White paper

A new role for DC Plans: Income for life

What is the mark of a successful retirement plan? While measures vary based on individual needs and circumstances, one metric is universal: A retirement plan should help employees generate adequate income for life in retirement.

Can the three-legged retirement stool hold up?

The traditional metaphor for American retirement planning was the three-legged stool. Two legs—Social Security and traditional defined benefit (DB) or pension plans—provided guaranteed retirement income. The third leg, defined contribution (DC) plans and other personal savings, would supplement that guaranteed income.

But times have changed. Outside of the public sector, very few workers have access to DB plans. And Social Security may face changes in the future due to financial pressures from both budget constraints and longer life expectancies.

As a result, Americans must now increasingly turn to their DC plans to fund much of their retirement. The problem is DC plans were designed as supplemental accounts—not as primary sources of income. It's time to rethink this role and help ensure that employees have the investment options and solutions they need to save for retirement and turn those savings into income for life.

Traditional retirement income sources under pressure

Uncertainty about future Social Security benefits abounds

Only 37% of Americans are confident that Social Security will provide the same level of current benefits to future retirees.[1]

Retirement income for life

Social Security Pension (DB) plans

DC plans & personal Pension savings

DC plans are the primary retirement savings vehicle for most Americans

58% have access to a DC plan while only 27% are covered by a DB plan.[2]

A new role for DC plans

The new role of DC retirement plans is to help ensure that people have the income they need throughout retirement. This includes replacing income traditionally provided by DB plans and trying to make up for any unanticipated shortfall in what Social Security provides. Fulfilling that mandate will require a new approach to retirement savings—a partnership between workers, employers, and plan providers to generate guaranteed retirement income through DC plans.

Why are guaranteed income options important?

Employers are concerned about employee retirement readiness[3]

64% of employers worry that employees will delay retirement because they do not have enough money

59% are concerned that their employees will run out of money in retirement

73% of Americans are looking for certainty[4]

49% with an employer-sponsored retirement plan think its primary goal should be to provide guaranteed money every month to cover living expenses in retirement

24% believe their plan's goal is to ensure that their savings will be safe, regardless of market conditions

Planning for 4 key risks

Employer and employee concerns are a call to action for plan sponsors and providers to work together to position all elements of a DC plan toward generating income for life. This includes offering lifetime income solutions to help your employees protect against and reduce the impact of four key risks.

Market risk is always present with investments and market crashes or recessions may cause significant portfolio losses that can't be diversified away. These losses could force pre-retirees to postpone retirement and retirees could experience significant income declines.

Interest rate risk is of particular concern to people near or in retirement, as they typically shift assets toward fixed income investments to reduce risk. However, it's important to understand that as interest rates rise, fixed income values fall and can reduce an individual's original investment and erode the value of their portfolio.

Longer retirements:

Today, a 65-year-old couple has an 84 percent chance of at least one spouse living to age 85, and a 14 percent chance of one partner living to age 100.[5]

Longevity risk arises from Americans living longer. The challenge is that people can figure out how much money they have saved for retirement, but they don't know how long they will live or how much they can safely spend. Living longer also raises the chances of individuals outliving their income.

Cognitive risk poses a challenge for people as they age and have trouble remembering, learning new things, concentrating, or making decisions that affect their everyday life. The loss or decline of these abilities may affect peoples' ability to make financial and other important decisions, including how to generate retirement income streams.

Focusing on retirement income

How can plan sponsors, consultants and plan providers work together to develop retirement plan offerings that help reduce these risks? Here are three actions to consider:

1. **Make retirement income the goal.** While most savers like to see their account balances grow, a better target for retirement savers is how much income they'll need in retirement. Planning decades into the future is an inexact science, but metrics such as income replacement ratios can help your employees gauge their future needs and track their progress. With this in mind, you may want to consider reviewing your plan design to help ensure it's aligned with your plan's income replacement goals.

2. **Offer a diverse investment menu that offers both growth potential and lifetime income.** Participants who take an active role in their retirement planning can benefit from a diverse investment menu that offers access to lifetime income options available through fixed and variable annuities.[6] Participants who are less involved may benefit from having a default investment option that provides a lifetime income component.

   This is especially true for the more than one-third of Americans who expect a target-date fund (TDF)—the most common default option—to provide a guaranteed monthly income check for the length of their retirement.[7] That isn't what TDFs provide. The principal value of a TDF is not guaranteed at any time, including at the target date. Including lifetime income options as part of a default investment option can help participants generate income streams they can't outlive.

3. **Encourage participants to access education and advice.** You're not alone if you find engaging employees in their retirement plan is a significant challenge: Seventy-one percent of not-for-profit plan sponsors feel the same way.[8]

   But, participant research shows that providing professional advice may encourage participants to act. Almost half of participants receiving TIAA's retirement plan advice either online or by working with a consultant chose to save more, adjust their portfolio allocation or rebalance.[9] The key is letting employees know they have access to advice through their plan whether they have $500 or $5 million.

Working together to pursue income for life

You can work together with your plan consultant or provider to help ensure that your retirement plan is focused on generating lifetime income for your employees. If you'd like more information about managing the retirement income risks outlined above and aligning your plan with income for life as the goal, contact your relationship manager, or call the Administrator Telephone Center at **888-842-7782**. If you don't currently work with TIAA, call **844-NEW-TIAA**.

1. EBRI Issue Brief No. 431, The 2017 Retirement Confidence Survey: Many Workers Lack Retirement Confidence and Feel Stressed About Retirement Preparations, March 21, 2017.
2. Bureau of Labor Statistics: https://www.bls.gov/ncs/ebs/benefits/2016/benefits_retirement.htm
3. 2017 NFP Plan Sponsor Insights Survey by TIAA
4. TIAA 2016 Lifetime Income Survey
5. Based on 2016 TIAA dividend mortality tables
6. Annuities are designed for retirement and other long-term goals. They offer several payment options, including lifetime income. Guarantees are based on the claims-paying ability of the issuer. However payments from variable annuities are not guaranteed and the payment amounts will rise or fall depending on investment returns. If you choose to invest in the variable investment products, your money will also be subject to the risks associated with investing in securities, including loss of principal. Withdrawals of earnings from an annuity are subject to ordinary income tax plus a possible federal 10% penalty if you make a withdrawal before age 59 ½.
7. TIAA 2016 Lifetime Income Survey
8. 2017 Not-for-Profit Plan Sponsor Insights Survey by TIAA
9. TIAA advice analysis of 176,279 TIAA participants who received retirement plan advice online or working with a consultant and took action in the 12 months ending 8/30/16. The overall action rate of 48% included 11% who chose to save more, 32% changed their future allocations and 31.5% rebalanced their portfolio.

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