Income diversification: A strategy for pursuing better retirement outcomes

Helping employees "to and through retirement" is a foundational objective of an employer-sponsored retirement plan. The "to" part is what employees have heard all along: Contribute to the plan, diversify across asset classes, and review/rebalance over time. But what about the "through" part? Retirement security requires more than just accumulating savings—people also need protection against outliving their assets.

You can strengthen your organization's retirement plan and help achieve better outcomes by including options designed to create lasting income in retirement. After all, a diversified *retirement income* portfolio is just as important as a diversified savings portfolio.

An approach to building employee confidence is to offer in-plan fixed and variable lifetime income options designed to work together to help mitigate the risks that can erode retirement savings.

In-plan menu options designed for both savings and income fortify a comprehensive diversified strategy

Today's workers may be in retirement for decades, and yet:

- Only 39% have estimated how much income they would need each month in retirement.[1]
- Only 23% say they are "very confident" about having enough money for a comfortable retirement.[1]

Consider an approach to help build employee confidence—and your ability to better manage your workforce. You can add fixed and variable annuities to your plan's menu to offer opportunities for both saving and lifetime income. Fixed and variable annuities can work together to help reduce the risks that can erode retirement savings, such as market volatility, inflation and outliving assets. Often available at a much lower cost than retail alternatives, in-plan annuities make it possible to accumulate savings through regular contributions. Later, they help fortify a diversified retirement income plan by allowing employees to convert their savings into income that never runs out.[2]

A combination of options helps diversify retirement income

A strategy of using fixed and variable annuities for lifetime income along with other investment withdrawal options can promote potential growth and sustainable income during a long retirement. Such a strategy also addresses the concerns many retirees face.

Consider how inflation can affect a retiree's income. Social Security benefits and some pensions may help retirees fight off inflation through annual cost-of-living adjustments. In-plan variable annuities complement these with their potential to provide increased income during favorable market periods. Of course, payments from variable annuities can decrease in down markets.

Living longer, market volatility, and cognitive decline can also significantly impact retirement savings and income. A portfolio diversified with fixed and variable annuities helps mitigate the downside of these risks. While each source of income is inherently risky, combining them can help manage the risk of each. A withdrawal strategy using different types of investments can mean receiving regular monthly "paychecks" in retirement as well as potentially more income.

Diversification to help manage risks can help give employees the confidence they want as they pursue their retirement goals.

Market risk
The stock market dropped more than **50%** through 2008–2009.[3]

Longevity risk
The average time spent in retirement is **19 years** for men, **21 years** for women.[4]

Cognitive risk
5.8 million Americans are living with Alzheimer's disease.[5]

Inflation risk
A big-ticket item that costs **$1,000** today will cost more than **$2,100** in 30 years.[6]

A diversified income strategy can help address the concerns employees face in retirement.

	Guaranteed income payments (fixed annuity)	Lifetime income payments (variable annuity)	Investment portfolio withdrawals
Market risk	■		
Interest rate risk	■		
Longevity risk	■	■	
Cognitive risk	■	■	
Inflation risk		■	■
Liquidity in retirement	With partial annuitization, access to some assets		■
Opportunity to leave an estate	With partial annuitization, potential for larger estate		■
Opportunity to preserve assets	Partial annuity with a guaranteed period		■

Any guarantees under annuities issued by TIAA are subject to TIAA's claims-paying ability. Payments from variable accounts will rise or fall based on investment performance.

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With the dependability of receiving lifetime income from annuities, retirees may choose to be more aggressive with other parts of their portfolios. Less concern about the risk of market volatility can mean greater confidence that they can help meet their everyday expenses with income that lasts a lifetime.

The value of a diversified retirement income strategy

Employees can create a diversified income strategy by combining different types of income.

Fixed annuity income payments + **Variable annuity income payments** + **Investment portfolio withdrawals** = **Diversified income plan for life**

Fixed annuity income payments

- Guaranteed lifetime income
- Payment amounts guaranteed

Variable annuity income payments

- Payments guaranteed for life
- Payment amounts may fluctuate with market performance
- Access to professional management

Investment portfolio withdrawals

- Post-retirement liquidity
- Access to professional management

Diversified income plan for life

- Guaranteed income that never runs out
- Growth potential
- Access to professional management
- Post-retirement liquidity
- Bigger legacy potential than a typical withdrawal strategy

Guarantees are based on the claims-paying ability of Teachers Insurance and Annuity Association of America.

- **Fixed annuities** offer growth while employees are saving, with a minimum guaranteed crediting rate regardless of market performance. In retirement, they can use fixed annuities for dependable income that never runs out. Employees typically can rely on this guaranteed income to help with everyday necessities.
- **Variable annuities** bring together the power of diversified investing with regular income payments during retirement. Even while retirees are taking income, variable annuities remain invested across their specific asset classes, strategies, styles, and sectors to potentially grow and help weather inflation and other risks. Because variable annuities adjust with market performance, the amount of a given payment may increase or decrease.

Case study
Income from a mix of fixed and variable annuities as well as investment portfolio withdrawals may improve outcomes

Below is a hypothetical illustration of how a diversified income strategy can help improve retirement readiness. This example is not intended to predict or project performance of any account. Actual returns will vary.

David is 68 years old	
Financial goals in retirement	▪ Income stability to meet his essential costs ▪ Income growth potential to maintain his lifestyle and help his family ▪ Retirement income for the rest of his life ▪ Opportunity to leave a legacy for his family
Amount saved	▪ $750,000
Preretirement annual income	▪ $80,000
Annual retirement income goal	▪ $60,000 (75% of preretirement income)
Annual income from Social Security and pensions	▪ $24,000

After receiving $24,000 from Social Security and pensions, David needs to generate $36,000 a year to meet his annual retirement income goal of $60,000.

