Innovations for in-plan retirement income.

SEI Investment Manager Services

Contents.

Introduction.

As defined contribution (DC) plans have replaced defined benefit (DB) plans as the primary US workplace savings vehicle, employees have gained flexibility and portability—ideal for a more mobile workforce—but have lost access to a guaranteed, steady income stream in retirement. This move to DC places the responsibility squarely on the individual participant for both determining the investment allocation and managing accumulated savings in retirement (i.e., the "deaccumulation" phase). Participants face myriad risks in managing their own drawdown process, which include not only market risk but also the potential to overspend and thus outlive their savings.

Despite the risks, most DC plans, because they were designed only to get participants "to" and not "through" retirement, lack the tools or investment products to help participants easily manage this post-retirement drawdown process. Those plans that do offer appropriate solutions, however, have suffered from extremely low adoption rates because of their lack of portability, high level of complexity, and expensive guarantees.

Recently, several factors have combined to drive renewed interest in in-plan retirement income solutions. First among these are growing plan sponsor concerns about the risks faced by their retiring participants and a belief that robust solutions within the DC plan may be the best way to manage these risks. At the same time, new legislation has reduced plan sponsors' past fiduciary concerns about offering in-plan income solutions. In this new environment, insurers and asset managers have developed a host of new products designed to fill the need. Working together and with recordkeepers and fintech firms, they hope to overcome past/current issues related to complexity, portability, liquidity, and cost.

In this brief, developed in partnership with the Retirement Leadership Forum (RLF), we review the industry's past and current efforts to incorporate retirement income solutions in DC plans, including:

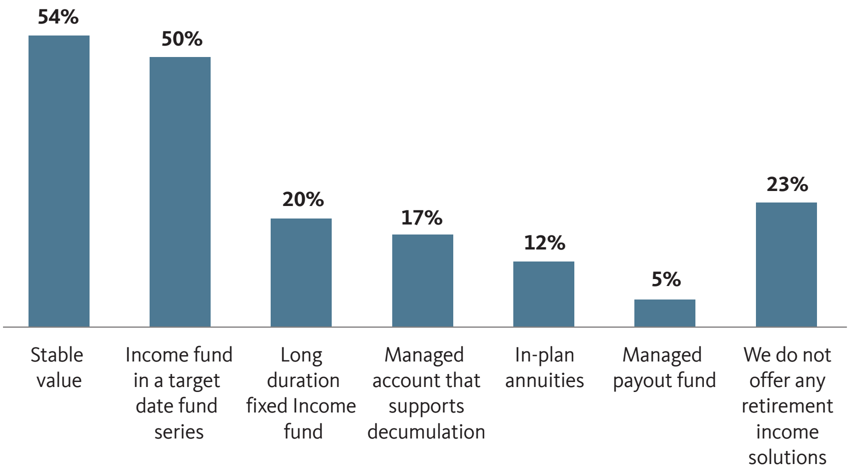
- Past frustrations: Why retirement income remains an unsolved problem for DC plans
- Renewed interest: Key drivers of the latest wave of retirement income product development
- Innovative solutions: How the industry is looking to solve the retirement income problem today
- Future outlook: Strategies to drive acceptance and adoption of in-plan retirement income

Background and history of retirement income initiatives.

The urgency to develop in-plan retirement income solutions has increased dramatically over the last four decades as DC plans have replaced DB as employees' primary source of income in retirement. In 1980, when the 401(k) plan first came into being, 38% of private-sector workers were covered by a DB plan. By 2010, that number had fallen to 20%, and was down to 15% by 2020. Concurrently, DC plan adoption took off and, as of year-end 2020, 64% of workers had access to this benefit.[1]

Yet, despite the industry having more than 40 years to build solutions to the retirement income problem, plan participants are still largely on their own when it comes to the drawdown phase. In fact, a recent Prudential Global Investment Management (PGIM) survey of DC plans[2] found that only 17% offered managed accounts with retirement income features, 12% had in-plan annuities, and 5% had managed payout funds. Twenty-three percent of plans offered no retirement income solution at all (**Figure 1**).

