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The Evolution of Retirement Savings to Retirement Income

Scott Boulton
Consultant

How Retirement Plan Sponsors are Restructuring and Rebranding their Retirement Savings Plans to Include Retirement Income Solutions

Defined Contribution Retirement Plans (DC plans) have gone through many transformations since their creation, initially positioned as supplemental retirement savings vehicles alongside a company's traditional Defined Benefit Pension Plan. Today, DC plans are the main source of retirement savings for most, with very few employees having access to a Defined Benefit Pension Plan. As DC plans have undergone this transition, the industry has responded with advancements in plan design features, investment offerings, and technology that have helped boost participation and saving rates for the benefit of participants. Many plan sponsors have been open to adopting auto-enrollment and auto-escalation features (as discussed in this earlier White Paper), using diversified, managed-for-you investments such as Target Retirement Date Funds and Managed Accounts. These enhancements have resulted in record highs in average account balances, diversification, and total retirement assets, which are now estimated at over $29 trillion[1], of which $8.2 trillion were held in Defined Contribution (DC) Plans. The 401(k) plan has truly evolved into a robust savings vehicle.

> *"Today, DC plans are the main source of retirement savings for most..."*

More recently, the focus of DC plans has shifted towards the aging workforce, with an estimated 10,000 baby boomers turning 65 every day[2]. Retirees are now faced with the need to view their retirement assets from a different perspective. After years of saving in their retirement plans, they must determine how to convert their accumulated balances into an income stream they can live off. Since their employers provided tools and features that promoted savings during their accumulation years, many retirees are looking to their previous employer plans as the primary resource for information during this transition.

Traditionally, retirement plans were structured in a way that encouraged retirees to withdraw their assets from the plan or roll them over to Individual Retirement Accounts through a lump sum withdrawal option. As more investors are carefully considering the benefits of institutionally priced investments and resources

[1] As of June 30, 2019 National Association of Plan Advisors
[2] Pew Research Center

available only in their workplace plans, retirees are now looking to retain their assets in their previous employer plans and are searching for income solutions. Plan sponsors too are recognizing the benefits of retaining retirees in the plan; most often these retired participants increase the average account balance for the plan, thus driving down overall recordkeeping costs to the benefit of all plan participants.

Sponsors looking to make the transition to providing income solutions can choose from plan design features or additional products aimed at income creation. Recordkeepers, asset managers, and insurance companies are developing new creative solutions to expand the options that are available today. As with most plan sponsor decisions, there is not a "one size fits all" answer; each solution carries its benefits and shortcomings.

In general, there are five key areas to consider when evaluating income solutions:

1. Income Yield – How much income will be produced?
2. Income Duration – Are payments guaranteed to last throughout a participant's lifetime?
3. Income Volatility - Will the income received vary from month to month, year to year?
4. Asset Liquidity – Will participants retain access to their nest egg throughout retirement?
5. Portability – As a plan sponsor, can you move this solution to a new recordkeeper?

While availability of solutions can be vendor-dependent, generally the marketplace has adopted the following solutions:

Systematic Withdrawals – This allows participants to elect scheduled, recurring partial withdrawals from their plan. Most solutions allow for a specified dollar amount to be withdrawn monthly, quarterly, or yearly. While this solution does allow for full asset liquidity and participant control, it does not guarantee asset preservation, income duration, or yield. Participants also must decide the appropriate amount to withdraw to not outlive their nest egg, placing more burden on them.

Managed Payout Products – Asset managers are developing investment products that have built-in distribution components. For example, an investment might annually distribute 5% of the last five-year average Net Asset Value (NAV) to participants. Depending on the solution, Managed Payout Products may allow for full asset liquidity while providing professional management of retirement assets and a distribution strategy aimed to provide income for a full retirement. Currently these products are still in their infancy.

Managed Accounts – The same advice providers that offer managed investment accounts for participants during their accumulation years are now offering distribution advice and managed payout structures that are aimed at providing income throughout retirement. These solutions can also be built into your default investment option, thereby defaulting retiring participants into a solution that provides income. There are additional costs to participants for these services that must be considered.

Annuities – While annuities have been widely available in 403(b) plans for years, their adoption in 401(k) plans has been much slower. Many sponsors have concerns over potentially high fees, little or no portability, and no asset liquidity for participants once they annuitize. In addition, there has been little guidance from the DOL as to how to appropriately select and monitor annuity providers, although proposed legislation is aimed to correct this. Annuities do prevail in providing high income yield, guaranteeing duration of income for the remainder of an annuitant's lifetime, and negating any volatility in income throughout retirement.

Plan sponsors considering the transition from a retirement savings plan to a retirement income plan should conduct a prudent and documented analysis of the options available to them. Regardless of the solution(s) selected, a robust communication and education plan will be necessary to inform participants of the new options available to them and potential benefits of remaining in the plan.

To learn more about how to incorporate income solutions into your company's DC plan, contact your FIA consultant.

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For More Information Please Contact:

Scott Boulton
Consultant
Fiduciary Investment Advisors, LLC
100 Northfield Drive
Windsor, CT 06095
Direct: (860) 697-7418
Email: sboulton@fiallc.com