

Research Paper

A Primer on In-Plan Retirement Income

A 101 of the current in-plan retirement income landscape

by Sean McCaffery, Research Analyst – Global Public Markets

June 2021

Key Observations

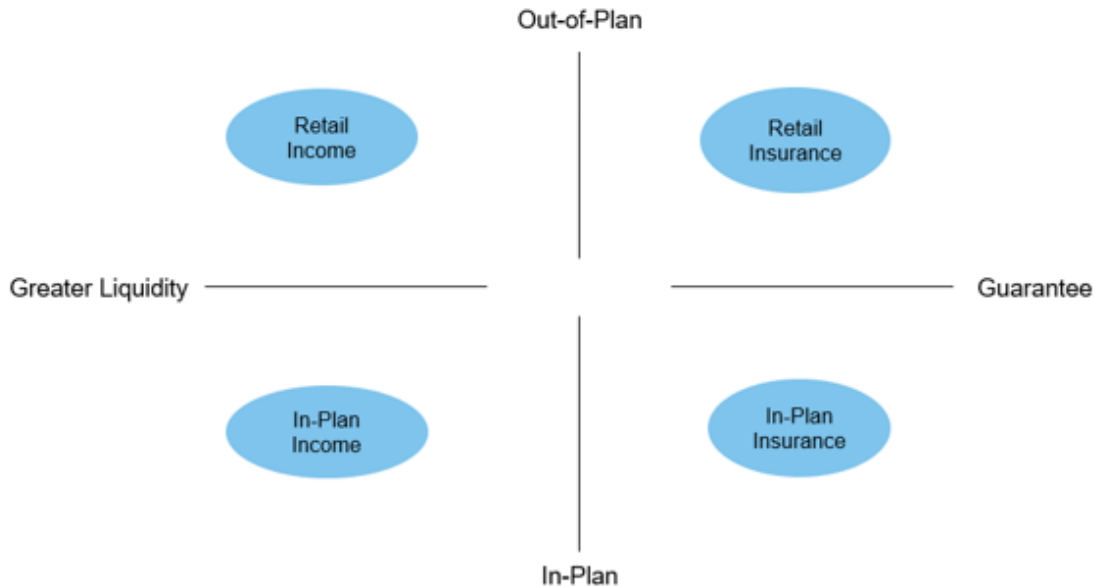
- *Plan Sponsors and advisors historically assisted participants in the accumulation phase of retirement planning. More recently, greater attention is being placed on the decumulation phase. According to the U.S. Census Bureau, “The 65-and-older population grew by over a third (34.2 percent or 13,787,044) during the past decade [2010-2019].”*
- *Participants are more reliant on their defined contribution assets than ever before and are beginning to look to their plans for solutions on the decumulation side of retirement.*
- *Various structures of retirement income solutions exist today with varying degrees of trade-offs. Education is crucial for both Plan Sponsors and participants, and likely no single solution is right for all participants.*
- *While many retirement income solutions have been available for decades, some solutions have only recently come to market with even more in the pipeline to come to market over the coming years.*

“Retirement Income” is a buzz phrase within the defined contribution (DC) landscape as decades of talk around retirement income is turning to action as pensions continue their secular decline and aging DC participants are nearing retirement. This paper offers a framework to organize the different products available, primary considerations for Plan Sponsors and key trends including new products and education.

This report is intended for the exclusive use of clients or prospective clients of Fiducient Advisors. The information contained herein is intended for the recipient, is confidential and may not be disseminated or distributed to any other person without prior approval of Fiducient Advisors. Any dissemination or distribution is strictly prohibited. Information has been obtained from a variety of sources believed to be reliable though not independently verified. Any forecasts represent future expectations and actual returns, volatilities and correlations will differ from forecasts. This report does not represent a specific investment recommendation. Please consult with your advisor, attorney and accountant, as appropriate, regarding specific advice. Past performance does not indicate future performance and there is a possibility of a loss.

Framing Retirement Income

Retirees can seek to replace pre-retirement income in a myriad of ways. We organized the retirement income landscape into a two-dimensional framework; in versus out of plan and guaranteed versus greater liquidity. We focus on the in-plan retirement income solutions and the key considerations for Plan Sponsors to know.



In-Plan Retirement Income Solutions

In-plan and liquid solutions are comprised of investments commonly found in lineups today and up and comers such as target date funds with decumulation offerings, risk-based funds, managed accounts with decumulation offerings and managed payout funds. These solutions also share a common trait as a “do it for me” offering in which participants may lack the time, interest or knowledge to make investment decisions on their own and would prefer professional guidance.