Figure 1. Retirement income options in 401(k) plan menus



Source: PGIM, *The Holy Grail of DC: Income in Retirement*, 2022

Focused mainly on the savings phase of retirement, most plans in the survey instead relied on offering stable value funds or a target date fund that allocates more heavily to fixed income after the retirement date (also known as "through retirement" target date funds). While these are relatively safe investments and appropriate for some retirees, they lack the DB-like periodic payouts and guarantees of the other options previously mentioned. Indeed, one could say that the reliance on stable value funds —a low-risk investment alternative as opposed to a strategic retirement income solution—highlights how unprepared many plan sponsors are in supporting retirees.

The low incidence of adequate retirement income products in plan lineups is not a function of a lack of available options. In fact, between 2005 and 2010, at least four major insurance companies launched in-plan retirement income products (see below).

Past retirement income solutions have gained little traction

Insurers led the first wave of retirement income product launches, but none of these products has gained significant traction in plan lineups and some are no longer available at all:

- **MetLife Personal Pension Builder.** An in-plan deferred fixed annuity where each contribution purchased a small piece of future guaranteed income. Launched in 2004 as the first-ever in-plan annuity option, the product was "sunset" in 2018 because of low utilisation.
- **Genworth ClearCourse.** An in-plan group variable annuity that promised a guaranteed income floor with potential for upside during the accumulation phase. The firm first offered the product in 2005 and stopped selling it when it closed its annuity division in 2011.[3]
- **Prudential IncomeFlex Funds.** A series of in-plan fund options that offered a guaranteed floor during the accumulation phase and a 5% guaranteed payout in retirement. Launched in 2006 as risk-based funds, they added target date vintages in five-year increments in 2009. As of Q1 2022, none of the vintages between 2030 and 2050 had over US$25 million in assets.[4]
- **John Hancock Guaranteed Income for Life.** A rider that could be attached to John Hancock's lifestyle funds, it offered principal protection and a guaranteed 5% payout for life on assets at retirement. The product was launched in 2009; there is no longer any current information about it on John Hancock's website.

RLF research interviews with dozens of retirement executives in 2018 uncovered five factors that have led to such low levels of adoption:[5]

1. Cost. The income guarantees are expensive. For example, the John Hancock Guaranteed Income for Life rider costs an additional 50 to 75 bps over and above the cost of the underlying lifestyle fund.

2. Complexity. The calculations for how much income a participant would receive at retirement are complicated and depend on factors such as market returns, interest rates, and retirement age. This makes it difficult for employees to understand what they are buying and what amount of future retirement income they can expect.

3. Portability. The products are not easily portable between plans. If an employee leaves their company and wants to transfer their assets to the new company's plan, they may have to liquidate the income product and, in the process, lose the future guarantee of income. Alternatively, participants who choose not to consolidate their balances could have multiple plan balances across multiple retirement plans and, potentially, multiple income streams following retirement.

4. Liquidity. Employees may be hesitant to "lock in" a sizable portion of their assets to generate guaranteed income. If they were to do so, they would lose the ability to access their assets for emergencies or large expenses.

5. Fiduciary concerns. Plan sponsors worry about the fiduciary implications of offering high-cost investment choices whose ability to pay the promised guarantees are tied to the fortunes of the issuing insurance company.

The first four of these concerns are in direct conflict with the DC plan's advantages over the DB plan: ideally the DC plan is a simple, low-cost savings vehicle whose portability and flexibility align well with a more mobile workforce. These attempts to "DB-ise" the DC plan ignored the trends that led to the shift away from DB decades ago. Moreover, just as these products were hitting the market in 2006, the Pension Protection Act (PPA) gave plan sponsors that offer a DC plan unprecedented fiduciary

89%

of participants in a 2021 BlackRock DC survey agreed that having guaranteed retirement income would affect their current well-being.