Scenario 1:
Using typical 4% withdrawals from investments along with Social Security/pensions

Using the industry rule-of-thumb 4% systematic withdrawal rate, David's savings of $750,000 would generate $30,000 each year. To achieve his goal of $60,000, he needs to generate $36,000, in addition to his $24,000 income from Social Security and pensions. This income strategy leaves him with an annual shortfall of $6,000.

In a scenario of using 4% withdrawals alone, David would need to have saved $150,000 more to achieve his income goal—$900,000 vs. the $750,000 he has today. In this case, David not only can't meet his retirement income needs, but he also won't have the benefit of guaranteed income payments that protect his savings from market volatility, steady lifetime income that helps keep up with rising costs, and the confidence of knowing he won't outlive his savings.

Withdrawal amount base		Payout rate	Savings required
$60,000 - $24,000 =	$36,000	4%	$900,000
	$30,000	4%	$750,000
Annual income shortfall:	**$6,000**		**Total savings shortfall: $150,000**

Scenario 2:
Adding annuity income to investment portfolio withdrawals and income from Social Security/pensions

In this hypothetical example, David fares much better by complementing his retirement income portfolio with fixed and variable annuities. David still has an annual income goal of $60,000.

He generates one-third of his income needs by using the typical 4% systematic withdrawal rate from his investments. But now he generates the remaining two-thirds using fixed and variable annuities that will give him lifetime income along with Social Security and pensions.

He selects a portion of what he's accumulated in his variable annuity ($112,500) and fixed annuity ($119,000), and receives $8,000 in annual lifetime income payments from each. Now David has $16,000 in income from his annuities and $24,000 from Social Security and pensions—half of his income goal.

To receive the remaining $20,000 to achieve his goal, David needs to use only $500,000 for his 4% systematic withdrawals.

A diversified income plan combining fixed and variable annuities allows David to meet his income goal and have money left over, vs. a typical 4% systematic withdrawal plan.

Withdrawal amount base		Assets
2/3 using Social Security, pensions and lifetime income annuities		
$60,000 x 2/3 =	$40,000	
Less amount from Social Security and pensions	– $24,000	
Amount remaining to annuitize	$16,000	
▪ ½ variable annuities	$8,000	$112,500
▪ ½ fixed annuity	$8,000	$119,000
1/3 using 4% systematic withdrawals		
$60,000 x 1/3 =	$20,000	$500,000
Total savings required:		**$731,500**

Desired income uses an inflation rate using Consumer Price Index (Urban) data from the Bureau of Labor Statistics. This case study assumes a combination of a variable annuity using actual CREF Stock history, a pure fixed annuity, and a withdrawal account with a 60/40 equity/fixed portfolio. Variable annuity assumes a CREF Stock Account payout rate of 7.11%, which was the 2018 payout rate, no matter which share class the money was in before retirement. Fixed annuity assumes a TIAA Traditional payout rate of 6.77% based on the 2018 TIAA new money rates of October 2018. This rate applies to all new settlements and is the same for all accumulating contracts. Income rates based on a Single Life Annuity with 10 years guaranteed, issued at age 68. The pure withdrawal strategy is a 60/40 equity/fixed portfolio. Equities assume historical CREF Stock performance; the fixed component is based on historical Ibbotson bond data with a 70/30 government/corporate mix. This hypothetical illustration is not intended to predict or project returns. Actual results will vary.

In Scenario 2, David has enough assets saved to meet his $60,000 retirement income goal—and has $18,500 remaining to use in other ways, such as the legacy he'd like to leave for his family. By annuitizing a portion of his fixed and variable annuities, he reduces the risk of depleting his retirement savings, has money for his family, and receives monthly income in retirement guaranteed to never run out.

Talk with TIAA today about how you can optimize your menu design with fixed and variable annuities to help improve outcomes and employees' confidence about retirement.

Visit TIAA.org/lifetimeincome or contact your TIAA representative.

Insight: A menu designed with fixed and variable annuities can help drive better outcomes

With the possibility that Social Security benefits may change, there is a greater need than ever for participants to have a diversified income plan or access to diversified investment options that can help promote retirement readiness and provide income that lasts a lifetime.

A diversified portfolio that includes lifetime income from fixed and variable annuities, available through the plan, can provide participants with more confidence, better outcomes, the ability to retire on time, and the reliability of having income for life.

As the example illustrated, the efficiency of realizing income goals by using annuities can potentially leave a retiree with more of their portfolio available for other pursuits. A retiree may choose to continue to invest that portion to provide a legacy to heirs.

Diversifying an income plan can also help provide protections against the risks retirees face, such as market fluctuations or outliving their savings.

In all, a retirement plan structure that includes in-plan annuities can help create the type of compelling benefits program you can use to better manage your workforce—from recruiting to retaining to retiring. Providing the resources that promote retirement readiness and the confidence of having income in retirement that never runs out can help employees retire on time and maintain their standard of living in retirement.

[1] Employee Benefit Research Institute, 2019 Retirement Confidence Survey, "2019 RCS Fact Sheet #3: Preparing for Retirement in America," April 2019.

[2] A periodic investment plan such as dollar-cost averaging does not assure a profit or protect against a loss in declining markets.

[3] The Balance, "Stock Market Crash of 2008," November 2018.

[4] Social Security Administration, "Calculators: Life Expectancy," June 2019.

[5] Alzheimer's Association, "2019 Alzheimer's Disease Facts and Figures," March 2019.

[6] Motley Fool, "3 Ways Inflation Affects Your Retirement Savings," March 2019.

Annuities are designed for retirement savings or for other long-term goals. They offer several payment options, including lifetime income. All guarantees, including lifetime income payments of fixed annuities, are based on the claims-paying ability of the issuer.

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