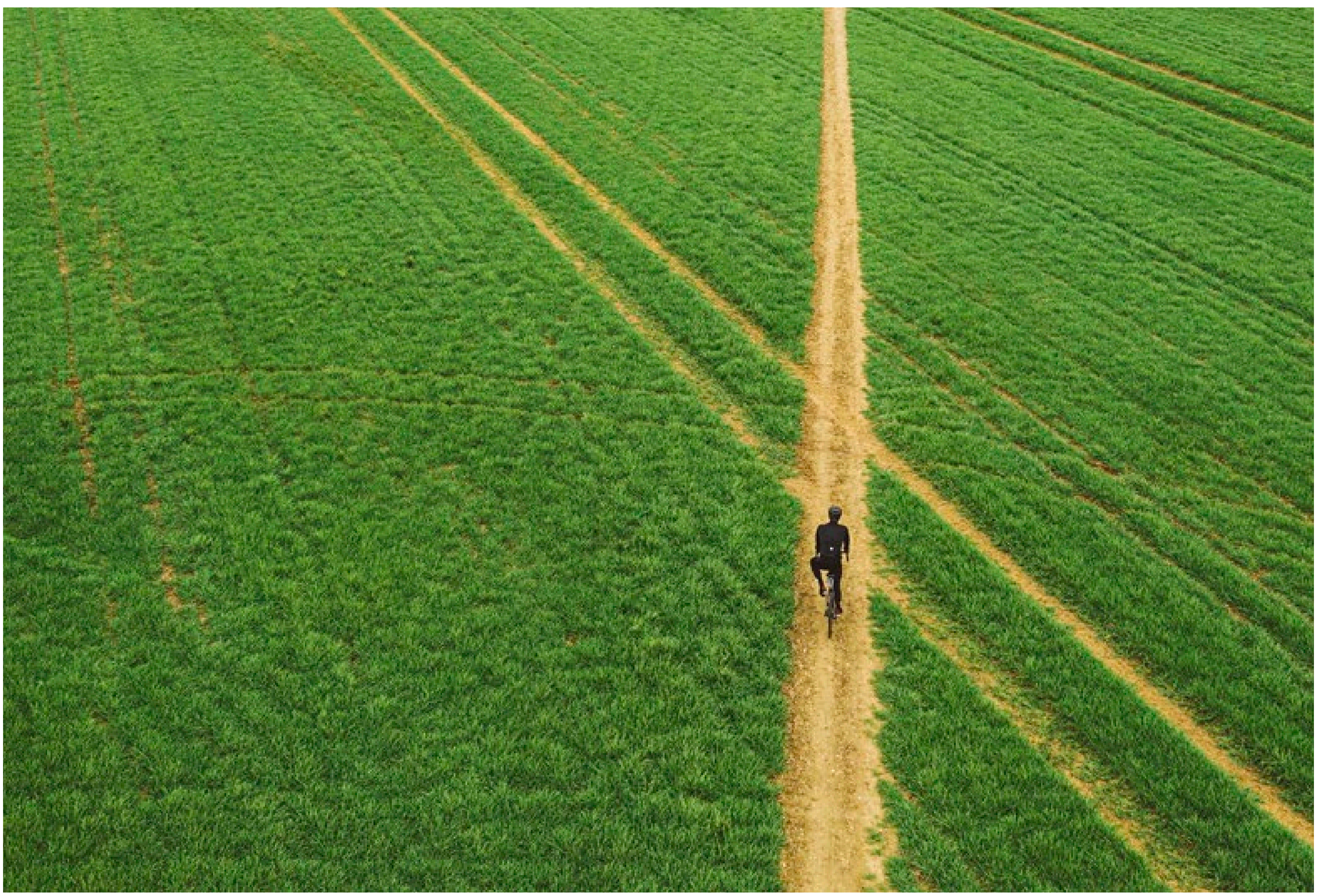
EXECUTIVE SUMMARY

The Forgotten Participant

Examining defined contribution participant investing behaviors and decision-making



What's missing from the DC investment menu?