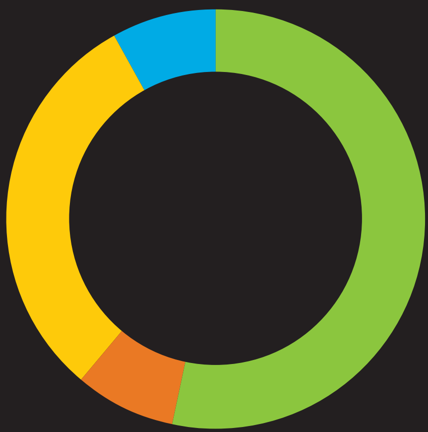
protection. However, because the PPA's "safe harbour" did not include annuity products, plan sponsors were reluctant to risk violating the safe harbour by implementing untested solutions. As a result, by 2018, an RLF survey found that only 5% of plan participants held one of these products in their 401(k) accounts.[6]

Looking back at these challenges, the results were perhaps predictable, but the desire for solutions has not abated. Plan sponsors support the idea of guaranteed income, even if they appear opposed to the solutions offered to date. For example, in a 2021 survey from AllianceBernstein,[7] 81% of sponsors felt that adding guarantees to their QDIA was either "appealing" or "extremely appealing." Moreover, a 2021 Allianz Life study found that, among plan sponsors that do not currently offer an in-plan retirement income solution, 85% or more are at least somewhat likely to add one in the next two years.[8] Employees likewise see the benefits of guaranteed income: a 2021 BlackRock survey[9] found that 89% of participants agreed that having guaranteed income in retirement would affect their current well-being. Both these constituencies are looking for steady retirement income, just not at the expense of giving up the previously mentioned benefits of the DC plan.

A proliferation of **new** products.

Fast forward to 2022: retirement income has returned to the top of the product development priority list for many asset managers and insurers. A recent RLF survey of asset managers found that 54% of firms in the DCIO space currently have a retirement income solution and 39% are in the process of building one (**Figure 2**).

Figure 2. DCIO retirement income product development efforts in high gear



54% One or more products currently available

8% No products, but plans to build within 12 months

31% No products, but plans to build in 12–24 months

8% No products/No plans to build

n=13
Source: RLF 2021 In-Plan Advice and Income Survey

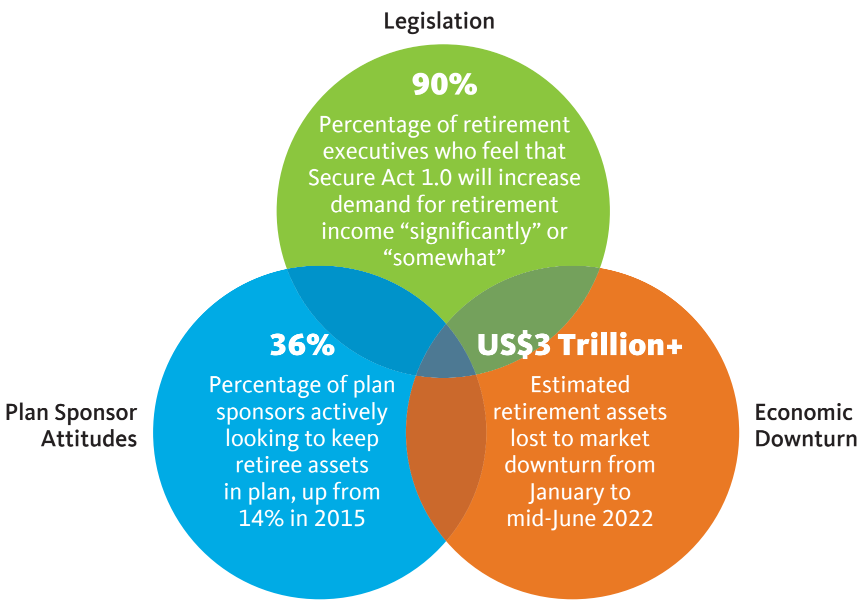
Given the poor adoption of past products, why are asset managers rolling out new solutions?

Three developments have stoked asset managers' optimism around retirement income (**Figure 3**).

- Over the last decade, plan sponsor interest in keeping participants in the plan after retirement has increased. A 2022 study from PIMCO[10] found that 36% of plan sponsors are actively looking to keep retirement assets in plan, up from 14% in 2015. The reason behind plan sponsors' increased interest in keeping assets is twofold: 1) to get better pricing for the plan (plans with higher assets generally are charged less); and 2) to allow retirees to benefit from pricing and products available within their DC plan (but perhaps not available through a retail IRA). Regardless of the reason, the trend heightens the urgency of implementing solutions to assist participants in the drawdown phase.