Managed payout products offer participants various forms of systematic income. Some investments pay a fixed percentage of assets, others a varied withdrawal rate, or even a dynamic spend similar to an endowment model in which spending is based on recent returns of the portfolio. In addition, some managed accounts and target date investments have begun to incorporate decumulation tools so participants can withdraw capital from a familiar and existing investment already in the plan.

On the spectrum of retirement income solutions, these types of investments provide participants with the greatest flexibility, portability and are more often understood by participants. However, like any retirement income solution, they still require necessary education and tools to assist with proper usage. Fees are generally competitive relative to other in-plan solutions but can vary by investment and structure. The most common drawback relative to other in-

plan solutions is the lack of a guarantee. With the secular decline of pension plans and the potential concerns of changes to social security benefits, many retirees are seeking stability and guarantee to replace these once common sources of income.

In-Plan Retirement Income Insurance Solutions

The word “annuity” has caused heartburn for many Plan Sponsors based on complexity, administrative burden and lack of familiarity. However, as Plan Sponsors continue to ponder solutions meant to fulfill the needs of their current and former employees, many have given annuities additional consideration. In-plan annuities are not a new phenomenon nor are they one size fits all. Additional products include:

- Immediate Annuities
- Deferred Annuities such as Qualified Longevity Annuity Contracts (QLACs)
- Guaranteed Minimum Withdrawal Benefits (GMWBs)

There are several benefits and drawbacks to these structures, some being more apparent than others. The ability to have a guaranteed income stream, such as with social security or a pension, is clearly an attractive attribute, as is the potential modeling aspect when incorporated into target date or managed account solutions. These solutions may also reduce market volatility for participants and have the potential to provide excess returns relative to fixed income. However, these benefits come with some additional considerations.

The complexity of these solutions for participants and Plan Sponsors is an important hurdle to consider. For Plan Sponsors, offering in-plan annuities may influence other plan level decisions such as plan level liquidity with a vendor or insurer. In-plan annuities may also carry additional administrative demands such as plan documentation, features offered within the plan and leveraging vendors based on the plan size and needs.

For participants, the intricacies of these solutions can be equally complex. Decisions such as when to purchase an annuity, the amount and how it fits within their broader sources of retirement income can be difficult to understand. Lack of liquidity is another common consideration. Participants may be unable to exit the investments under certain scenarios in which they have annuitized or, by contrast, exit the investment with penalty. It is also important to note that once a participant annuitizes, their assets become the property of the insurance company, and the participant’s only claim is on the income stream from that annuity. Other solutions, such as GMWBs, might allow for principal to be returned if a participant changes their mind or passes away, but there are other tradeoffs with these solutions including the fees (which contractually can increase to even higher levels than advertised), portability and complexity.

Given the complexity of these solutions there are multiple considerations for Plan Sponsors:

- Is there a need and demand from the participant base?

- What is the influence on the overall plan level decisions and does it impact who is selected as the recordkeeper?
- What is the overall influence on the investment menu and plan design?
- Do we have the correct support and partnerships available for educating our committee and our participants?