What beliefs and needs drive various participants to construct their retirement portfolios in the way that they do — some for better and some for worse?

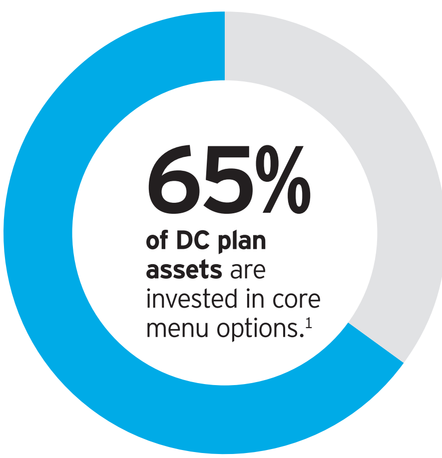
Industry Challenge

Our research initiative addresses the evolving assumptions around today's DC investment menu design by better understanding the investing behaviors and drivers among a certain segment of participants — those who allocate across individual options in the core investment menu (core menu) and target-date funds (TDFs). We believe these are the "Forgotten Participants" that DC decision-makers often overlook.

> "I think at this point in my life I'm willing to take the maximum [investment] risk there is."

> "I want my investment to be diversified, but with more control. I want to select different types of funds to balance my [investment] risk."

Today's DC investment menu challenges



- Despite TDFs' "simple" approach and widespread use, our research confirmed that many participants are still confused about what they are and how they work best. While TDFs are intended to be used as a standalone investment, many participants do not use them as such, instead, allocating across multiple investments.
- While QDIAs (predominately through the adoption of TDFs) have steadily evolved with the passing of the 2006 Pension Protection Act (PPA), core menu design has remained relatively unchanged. Participants investing in the core menu are often confused by investment jargon and naming conventions, are not systematically rebalancing and often approach decision-making with limited investment knowledge and overconfidence.
- In combination, allocating across multiple vintages of TDFs and the core menu may lead to poorly constructed portfolios that could negatively impact a participant's retirement outcome.

[1] Callan DC Index, quarter-end, September 30, 2019.

Sources: Invesco focus group and survey participants; all quotes in this paper are used with permission.

What we learned

By narrowing the focus on how (and most importantly, why) these participants invest this way, often to their detriment, we uncovered three key insights that could help plan sponsors provide the right mix of investment solutions for an optimal menu that may better address the retirement needs of participants.

Together with Greenwald & Associates, we **connected with 110 plan sponsors and 2,001 DC plan participants** (large employers with more than 5,000 employees) through online surveys, in-depth interviews and focus groups across multiple cities nationwide.

Our research uncovered three key insights:

INSIGHT

01

There is a significant subset of participants who prefer more control in building their own portfolios and don't view investing in a single TDF as right for them.

INSIGHT

02

There is a healthy appetite among Forgotten Participants for a professionally managed solution tied to their investment risk profile.

INSIGHT

03

There is substantial interest among participants and plan sponsors for a dynamic risk profile tool that helps with decision-making and increases engagement.

Adding a suite of risk-based strategies to the DC plan menu — along with an engaging and dynamic risk profile tool to support decision-making — could help innovate the DC investment menu for a significant subset of participants who appreciate the support, but still want to feel in control of their DC plan portfolio.

INSIGHT

01

There is a significant subset of participants who prefer more control in building their own portfolios and don't view investing in a single TDF as right for them.

These participants intentionally allocate across TDFs and the core menu in an effort to diversify and fine-tune their risk level. We believe these are the Forgotten Participants that DC decision-makers often overlook. These participants approach decision-making with limited investment knowledge and often with over-confidence. This can lead to poorly constructed portfolios that may not be systematically rebalanced, properly diversified or in line with how much (or how little) risk a participant is willing to take.

