their own growth agenda.

[4] PwC Market Research Centre analysis based on ICI and DOL data.

Why now

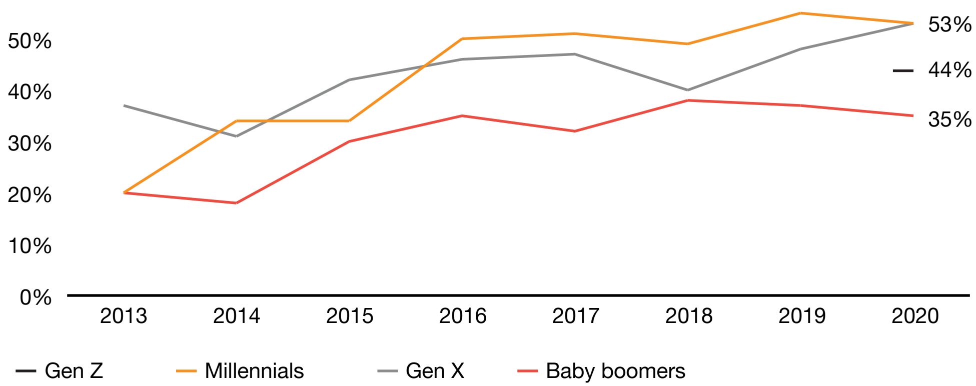
There are trends on both the demand and supply side that are sparking the emergence of a retirement ecosystem, or an interconnected system of offerings from a variety of participating providers. This ecosystem is starting to expose the inadequacy of monoline retirement providers.

On the demand side, both plan sponsors and participants want broader suites of offerings to address a broader definition of life planning — effectively extending benefits to meet needs that may arise during working years and into retirement. Emergency healthcare and elder-/childcare expenses are just two examples of the kinds of financial stresses that participants may face. Addressing these types of needs can be an effective method in helping participants stay on track with meeting overall retirement planning goals while retaining assets over time.

On the supply side, consolidation is reshaping the market. As fees fall and margins compress, firms are targeting deals that build scale. Meanwhile, new players — agile, tech-savvy competitors — are beginning to fill in parts of the ecosystem that incumbent retirement firms have neglected. These firms are capturing stickier revenues with a compelling value proposition and a focus on the participant experience.

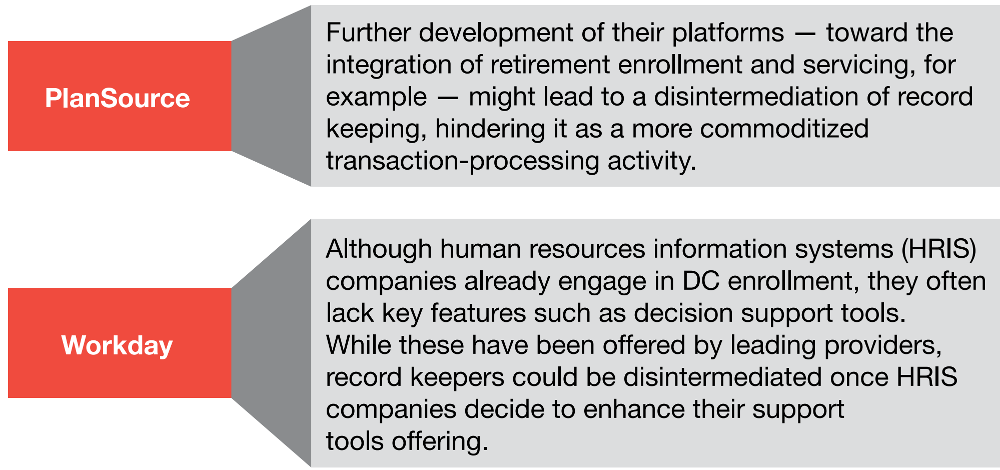
Plan providers and investment managers have a great business in the US retirement market given its sheer size and sustainability. But the long-term growth potential will depend on expanding to adjacent markets rather than just building scale. By focusing on the entire retirement ecosystem, firms can better position themselves to meet the broadening range of participant demands.

Employees who think it's likely they'll need to use money held in retirement plans for expenses other than retirement



Source: PwC 9th Annual Employee Financial Wellness Survey

Impact of in- and out-of-industry players on the retirement market



Source: PwC, company reports

Steps to take

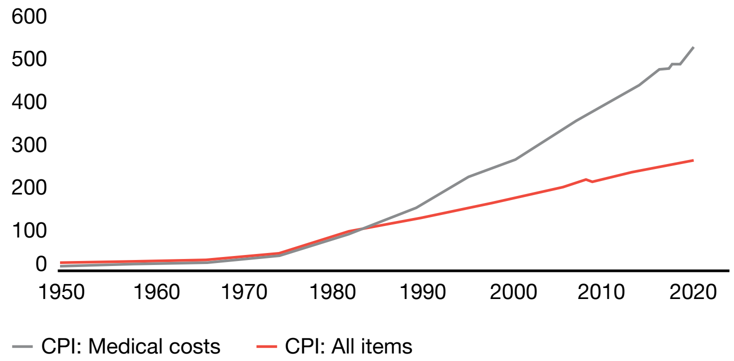
An effective portfolio approach to address a wider retirement ecosystem is key, but that won't come casually. Our insurance team has developed an effective programmatic method that includes 1) strategically identifying your role, 2) making agile buy-build-borrow decisions, 3) understanding varying maturity levels and 4) rethinking reinvestment within an ecosystem construct.