  It's worth noting that, perhaps following the lead of their plan sponsor clients, the same PIMCO study found that more than 80% of advisors and consultants believe the DC plan should offer services that support the retirement income needs of plan participants.[11]

Figure 3. Drivers of renewed interest in retirement income product development



Source: RLF Secure Act Survey 2020, PIMCO, Boston College Center for Retirement Research

- In December 2019, the US Congress passed the SECURE Act (Setting Every Community Up for Retirement Enhancement). Among other provisions, SECURE offers a safe harbour for plans that offer annuities, specifically protecting the plan sponsor against liability if the insurer behind the annuity is unable to meet its obligations to plan participants. As noted earlier, the fear of litigation prevented broader adoption of in-plan retirement income products in the past; SECURE removes this roadblock.
- Finally, and most recently, the stock market downturn that began in January 2022 has highlighted the perilous position of plan participants on the eve of retirement and the value of guaranteed income. All told, retirement accounts have lost more than US$3 trillion in market value year-to-date as of mid-June 2022, according to calculations from the Boston College Center for Retirement Research. Because participants in their later years hold the majority of retirement assets (investors in their 50s and 60s hold 63% of all 401[k] assets[12]), older workers nearing retirement are disproportionately affected by market volatility. The situation has highlighted the need for solutions such as guaranteed income as protection against a significant loss in portfolio value just as a participant is entering retirement.

Figure 4. In-plan retirement income products launched since 2020

Product Type	Description	Recently Launched Products
In-plan annuity	Fixed or variable annuity designed to accept periodic investments in a DC plan, and, based on these investments over time, pay out guaranteed income at retirement	• Allianz **Lifetime Income+** • Nationwide **Indexed Principal Protection**
Target date fund with annuity options	Traditional target date funds that include an allocation to annuities (or the right to purchase an annuity at a future date). The annuity typically replaces some or all of the allocation to fixed income.	• BlackRock **LifePath Paycheck** • Income America **5ForLife** • Nationwide **Lifetime Income Builder TDF** • JP Morgan **SmartRetirement Plus**
Target payout funds	Mutual funds that target a specific payout, such as 5%, but without the guarantee of an annuity. Income is generated by investing in credit funds or buy-and-maintain strategies.	• Legal and General **Retirement Income 2040 Fund** • Schroder **Income Plus**

Changing plan sponsor attitudes and new legislation have led to a proliferation of new in-plan retirement income solutions (**Figure 4**), while the more recent market downturn has, according to multiple RLF research interviews with asset managers, increased plan sponsors' urgency to evaluate retirement income solutions.

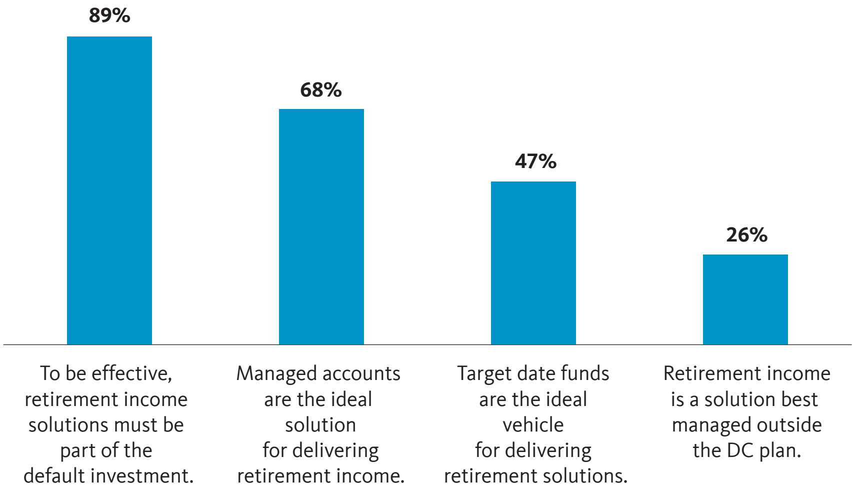
Notably, each of these new products addresses one or more of the shortcomings of the prior generation of retirement income solutions. Specific areas addressed include:

- **Decreased complexity.** TDF-based income products take advantage of the "auto-pilot" asset allocation strategy that has made target date funds the most popular investment choice in DC plans. Also, as a TDF, they fit naturally into the QDIA slot and the plan sponsor can therefore choose to default participants into the product, eliminating the need for any participant decision-making.
- **Lower cost.** Because the target payout funds do not include a guarantee, they are able to avoid the additional expense of the insurance component. As indicated earlier, the guarantee could add up to 75 bps to the cost of the investment option. By contrast, one of the target payout products noted previously has a total all-in fee of 68 bps.
- **Better flexibility.** Target payout funds do not "lock up" participant assets the way an annuity does. Participants can sell the target payout fund without complex annuity present-value calculations and associated penalties. And, at least some in-plan annuities have eliminated some of the penalties for early withdrawals (e.g., Nationwide's Indexed Principal Protection).

The delivery method matters.

As previously referenced, auto plan features and target date funds taught retirement providers an important lesson about delivering complex solutions to plan participants. Prior to their emergence in the mid-2000s as a result of the PPA, plan providers were confounded in their attempts to help participants make appropriate retirement savings decisions. Anything they built to help participants—enrollment tools, advice call centres, on-site advice teams, web-enabled advice tools—was met with low participant utilisation. Enter auto enrollment and the target date fund, two solutions that dramatically decreased the need for ongoing participant involvement: suddenly millions of plan participants became enrolled in plans and received ongoing asset allocation advice without knowing it. As a 2021 RLF survey indicates, it seems clear that the delivery mechanism for advice is as important as the advice itself. (**Figure 5**).

Figure 5. Retirement providers agreeing with each statement on delivery of income solutions



Source: RLF 2021 Retirement Income and Advice Survey

Retirement providers feel strongly that this insight should be applied to the retirement income space. Eighty-nine percent of providers surveyed by RLF agree that to be used properly (and not misused), retirement income solutions must be embedded in the default investment option for the plan. A majority of providers (68%) believe that managed accounts, with their ability to personalise asset allocation to each individual participant, are the right vehicle in which to package the annuities, payout funds, or other income-generating vehicle. A smaller but significant percentage (47%) believe that the ease and simplicity of target date funds, such as the BlackRock, Income America, and Nationwide solutions mentioned earlier, make them the ideal delivery vehicle.

Finally, 26% of respondents felt that the DC plan, in general, wasn't the right platform for retirement income. Instead, some industry executives contend that advisors or third-party technology solutions outside of the DC plan might be better positioned to offer the holistic advice needed to develop a retirement income plan. This opinion is certainly shaped by the challenges that DC plans faced in delivering solutions in the past. Given recent SECURE legislation and plan sponsor interest in keeping participants in the plan, however, it seems unquestionable that DC plans will play an important role going forward in assisting participants with the drawdown phase.

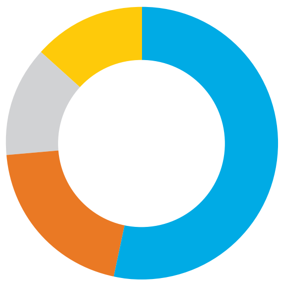
At least one in-plan income product has already found a place on a managed account platform. In mid-2021, Allianz Life announced that Lifetime Income+ would be the first annuity offered through Morningstar's Retirement Manager, a partnership that will allow participants in Morningstar managed accounts to build up guaranteed income by investing part of their contributions in an annuity.[13] The move is important because it reduces the burden on the participant to make complex decisions: Morningstar sets and adjusts the allocation to the annuity based on multiple participant data points such as age, income, and account balance.

The role of CITs in enabling in-plan retirement income.