Forgotten Participants are engaged investors.
They are hands-on, like to feel in control of their investing and want the flexibility to make changes as needed:

- Most check their retirement plan statement or view it online at least semiannually.
- All review their account balance and check to see how much it has grown or declined.
- Some review their contribution rate and make changes to it periodically.
- Many actively check the performance of individual funds to see if any aren't performing as expected.
- About a quarter to a third made investment allocation changes in the past year, based on conversations with a plan representative or an advisor, and/or expectations for a market correction.

Source: Invesco participant focus groups and surveys, 2019.

Top 3 perceived reasons participants are NOT investing 100% in a single target-date fund:

#1	**Increased diversification**	→	"I don't want to put all of my eggs in one basket."
#2	**Increased potential return**	→	by adding riskier investments.
#3	**Reduced investment risk**	→	by adding more conservative investments.

Source: Invesco participant survey, March 2019.

Rather than investing 100% in a single TDF, these participants consistently believe that the best strategy for them is to fine-tune their portfolio by:

- Ratcheting their risk exposure up or down, according to their personal beliefs and needs, and/or
- Investing across multiple TDFs and/or the core menu for "increased diversification." Despite this belief, they did not seem to have a concrete approach to diversification.

Despite their best intentions, we found these participants are making financial decisions in their retirement plan based on the following, which could be of significant fiduciary concern for plan sponsors:

Limited investment knowledge
Alarmingly, 68% of participants did not really understand the investment options they had personally selected. Only a third (33%) are confident that their investment mix is the right mix to help them achieve their goals, with 62% saying that "guessing or going with their gut feeling" was a factor when choosing their investment options.

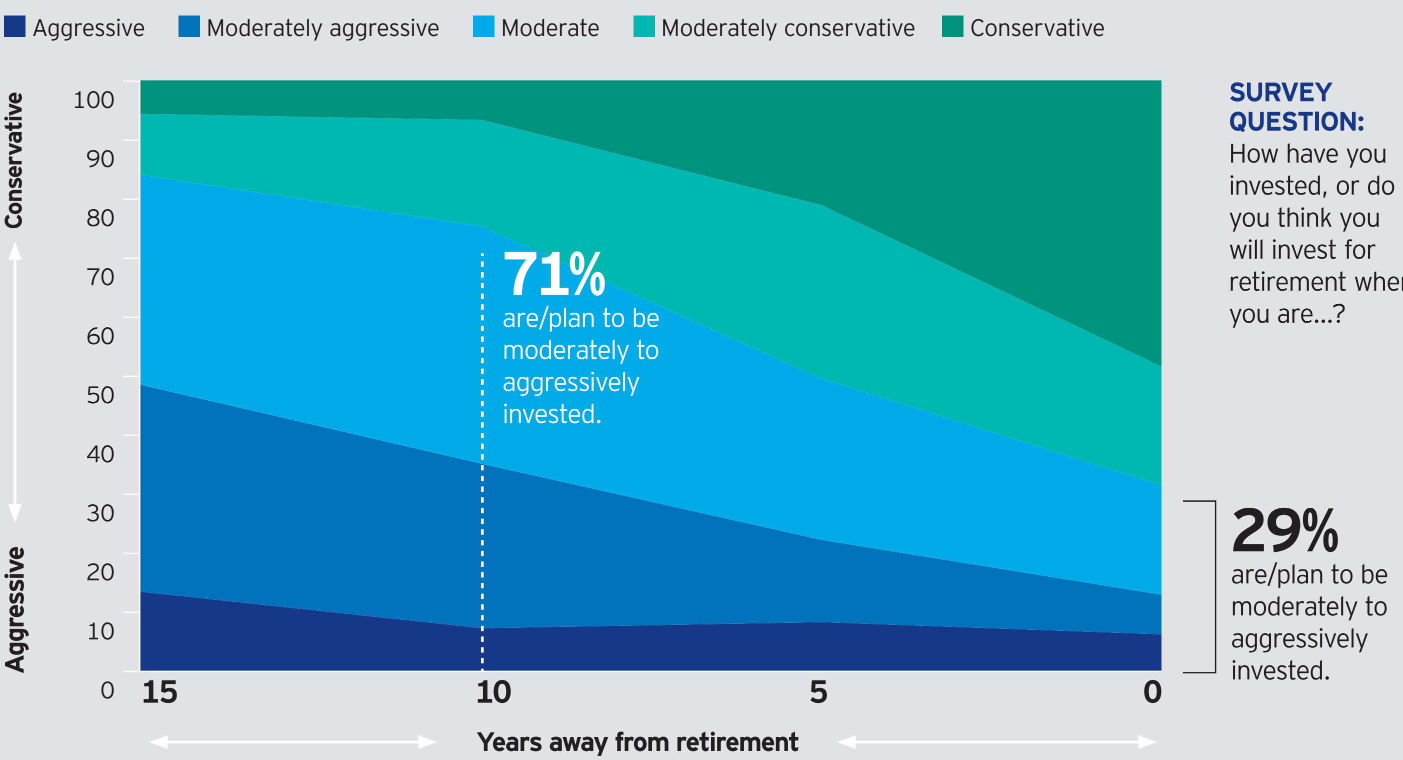
(False) overconfidence
Self-reported investment knowledge is tied to higher confidence but not necessarily a better understanding of investing for retirement. Four in 10 (41%) rated themselves with high investment knowledge; however, they did not score any better on a basic financial literacy quiz than peers that self-identified as those with little to no investment knowledge (average score just 4.5 out of 7 answers correctly).

