REAL RETIREMENT: Accumulation and Distribution

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Benefit Adequacy

There are three fundamental questions for participants in the pursuit of benefit adequacy.

- How much income will I need in retirement?
- How much do I need to save to reach that goal?
- How should I invest my 401(k) savings?

Determination of Benefit Adequacy

To answer those questions, participants need to know:

- How much will I have based on what I am doing?
- How much do I need based on reasonable assumptions?
- How do I make up the difference?

There is a changing perspective from account balance to retirement income.

Needed Levels of Deferrals

Percentage of Income a Participant Must Save Over 35 Years

	DC-Only Benefits Design		
	Plan A No Match	**Plan B** (3% Match)	**Plan C** (3% Match and 2% Profit Sharing)
Current Income			
$25,000	14%	11%	9%
$50,000	17%	14%	12%
$75,000	18%	15%	13%
$100,000	20%	17%	15%

Note: Based on 90% probability of achieving a 75% replacement ratio at retirement at age 65; full Social Security benefits at 67; a balanced investment strategy; and for the DB plan scenarios, a pension benefit at 65 equivalent to 22% of pre-retirement pay. High-income participants may be limited in their ability to achieve these savings rates through a qualified retirement plan. Source: The Vanguard Group, 2004.

Proposed Legislation on Retirement Income

"Under the proposal, defined contribution plans subject to ERISA would be required to include "annuity equivalents" on benefit statements provided to employees. An annuity equivalent would be the monthly annuity payment that would be made if the employee's total account balance were used to buy a life annuity that commenced payments at the plan's normal retirement age (generally 65)."

Description of S. 2832 from Office of Senator Bingaman.

Participant Investing

Recent Congressional and DOL activity has created a fiduciary safe harbor for defaults into “multi-asset class” investments (QDIAs), including target date and risk-based investments and managed accounts.

Explicit and implicit protection

Implicit expectations

Note: ERISA perspective on participant investing.

QDIA—Eligible Investments

To qualify for the fiduciary safe harbor for QDIAs, the investments must be based on generally accepted investment theories and be:

- age based (*e.g.*, target date funds);
- risk based (*e.g.*, lifestyle or balanced funds); or
- age-based managed accounts.

Safe Harbor Default Investment

Where are we going? The "safe harbor" investments are expanding the use of defaults:

- Traditional defaults
- Automatic enrollment defaults
- Conversion defaults
- Existing plans: re-enrollment
plan mergers

QDIAs with Insurance Features

“An investment fund product or model portfolio that otherwise meets the requirements of this section. . .” qualifies . . .

. . . without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment fund product or model portfolio.”

DOL final regulation on Qualified Default Investment Alternatives.

Disclosure: DOL Activity

- DOL activity:

  --Point-of-sale disclosure to fiduciaries for advisers and providers (408(b)(2) project).

  --Revisions to Form 5500, Schedule C (report).

  --Changes to 404(a) regulation (participants)

Shifting responsibility to 401(k) industry.

Disclosures—Where are we going?

The future holds:

- Written service arrangements or agreements
- Which describe:
  - services
  - compensation—direct and indirect
  - conflicts of interest

The Distribution Dilemma

The concern is two-fold:

- Will they have enough money when they retire (benefit adequacy)?
- Will (or can) they withdraw it responsibly, so that they do not exhaust their 401(k) accounts or IRAs before they die (lifetime income)?

Note: RFI by Departments of Labor and Treasury.

Distributions

- Need for guaranteed income: Real people, real needs
- The 4% draw-down
- Life annuity option: 7%$\pm$
- Guaranteed withdrawal benefits
- Solutions: In-plan or outside-plan

Guaranteed Distributions

The concept of guaranteed withdrawal benefits <u>while participating</u>:

- benefit base
- account value

Guaranteed Income for Life

GMWB during retirement:

- guaranteed income
- benefit base
- account value

The Relevant Facts

Based on our analysis of the issues and conversations with people in the industry, the following are the key facts and circumstances:

- The value of the features offered: *Is the cost reasonable in relation to the features offered?*

- The quality of the underlying investments.

continued . . .

The Relevant Facts

- Employee understanding: *Are the employees provided with the information needed to appropriately evaluate the guarantee?*

- Portability of guaranteed feature
  - *Is the guarantee transferable if the plan switches providers?*
  - *Is the guarantee transferable to an IRA?*

- Financial viability of the provider
  - *Is it prudent to select the insurance company?*
  - *DOL fiduciary safe harbor.*

Questions?

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