As new opportunities emerge in the retirement income space, collective investment trusts (CITs) are again at the centre of many asset managers' product development efforts. More than half of the new in-plan products hitting the market today are in a CIT structure (**Figure 6**). They are a natural fit in the retirement income space for two reasons:

- CITs offer a high level of flexibility that is important to the development of in-plan retirement income products. For example, a CIT makes it much easier to include annuities alongside equities and fixed income in a single vehicle. In fact, the income-focused target date funds from BlackRock and Income America both chose to use a CIT structure. This is also true of the periodic payout funds from Schroders and Legal & General. Even though these products do not include annuities, CITs allow these firms to include the broader range of investment types they need to ensure a steady stream of income in retirement.
- CITs' ability to deliver asset management at a lower cost is important to the success of the in-plan retirement income products. As noted earlier, cost is often cited as one of several reasons that past products failed to gain traction. If CITs can lower the cost of in-plan retirement income products by even a few basis points, they will help lower the barriers to broader implementation and acceptance of DC plans.

Figure 6. **Vehicle used by asset managers for most recent in-plan retirement income product**



53% CIT

20% Mutual funds

13% Managed account/other

13% Separate account/other

n=15

Source: RLF 2021 Retirement Income and Advice Survey

The challenge of operationalising income.

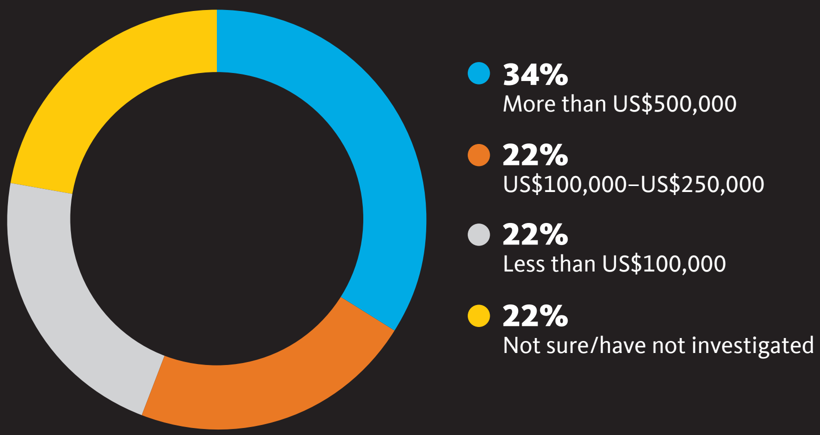
Our research indicates that despite the abundance of new product options, improved product features, and lower costs, at least two significant challenges exist in making these new retirement income products more widely available within DC plans. The first, and most critical, of these challenges relates to the recordkeepers' reluctance to offer these new products on their platforms.

The reason for the reluctance is consistent across most of the recordkeepers interviewed for this research: they face significant technical complexities in offering retirement income products with both periodic payouts and, potentially, annuity components. As noted earlier, the 401(k) plan was designed initially as an investment accumulation vehicle, but many of the recordkeepers' systems and technologies cannot support products or services that participants need in the drawdown phase. Three of the most commonly cited challenges from interviews with recordkeepers include:

- **Support for annuity trades.** Unlike mutual funds, trades for annuities cannot be cleared though a FUND/Serv-like organisation and instead much be executed and reconciled directly with each insurer that the recordkeeper supports on their platform.
- **Support for periodic distributions.** Recordkeeping systems do not generally have the ability to automatically distribute a set amount on a regular basis (e.g., monthly). Participants must generally request a withdrawal via phone, website, or fax.
- **Building a participant experience.** Recordkeepers believe they will need to provide additional education and tools on their participant websites to help participants make informed decisions about the amount of income they will need in retirement and how to best allocate their contributions to in-plan retirement income products to achieve the needed levels.

The cost of adding the functionality needed to support retirement income products is not insignificant. A 2020 RLF survey found that costs for a recordkeeper to build the connectivity required for a single annuity product from a single insurer range from less than US$100,000 to more than US$500,000 (**Figure 7**). Further interviews in June 2022 with five large recordkeepers put this figure as high as US$1 million per insurer.