> "I always want to feel that I have some sort of control over my investments and that I can change my mind as things change in my life."
>
> — Focus group plan participant

Contrary to conventional wisdom

For those participants who want to increase their exposure to growth as they approach retirement, a large majority (71%) in our study are currently investing (or plan to be) moderately to aggressively 10 years out from retirement, with 29% saying the same at retirement.

Plan participants are looking for more portfolio risk as they approach retirement, which many TDF glide paths may not offer.



SURVEY QUESTION:
How have you invested, or do you think you will invest for retirement when you are...?

Source: Invesco participant survey, September 2019.

INSIGHT

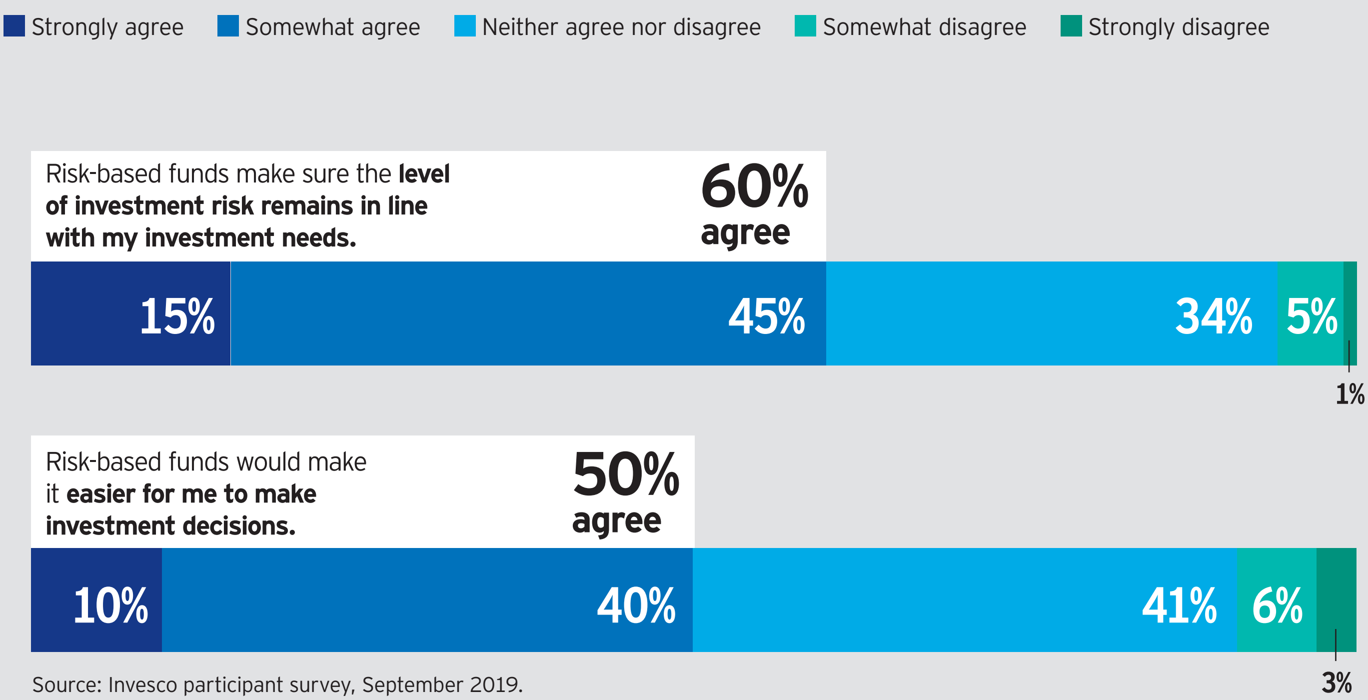
02

There is a healthy appetite among Forgotten Participants for a professionally managed solution tied to their investment risk profile.