With this structured approach, we see a few areas where retirement firms can expand.

Extend product innovation with health savings. There's a clear opportunity in bridging the gap between retirement plans and offerings that help with health savings, especially in light of rising life expectancies and soaring healthcare costs. For participants, healthcare isn't just a large fast growth market, it's a financial problem that's intertwined in planning and wellness goals.

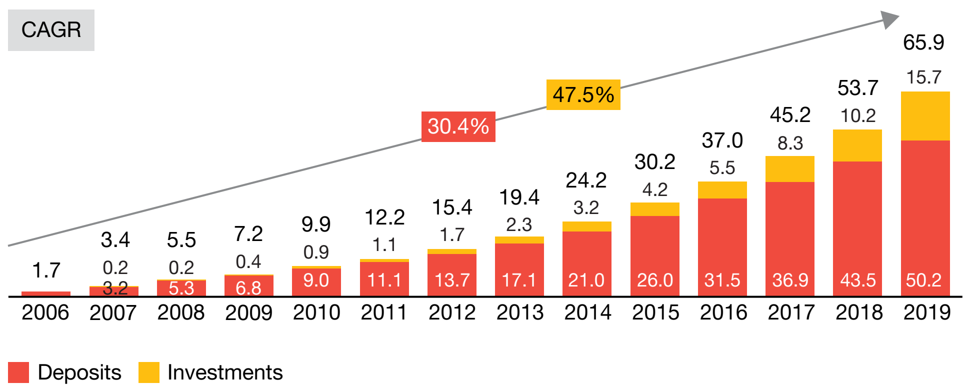
To take advantage of this opportunity, platform providers and record keepers might consider expanding to adjacent product lines such as health savings accounts or other health related services. Depending on the specific product, platform providers can leverage common technology underpinnings such as payroll connectivity to help create a unified employee experience.

CPI: Medical versus general items (Index 1982-1984 = 100)



Source: PwC Market Research Centre, Federal Reserve Economic Data

Health savings accounts assets ($ in billions)



Source: PwC Market Research Centre, Devenir

Pursue targeted transactions to solve individualized needs. The recent wave of industry consolidation has been based largely on scale to find synergies and mitigate the impact of fee pressure.

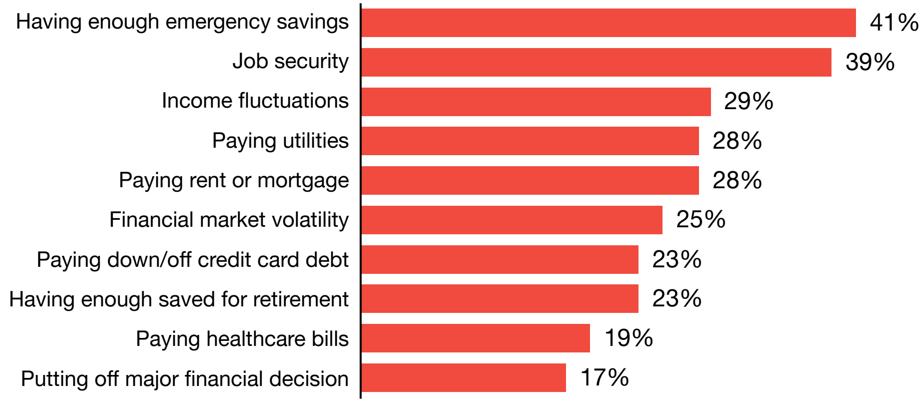
Targeted transactions, whether acquisitions or leveraging a variety of partners within an ecosystem, can give investment managers and plan providers the opportunity to reach a participant from a multitude of different angles. Partnering to leverage digital assistants, for instance, can help improve the participant experience and increase margins. On the other hand, acquiring automated goal-based financial tools might be preferred to leverage the benefits of deep technology integration.

In our work with retirement firms, we've come to recognize that growth shouldn't be limited to the current market. Rather, firms should think about meeting the adjacent interests of participants in order to identify more opportunities.

Expand beyond financial planning into financial wellness. The COVID-19 crisis has highlighted the as-yet-unsatisfied demand among plan participants for a broad suite of financial wellness products that can help them live better lives now as opposed to simple traditional post-retirement planning. The biggest gap in perception between employers and employees regarding the success of a company's efforts to support remote work relates to childcare: According to a recent PwC survey, 81% of executives believe their companies satisfy their employees' childcare coverage needs while just 45% of employees agree.[5]

This opens a variety of areas for expansion, such as debt relief and childcare that retirement firms can use to diversify and grow their revenue base. Online tools, credit score guidance and health cost assessments are other angles on wellness that can help not only in reducing employees' financial concerns but also in increasing engagement and asset retention.

Considering the COVID-19 crisis, which of the following are among the top five things causing you the most stress?



Source: PwC Market Research Centre, National Endowment for Financial Education (NEFE)

[5] PwC US Remote Work Survey, January 12, 2021.

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