Retirement Income Structures

| | Systematic Withdrawal Program | Managed Payout Fund | Managed Account | Bond Ladder | Guaranteed Lifetime Withdrawal Benefit | Single Premium Immediate Annuity | Qualified Longevity Annuity Contract (QLAC) |
|--|---|---|--|--|---|--|---|
| General description | Withdrawals made from an account on a preset schedule where the individual can have the ability to determine the amount to withdraw | Designed to provide equal, periodic payments based on a percentage of the assets (e.g., 4%) | Personalized asset allocation based on user/adviser provided data (i.e., age, current assets, savings rates, risk preferences, etc.) | A portfolio of fixed-income securities where each security has a set maturity date. The laddering effect generates a stream of income as each security matures | A rider often attached to an annuity (typically a variable annuity) that guarantees a level of income regardless of market volatility | Provides a stream of lifetime income in exchange for a single purchase amount. Payments generally start within 30 days of purchase | Provides a stream of lifetime income in exchange for a single purchase amount. Payments typically start at a later age (e.g., age 85) |
| Duration of income payments | Design dependent, but payments typically end when assets are depleted | Design dependent, but payments typically end when assets are depleted | Design dependent; guarantees may be available if annuities offered as investment option within line-up | Payments typically end once the last security matures. Bond ladders can range from 5-30 years | Lifetime | Lifetime | Lifetime |
| Guarantee of income payments | Design dependent; generally not guaranteed | Design dependent; generally not guaranteed | If annuities available, guaranteed by insurance company | Design dependent; generally not guaranteed | Guaranteed by insurance company | Guaranteed by insurance company | Guaranteed by insurance company |
| Preservation of purchasing power / Potential to take advantage of market appreciation | Design dependent / Can provide opportunity to benefit from market appreciation | Design dependent / Can provide opportunity to benefit from market appreciation | Design dependent / Can provide opportunity to benefit from market appreciation | Design dependent, but typically only offers a level income payment / Limited ability to benefit from market appreciation | Potential for ratchet based on market value can provide opportunity to preserve purchasing power | Usually none, but COLA options may be available / No ability for market adjustments | Usually none, but COLA options may be available / No ability for market adjustments |
| Liquidity | Yes | Yes | Yes, if annuities offered, depending on type, that portion may be illiquid | Yes | Yes, but lose guarantee | No | Only upon death before payment inception (election of this option may provide for a reduced income benefit) |
| Legacy | Potential for yes | Potential for yes | Potential for yes | Potential for yes | Potential for yes | No, but benefit from chosen may allow for continuation of payments | Potential for yes |

Source: T. Rowe Price

Education

Regardless of a liquid or guaranteed retirement income solution, education is vital to both Plan Sponsors as fiduciaries tasked with prudent selection and monitoring and participants seeking a stable retirement. A strong partnership with vendors to provide communication and education at both the committee and participant level is an important component to success.

For Plan Sponsors, some retirement income solutions provide on-going communications or a dashboard for committees to evaluate utilization rates and which demographics of their participant base might be using or not using the available solutions.

Beyond specific retirement solutions, many recordkeepers also offer tools and education surrounding retirement income for participants. While many have an online platform, some also utilize spending and social security tools, calculators, social media, in-person sessions and call center representatives. We believe the focus on education in the accumulation phase should continue through decumulation to help participants retire soundly. Education is significant within retirement income, as it has the potential to differentiate providers that offer superior solutions.

Closing Thoughts

Plan Sponsors have a number of responsibilities when it comes to their participants being adequately prepared to retire. In the past few decades we witnessed a transition from defined benefit pension plans to defined contribution retirement plans, placing the majority of the responsibility onto participants. With this transition, Plan Sponsors are now tasked with the decumulation side of retirement planning for participants. While this is a facet of retirement planning in which participants have expressed their desire for in-plan solutions, it is not a decision Plan Sponsors or participants should take lightly.

While the retirement income landscape may seem difficult to navigate, it is important to recognize that we are potentially in the infancy stage of in-plan retirement income solutions. We continue to receive further guidance from the DOL, IRS and other regulatory authorities. While some Plan Sponsors might find a current solution or combination of multiple solutions that suffice, others might continue to survey and monitor the space as products develop. It is important for Plan Sponsors to be aware of the retirement income landscape, various structures that exist, and if a product is chosen, to properly document the decision-making process as part of their governance procedures.

As mentioned at the onset of this paper, consultants and advisors historically assisted Plan Sponsors and participants in the accumulation phase of retirement planning, however, due to changing participant demographics and the increased interest in retirement income products and services, it has become increasingly important for Plan Sponsors to engage with their consultants on the decumulation aspect of their retirement program. While in this paper we attempt to simplify the retirement income structures currently available, it is a complex marketplace that is ever changing with new solutions coming to market frequently. It is also important to evaluate other factors such as a recordkeeper's ability to integrate a product, portability (can the product be transferred between recordkeepers), implications to plan design or administration, as well as, how to develop an education program focusing on retirement income considerations. The professionals at Fiducient Advisors can assist fiduciary committees in the exploration of the retirement income landscape including products, services and tools.

For more information, please contact the professionals at Fiducient Advisors.

About the Author



As a member of the Global Public Markets Team, Sean researches and performs operational due diligence on core investment managers. He joined Fiduciary Investment Advisors LLC in 2014, which combined with Fiducient Advisors in 2020. Sean received his MBA from the University of Hartford and BS from the University of Connecticut School of Business. His personal interests include skiing, fishing and golf.

Sean McCaffery

Research Analyst – Global Public Markets