This segment of participants in our study appreciates help in maintaining a level of investment risk appropriate to their needs and making their investment decisions easier. To that end, a majority were interested in a suite of well-diversified, professionally managed options tied to risk tolerance, not just their time horizon. In fact, 65% of all participants felt that a risk-based solution would be a good fit for them personally.

> "Risk-based portfolios are a good 'middle of the road' option."
>
> — Focus group plan participant

Sentiment around risk-based strategies



Source: Invesco participant survey, September 2019.

Among higher income ($100K+) participants who are hands-on investors and appreciate some investing support, **80% of participants describe risk-based strategies as a good fit.**

Why? They want more control than what TDFs offer but don't want the total control (or hassle) of selecting individual investments.

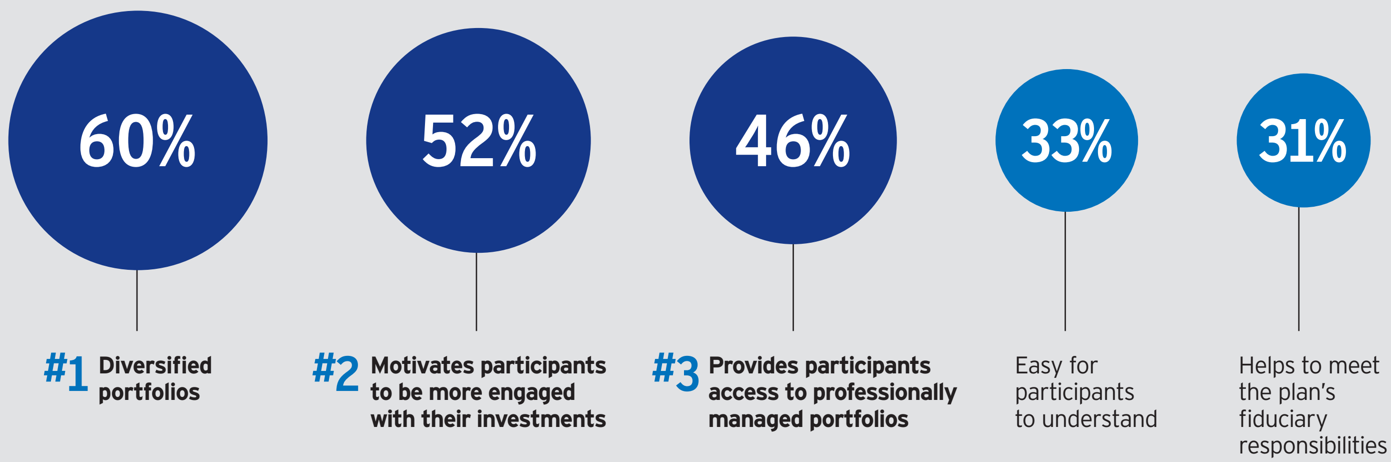
Source: Invesco participant survey, March 2019.

