Ten Reasons Plan Sponsors Should Have A Guaranteed Retirement Income Benefit In Their Retirement Plan

Volume 1, Number 2

1) Plan sponsors should have a guaranteed retirement income option in their retirement plan to provide **certainty** regarding a minimum income amount that can be taken by participants during retirement**.**

Most Americans have no idea how much they can withdraw, each year, from their retirement plan without risking running out of money. Yet a recent survey indicated that this was of major concern to individuals as 61% of respondents indicated that they feared outliving their assets more than they feared death.[i] A guaranteed income benefit transfers that risk for a nominal fee and provides certainty of a minimum retirement income amount.

> "The lower cost of institutionally-priced benefits results in higher lifetime income."

2) Plan sponsors should have a guaranteed retirement income option in their retirement plan to provide **protection** against the impact of market fluctuation on retirement income.

According to The Center for Retirement Research, more than $2 trillion of 401(k) and IRA assets was lost during the one-year period ending October 9, 2008.[ii] Plan participants with a guaranteed income option had their retirement income protected from this significant market fluctuation.

3) Plan sponsors should have a guaranteed retirement income option in their retirement plan to provide guaranteed income at **lower cost** group rates instead of higher cost individual rates.

Similar guaranteed income benefits are available in individual, retail products. Unfortunately, these individual products often cost approximately twice what is charged for institutionally-offered benefits. The lower cost of institutionally-priced benefits results in higher lifetime income. For example, one researcher reports that the total cost of the top three providers of in DC plan guaranteed withdrawal benefits ranges from 1.43% to 1.61[iii] while the average cost for a similar benefit is about 3.32% in the retail market.[iv]

4) Plan sponsors should have a guaranteed retirement income option in their retirement plan to support a **larger income stream** in retirement.

Many retirement plan income options guarantee a minimum payout of 5% of a participant's highest previous anniversary balance. This is a 25% increase in payout from the 4% withdrawal rate generally accepted by most financial planners. Morningstar has researched varying withdrawal rates over every 25-year period back to 1926. They have determined that a 75% stock/25% bond portfolio with a 4% inflation-adjusted withdrawal rate is sustainable 94% of the time.[v] A 5% payout guaranteed income option both increases the initial payout by 25% and provides 100% certainty that it will happen. Further, the 5% benefit is a fixed minimum benefit that may increase (depending on the product) whereas the 4% withdrawal rate is designed to increase by the inflation rate each year.

5) Plan sponsors should have a guaranteed retirement income option in their retirement plan to provide a good long-term **hedge against the ravages of inflation** during retirement by enabling a larger portion of funds to be invested in the stock market.

Inflation at a 3% rate reduces the buying power of a retiree by 45% over 20 years. Inflation in the 1970's and 1980's was even higher at 7.8% and 5.1% respectively.[vi] Several quality providers of guaranteed income options provide the benefit of investing in portfolios of up to 60%-70% of equities. This investment allocation has tended to outpace inflation over time.

6) Plan sponsors should have a guaranteed retirement income option in their retirement plan to enable participants to have greater **confidence** when investing in equities.

Having a guaranteed income benefit can give participants the confidence to increase their exposure to the stock market and realize the higher returns that equities have traditionally provided over the long term compared to fixed income investing. Although older workers should plan on making their assets last for two or three decades of retirement, EBRI reports that 47% of 401(k) assets for participants in their sixties are held in bond, money market, or stable value investments.[vii]

7) Plan sponsors should have a guaranteed retirement income option in their retirement plan to allow participants to **lock in** a future, higher annual income payout, even during retirement.

The stock market cycles up and down over time. It is impossible to predict when a peak in the market cycle will occur. Many lifetime income options now offer the ability to capture a future market peak upon which to base a guaranteed amount of retirement income. Many 401(k) investors saw their equity holdings drop 50% or more during the 2007-2009 market collapse. Those unfortunate enough to retire during this period would have suffered a similar 50% or more permanent loss of lifetime income.