Figure 7. Recordkeepers' cost to add a new annuity-based product to their platform

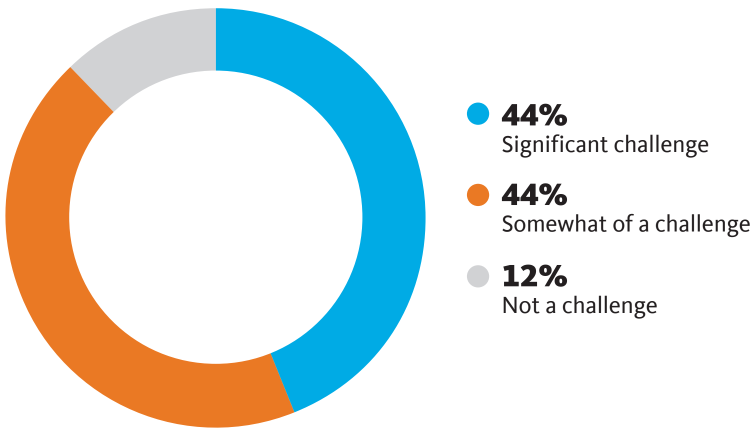


n=9
Source: RLF, Rethinking In-Plan Retirement Income, 2020

Beyond the direct cost concerns, resource constraints play a role in the failure of retirement income to gain traction with recordkeepers. Many have been working on a lengthy list of new product enhancements—such as advisor managed accounts—leaving little room to dedicate resources to implementing new in-plan income products. In fact, one recordkeeper noted in our research interviews that it would take strong interest (and a commitment to dedicate assets) from a large plan sponsor to bump retirement income up as a priority.

Given these cost and resource issues, and the failure of past in-plan products to gain traction, recordkeepers are moving slowly in committing to add new retirement income products to their platform. For asset managers, recordkeepers' reluctance to invest in new retirement income products is a top challenge (**Figure 8**), but one that must be overcome for a plan sponsor to even consider offering in-plan retirement income to their employees.

Figure 8. Asset managers' level of challenge with getting recordkeepers to add their income products



n=9
Source: RLF 2020 Retirement Income Benchmarking Survey

Portability issues persist as another operational barrier to wider acceptance of in-plan retirement income solutions. If a participant accumulates a significant amount in an annuity product offered by an employer plan, they may not be able to move that balance to a new plan or roll it over to an IRA if they change jobs (if the new plan or IRA provider does not support the annuity product). They are thus faced with having to either 1) leave the money in the old employer's DC plan, or 2) cash in the annuity at the current market value, losing all of the future guarantees in the process. Again, this challenge results from the fact that no centralised clearinghouse for in-plan annuity products currently exists.

Fintechs building enabling technology.

Understanding both the strong need for in-plan retirement income solutions and the challenges associated with offering them, at least two fintech firms are looking to fill the gap between the products from asset managers and insurers, and the platforms managed by recordkeepers. These firms are looking to reduce the cost for recordkeepers to support in-plan products by building technology that overcomes one or more of the recordkeepers' key operational challenges mentioned earlier.

For example, Micruity is a fintech startup looking to act as a centralised clearinghouse for annuity trading and settlement data. For a recordkeeper, this means that by connecting to Micruity, they could theoretically offer any in-plan annuity product on the platform. The reverse is true for any insurer or asset manager on the Micruity platform. However, the firm also has functionality to assist participants with the aforementioned portability issues. Upon termination from a plan, Micruity's technology can help a participant to either make an income election (if they are at retirement age) or transfer the accumulated balance in a retirement income product to a new plan. The firm recently received more than US$5 million in seed funding to help them move from proof-of-concept to a viable product. Several firms with a long history in the DC space and significant opportunities with in-plan in retirement income (such as Allianz, Franklin Templeton, and Pacific Life) participated in the funding round.[14]

At least two fintech firms are looking to reduce costs for recordkeepers to support in-plan products by building technology that overcomes key operational challenges.

If new fintech solutions succeed, major technology barriers between recordkeepers and retirement income product providers will finally be removed.

iJoin, on the other hand, is focused on the participant experience. Their software helps participants set goals around how much income they will need in retirement and to help participants allocate to the most appropriate investments, including annuities, to achieve these goals. Rather than build this participant experience internally, recordkeepers can instead choose to integrate with iJoin's platform, eliminating a potentially large development expense.