Plan sponsors see advantages of risk-based strategies

64% of plan sponsors are interested in adding risk-based strategies to the investment menu as they:

- Allow participants to take the amount of investment risk that meets their unique needs and encourages them to be more engaged with their investments.
- Would be appropriate for a segment of their participant population and serve as a "middle option" between TDFs and the core menu.

Which of the following are the **top three benefits** of offering risk-based funds as an investment option in your plan?



Source: Invesco plan sponsor survey, reflects responses of employers who offer risk-based funds, May 2019.

Risk-based strategies may offer additional fiduciary protection.

- By adding a risk-based strategy to the DC plan menu, plan committees can enable participants to invest in a way that matches their preferences for risk and volatility without needing to know how to construct a diversified portfolio out of the individual funds in the plan's core investment menu.
- In doing so, committee members may be better protected from potential claims of imprudent participant investing because risk-based strategies are based on the Employee Retirement Income Security Act's (ERISA) investment principles.

INSIGHT

03

There is substantial interest among participants and plan sponsors for a dynamic risk profile tool that helps with decision-making and increases engagement.

We found that participants are very interested in the risk-based resources and tools (specifically a mobile application) to help identify their risk tolerance and select the right strategy.

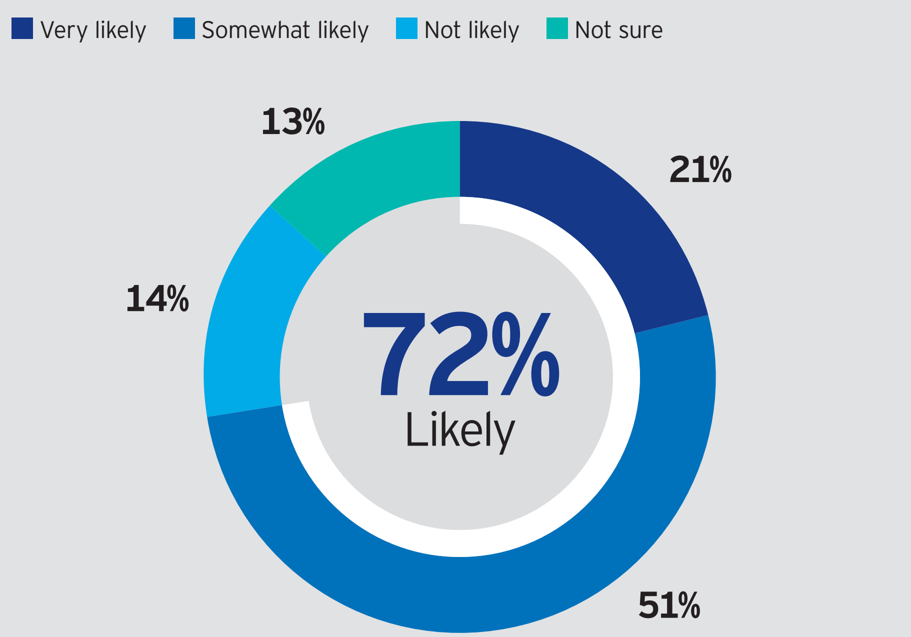
For plan sponsors who see increased participant engagement as a key differentiator, this type of support would increase their likelihood of offering risk-based solutions.

"I like the idea of an app. Everything is on our phones now."

— Focus group plan participant

For those participants who originally felt the strategies were not a good fit for them, 49% said they would be more likely to invest in risk-based strategies if given these resources.

