Plan Sponsor Challenges Series

Part 3: Helping your employees make the right choices for lifetime retirement income

The first two articles in our Plan Sponsor Challenges Series addressed the importance of a well-designed investment menu and of an education program focused on engaging employees with relevant information.

This article focuses on what we believe is the objective that should underlie both those aspects of plan management — and, in fact, all your decisions about how you structure and manage your plan. That objective is retirement readiness, leading to lifelong financial security and well-being.

The objective that matters most

As defined benefit plans continue to give way to defined contribution plans, sponsors have focused largely on maximizing savings accumulation, with less attention — if any — given to addressing income needs in retirement.

But savings growth alone can't ensure retirement security, which should be the primary objective of your retirement plan. The fact is, many participants simply can't save enough, or are at risk of market losses with too little time left to recover. A retirement readiness simulation by the Employee Benefit Research Institute found that, among early baby boomers, 47% were at risk of not having enough money for retirement.[1]

Participants themselves are beginning to recognize the importance of a guaranteed stream of lifetime retirement income. Research indicates that 72% of participants surveyed are interested in contributing to an investment option within their 401(k), 403(b) or 457 plan that, instead of accumulating asset balances, focuses on generating a guaranteed monthly income in retirement.[2]

So the question for plan sponsors is: How do I design and manage a plan to satisfy my fiduciary responsibilities, while at the same time making it easy for employees to participate and make investment choices that provide guaranteed income to help them achieve lifetime financial security?

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[1] *The EBRI Retirement Readiness Rating: Retirement Income Preparation and Future Prospects,* EBRI Issue Brief No. 344, July 2010.

[2] Retirement Research, Inc. (conducted by Brightwork Partners), 2011.

Help employees keep their feet on the "floor"

Most plan investment options don't address the retirement income gap — the shortfall between what people can expect to receive from Social Security and what they will actually need to meet basic living expenses in retirement. One solution is to give employees a way to carve out a portion of their portfolio for a guaranteed income product that, when combined with Social Security, will create a guaranteed income floor in retirement.

By income floor, we mean a level of guaranteed income that's adequate to pay for basic needs in retirement — food, shelter, clothing, healthcare and other non-discretionary items — no matter how the markets perform or how long you live.

An investment menu focused on savings *and* lifetime income

In a world of vanishing pensions, uncertainty around Social Security and Medicare, and increasing healthcare costs, retirement readiness depends more than ever on the choices participants make from the investments offered in the retirement plan. To make sure your menu addresses both asset accumulation and lifetime income, you must consider investments beyond mutual funds.

As noted in **Part 1** of our Plan Sponsor Challenges Series, you should work with your provider to offer a menu of diversified choices appropriate for all employees. An open architecture that includes quality mutual funds, a wide variety of asset classes, flexible allocation solutions and proven lifetime income products has been a proven strategy for building savings and generating lifetime income.

In keeping with your desire to meet all employees' needs — that is, the 80% who require a simple menu and the 20% who want a variety of choice so they can build their own portfolios — a tiered approach can provide a solution.

Generally, one tier offers "one-decision" investments (often target date funds). Another offers an open architecture that lets participants design their own portfolios. A third tier offers lifetime income options such as guaranteed and variable annuities. And a fourth tier offers a brokerage option providing access to thousands of mutual funds and individual securities for those seeking maximum choice.

The tiered approach has several benefits. It can improve participation and the likelihood of successful outcomes by making it easier for participants to choose investment options that fit their unique needs and preferences. Just as important, a tiered structure is an ideal way to include annuities that provide lifetime income options — choices that can help employees replace their preretirement salaries with reliable income after retirement.

Income and where to get it

Given the growing importance of lifetime income to retirees, you should make sure your plan includes the services and investments designed to generate it. The most common options for producing income include traditional annuities, guaranteed minimum withdrawal benefit (GMWB) features, longevity insurance, managed payout and retirement income mutual funds, and managed retirement income accounts. A fixed-income annuity is one of the best ways to guarantee income for life.

The "pension" that didn't disappear

Properly allocating assets to a fixed annuity in a diverse portfolio can provide defined contribution plan participants some of the same security offered by a traditional pension. Plan sponsors should encourage participants to carve out this allocation to an annuity before turning to other retirement spending or investment needs. Because if they don't take care of the basic needs first, then achieving the rest of their retirement goals will be that much harder.

An appropriate allocation to a fixed annuity can support both goals of a retirement plan: savings accumulation and guaranteed income. That's because a fixed annuity guarantees the safety of all contributions made to the account. It also pays a guaranteed minimum interest rate, and, depending on the specific annuity, may offer additional amounts of interest that are not guaranteed but may be periodically declared by the issuer. Note that any guarantees are subject to the claims-paying ability of the issuing company.

Remember, too, that while fixed annuities offer steady, stable returns, they are not an investment product like a mutual fund or variable annuity. Rather, they are guaranteed insurance contracts whose ultimate goal is to help meet long-term income needs in retirement. They should not be treated as a short-term asset or a substitute for bond funds, money markets or other investments.

Coming soon
Part 4 in our Plan Sponsor Challenges Series: Considering the move to sole recordkeeping

Take action to meet the challenge

Consider the benefits of offering annuities that provide lifetime income options. Participants benefit from the guaranteed income, steady reliable performance over time, and enhanced portfolio diversification fixed annuities can provide. At the same time, plan sponsors with a fiduciary responsibility to support positive outcomes also benefit. They can be confident they're offering employees a practical solution that can help reduce investment risk and improve retirement readiness. And, as we've seen, that's the outcome that matters the most for any employer-sponsored retirement plan.

Visit tiaa-cref.org for more information on how plan sponsors and fiduciaries can address the challenges they face.

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