While each of these solutions holds promise and both have ardent supporters from within the retirement industry, their ability to increase the availability of in-plan solutions is still unclear. Micruity is only recently emerging from the proof-of-concept phase and ramping up operations. iJoin only recently announced their retirement income initiative in the third quarter of 2021, so it's too early to know if they will have an impact on utilisation of retirement income products. If they succeed, however, major technology barriers between recordkeepers and retirement income product providers will finally be removed.

Imperatives for insurers and asset managers.

While there is significant momentum behind in-plan retirement income solutions, success is by no means a certainty. History has shown that even well-conceived solutions can fail to find their way onto plan lineups and attract assets. With that in mind, we've identified four imperatives for asset managers and insurers looking to build and grow their in-plan retirement income products.

1. Partner with recordkeepers. Because they are the conduit to the plan participant, broad-based recordkeeper implementation of in-plan retirement income products is critical to driving utilisation. Given the significant costs and resources involved for recordkeepers, however, retirement income product providers must find ways to establish mutually beneficial partnerships with them. "Partnership" could include covering part of the cost of implementation of retirement income products, offering favourable pricing, or both.

2. Support the development of "middleware" providers. In addition to making it easier for recordkeepers to get the data needed to offer in-plan income products, technology-based middleware providers such as Micruity can also help overcome the portability challenge. The key imperative for asset managers and insurers is to leverage their relationships with recordkeepers to encourage them to connect to the middleware solutions.

3. Integrate with advice products and services. Target date funds and managed accounts are now established as the standard for delivering in-plan advice to participants. Integrating with these solutions can speed the adoption of in-plan income products by making it much simpler for participants to allocate to them.

4. Manage product costs. Plan fiduciaries often weigh cost above all other factors in evaluating investments for the lineup. Keeping costs low, including by using CITs, will be critical to gaining support from plan sponsors, consultants, and advisors.

Final thoughts.

Despite the clear need for participant help in managing the process and risks during the decumulation phase, generating retirement income remains a problem in search of an adequate solution. The first round of solutions in the mid-2000s suffered from low adoption because of their complexity, excessive cost, and lack of portability. Additionally, they found a tough time finding a place on recordkeeping platforms designed to manage the accumulation, and not the spending, phase of retirement.

However, the SECURE Act and growing plan sponsor interest in keeping participants in their plans has given a significant boost in demand for in-plan retirement income solutions. Product providers have responded by developing a host of new products to fill the need. Furthermore, key developments in the DC industry throughout the last decade provide additional reasons for optimism that this new round of solutions will find success:

- Target date funds and managed accounts have demonstrated the value of packaging solutions in a way that reduces the reliance on ongoing participant intervention—lessons that the industry is now applying in the retirement income space.
- CITs have emerged as popular options in 401(k) plans, offering a low-cost, flexible way to build in-plan income solutions that include a variety of asset classes.
- Fintech firms have stepped in to attempt to establish an integrated flow of retirement income data among recordkeepers, insurers, and asset managers, addressing what in the past was a major hurdle to adoption.

If product providers (asset managers and insurers) were to partner more closely with recordkeepers, support the development of middleware solutions, and integrate with existing advice solutions, all the while keeping costs under control, we believe that in-plan income would finally achieve the level of success providers and participants alike have wanted.

Endnotes

[1] All DB and DC access statistics are sourced from the US Bureau of Labor Statistics Employee Benefits Survey.

[2] Prudential Global Investment Management, *The Holy Grail of DC: Income in Retirement*, 2022.

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[10] PIMCO, *US Defined Contribution Consulting Study*, 2022.

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[13] 401(k) Specialist, *Allianz Life Annuity Added to Morningstar Retirement Manager*, August 2021.

[14] Micruity Press Release, *Micruity Raises $1.5 million to Personalize Pension Plans*, 10 February 2022.

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*Based on *Pensions & Investments*' Largest Money Managers 2021 ranking.

About Retirement Leadership Forum

The Retirement Leadership Forum (RLF) is a best practices research firm serving the needs of more than 30 recordkeeping and DCIO businesses. Spun out of the Corporate Executive Board, the RLF has more than 15 years of research published in the retirement space. The group is known for providing leading industry insight and hosting superior executive events. For more information, please visit www.retirementlf.com

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