Participants who would consider a risk-based strategy with the right "easy-to-understand" resources available

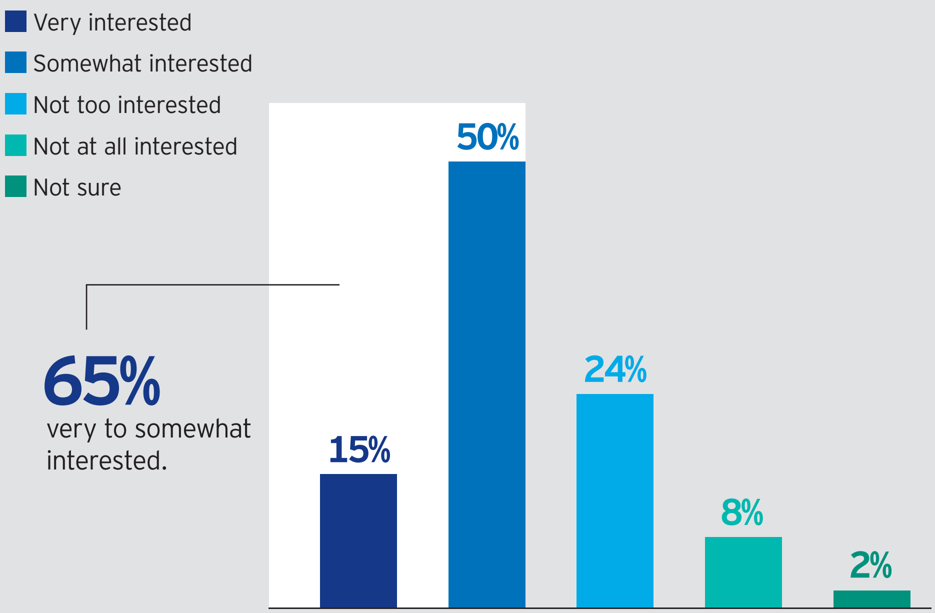


Source: Invesco participant survey, March 2019.

72% of participants would be likely to invest in a risk-based strategy if simple, easy-to-understand resources are made available to help them select the right option.

Source: Invesco participant survey, March 2019.

Interest in an online tool or calculator to measure risk tolerance and suggest investment options

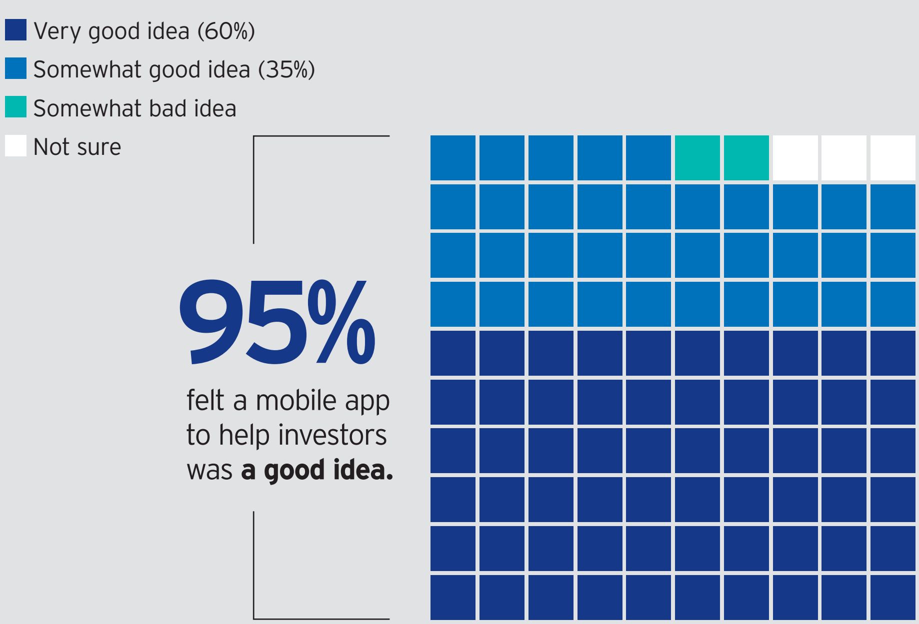


Source: Invesco participant survey, March 2019.

Offering simple, easy-to-understand resources to participants have always been a critical plan component. Among employer-provided resources and tools that assist participants in choosing their investments, online calculators are most commonly offered by plan sponsors (87%) and used by participants (65%) in our study.