8) Plan sponsors should have a guaranteed retirement income option in their retirement plan to enable participants to **access funds** for emergencies or unscheduled payments.

Unlike guaranteed lifetime income payments from traditional DB pension plans, many newer DC retirement income options allow retirees to take a larger, unscheduled withdrawal. These "excess" withdrawals typically reduce future annual guaranteed withdrawal amounts, although some products may allow retirees to capture market gains in excess of 5% without reducing future guaranteed lifetime payment amounts.

"Having a guaranteed income benefit can give participants the confidence to increase their exposure to the stock market and realize the higher returns that equities have traditionally provided over the long term compared to fixed income investing."

9) Plan sponsors should have a guaranteed retirement income option in their retirement plan to enable participants to **exactly project** a minimum amount of income that they will receive in retirement as long as the projected contributions are made.

For example, some product offerings provide a guaranteed growth rate in the benefit base and therefore participants will know exactly what the minimum floor amount of income will be when they retire.

10) Plan sponsors should have a guaranteed retirement income option in their retirement plan because some products allow for the purchase of a deferred fixed income annuity which **maximizes guaranteed income** during retirement.

Unlike most guaranteed income options, a fixed income annuity transfers ownership of the participant's market value to the insurer at retirement. This transfer of ownership and the use of life annuity tables results in a maximization of income benefits, often in excess of 6% or more of the benefit base at age 65.

Endnotes:

---

[i] "Reclaiming the Future", page 6, Allianz, 2010
[ii] "Are Retirement Savings Too Exposed to Market Risk?", Issue Brief 8-16, The Center For Retirement Research at Boston College, October 2008.
[iii] "Retirement Income Market Overview: Where It's Been, Where It is Today and Where It Needs To Go", page 86, Retirement Research Inc., 2010.
[iv] Note that many guarantee fees for individual annuities are also charged on the higher benefit base as opposed to the market value, VARDS, 2Q 2010.
[v] Morningstar, Inc. 2008.
[vi] "Stocks, Bonds, Bills, and Inflation 2003 Yearbook", page 344, Ibbotson Associates, 2003.
[vii] EBRI Issue Brief #335, October 2009, page 26, Employee Benefit Research Council, 2009.

Institutional Retirement Income Council (IRIC)

As the burden of funding retirement has shifted from employer to employee, defined contribution plans, such as 401(k)s, have become the primary source of retirement savings for an increasing number of Americans. Yet DC plans were originally designed as supplemental retirement savings vehicles and were generally never intended to provide guaranteed lifetime income.

The mission of the Institutional Retirement Income Council (IRIC®) is to facilitate the culture shift of defined contribution plans from supplemental savings programs to programs that provide retirement security. By providing a forum for insightful, solutions-oriented thought leadership on institutional retirement income, IRIC is promoting the need for retirement income adequacy for defined contribution plan participants.

A membership-based organization, IRIC is supported by sponsors, and a panel of industry advisors, who are dedicated to sharing best practices, informing about legislative and regulatory issues and facilitating solutions for plan sponsors and their participants.

Contributing Writer:

Michael Preisz
President, Preisz Associates, Inc.

Michael has over three decades of financial consulting and private industry experience, bringing his clients a special blend of understanding problems and implementing solutions. He started his career with Deloitte, Haskins & Sells, Certified Public Accountants, and obtained his Certified Public Accountant certificate in 1976. Thereafter, for nine years, he worked as a Controller and Chief Financial Officer.

Changing his career direction, Michael has now spent another twenty five years as a Financial Advisor. During this time, he obtained his Chartered Life Underwriter (CLU), Certified Financial Planner™ (CFP®) and Chartered Financial Consultant® (ChFC®) professional designations and has registered his company, Preisz Associates, Inc., as an Independent Investment Advisor.

Michael Preisz focuses exclusively on qualified retirement plans and business and estate life insurance. He does not maintain a book of individual investment clients. Michael can be reached at michael@preisz.com.