2/3 of participants are interested in an online tool to specifically help measure risk tolerance and suggest investment options.

Plan sponsors' interest in a risk profile mobile app for participants



Source: Invesco plan sponsor focus groups, 2019.

When presented with a description of a mobile app to help their participants determine investor profiles in select risk-based strategies, almost all plan sponsors thought it was a good idea. And 62% were more likely to offer these strategies to their participants.

For plan sponsors who see increased participant engagement as a key differentiator, this type of support **would increase their likelihood to offer risk-based solutions.**

Evolving the DC menu

Our study set out to better understand the needs of the Forgotten Participants, an overlooked segment who allocate across TDFs and the core menu in an effort to diversify and fine-tune their risk level.

By gaining a better understanding of how (and most importantly, why) these participants invest the way they do, both the industry and plan sponsors are better positioned to provide the right mix of investment solutions for an optimal menu that may better address the retirement needs of all participants.

We believe there is room to evolve the current DC investment menu beyond TDFs and the core menu. Our research suggests that adding a suite of risk-based strategies to the DC plan menu — along with an engaging, dynamic risk profile tool to support decision-making — could help innovate the DC investment menu for a significant subset of Forgotten Participants who appreciate the support, but still want to feel in control of their DC plan portfolio.

This could provide increased participant engagement, enhanced participant outcomes and the potential for added fiduciary protection.

To help address the needs of Forgotten Participants, adding a suite of risk-based strategies could be a beneficial way to innovate the DC investment menu for increased participant engagement, enhanced participant outcomes and the potential for added fiduciary protection.

For plan sponsors looking to evolve their DC menu to engage Forgotten Participants, consider the following:

- Offer a suite of five risk-based strategies as a **separate tier** within the investment menu.
- Regularly examine participant investing behaviors and demographics to determine if your plan's existing QDIA (typically a suite of TDFs) is still appropriate. Fiduciaries may want to **consider a risk-based strategy as an alternative QDIA.**
- Explore risk-based solutions as an easier gateway to incorporate **Environmental, Social and Governance (ESG)** options into the investment menu versus adding an individual ESG fund that may be a potentially riskier, asset-class specific option for participants.

Continue the conversation with your Invesco DC professional

To access the full white paper, continue the conversation with your Invesco DC professional or visit **invesco.com/forgottenparticipant**

About Greenwald & Associates

Greenwald & Associates is a leading research firm with focused industry expertise in financial services, employee benefits and healthcare. Conducting customized research for over 30 years, Greenwald leverages its extensive knowledge and industry expertise to help clients explore and build products, design effective communication, and demonstrate their thought leadership.

About Invesco

Invesco is a leading global investment manager and a top provider of Defined Contribution solutions, managing more than $132 billion in DC assets.* With a thoughtful insights platform, one of the broadest investment offerings, and a commitment to a superior client experience, Invesco is helping plan sponsors, advisors and consultants achieve optimized participant outcomes.

Methodology

Together with Greenwald & Associates, our research focused on plan sponsors and participants working for large employers with more than 5,000 employees. The in-depth research included **interviews with 12 plan sponsors,** a national **survey of 97 plan sponsors, 10 participant focus groups** across multiple cities in the US, and **two national surveys of 2,001 plan participants** of various genders, income levels and ages.

*Invesco data as of December 31, 2019.

Invesco

ReDefined
CONTRIBUTION PLANS

Research Series

Across the ever-changing world of defined contribution (DC), plan sponsors and intermediaries are seeking actionable insights and solutions to help optimize participant outcomes and strengthen their fiduciary responsibilities. Our **ReDefined Contribution Plans Research Series** is designed to assist with holistic decision-making by:

- Uncovering the drivers of participant behaviors and investment choices and
- Identifying language that resonates with participants and increases engagement.

Leverage our latest research to help move your DC plan forward. To access the series, visit **invesco.com/dc** or speak with your Invesco DC Professional.

For more information, visit **invesco.com/forgottenparticipant**

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Diversification does not guarantee a profit or eliminate the risk of loss.

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