Plan Sponsors and Retirement Income:

What's In It For Me?

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If you're in or around the retirement industry you've undoubtedly noticed the shift in discussion over the past few years from accumulation related topics to decumulation and retirement income. We've reached a critical point in the evolution of the retirement industry. Each day for the next 15 years, 10,000 members of the first generation to broadly participate in defined contribution plans will turn 65. The reality, and accompanying stress, of having to convert savings to income is setting in and many Americans are ill-prepared to make the complex decisions that will impact their quality of life for the next 30 to 40 years.

It's clear that plan sponsors are in a position to help participants more effectively position themselves to achieve retirement income security. Much has been written about various in-plan retirement income solutions as well as those that fall outside the employee-employer relationship such as private annuities, Social Security benefits, reverse mortgages, long-term care insurance, and longevity insurance. With so many options available to plan participants at retirement, why would a plan sponsor consider an in-plan solution? In other words, what's in it for them?

There are a number of answers to this question. This paper will outline how offering a retirement income solution can accomplish the following, without significantly increasing the costs borne by plan sponsors:

- Reduce plan expenses
- Improve workforce management
- Attract and retain employees, and
- Help to ensure the future success of the defined contribution model.

Reduce Plan Costs

The easiest advantage to quantify for a plan sponsor that offers an in-plan solution is the increase in total assets and total accounts from retaining account balances of retirees enticed by an institutionally priced income product. In addition to increasing total plan assets, participants who are approaching retirement or have just recently retired tend to have accumulated more assets than younger, less tenured employees. This can raise the average participant balance and make the plan more attractive to some service providers, thus driving down costs for all participants. More accounts and a higher average balance drive economies of scale for recordkeepers, making the plan more attractive to these service providers.

Improve Workforce Management

A less tangible advantage to a plan sponsor offering a retirement income solution is to encourage a timely retirement for aging employees before they become unproductive. Studies have shown that more workers are changing their plans to retire later in their career. A 2012 Study by The Conference Board found that the number of workers planning to delay retirement jumped from 42% to 62%. While this trend is certainly the result of many factors, one factor is participant concern about prematurely depleting savings. Low yields on short-term fixed income securities that generally make up the bulk of retirees' portfolios add to this concern. Offering a retirement income solution in a defined contribution plan can help give participants the confidence they need to make the decision to retire.

Citation: http://www.shrm.org/hrdisciplines/benefits/articles/pages/workers-delay-retirement.aspx (Citation: Trapped on Worker Treadmill)

Attract and Retain Employees

Currently, retirement income products are not widely available in 401(k) plans. A 2013 study by Aon Hewitt shows that:

- 10% of plans offer in-plan annuities,
- 12% offer in-plan managed payouts,
- 13% offer annuities outside of the plan,
- 19% offer professionally managed accounts for the decumulation phase, and
- 61% offer online modeling tools.

While offering retirement income products as an "asset class" in plans may be rare, plan sponsors clearly recognize that participants need assistance in converting savings to retirement income. As defined benefit plans become scarcer, early adopters are taking on robust retirement income solutions and the market continues to develop. It will be increasingly important for plan sponsors to offer these products to attract and retain employees. As far back as 2010, a study by MetLife showed 44% of employees would like an annuity option in the plan. Plan sponsors who step up to meet these needs will have a competitive advantage in attracting and retaining talent.

Citation: Aon Hewitt, *Hot Topics in Retirement*, 2013

Citation: MetLife, 8th Annual Study of Employee Benefit Trends

Future Success

More than 30 years have passed since the 401(k) plan was introduced. It was originally intended to supplement other sources of retirement income like Social Security and employer-sponsored defined benefit plans. As recently as 1998, only 10% of Fortune 100 companies offered a stand-alone defined contribution plan. Fully 90% offered also a defined benefit plan. By 2011 those numbers shifted to 70% and 30%, respectively. The reasons behind this transition are clear: defined contribution plans offer more portability and flexibility and at a lower cost. A study by the Department of Labor showed that in March 2012, participation costs for defined benefit plans in the private sector were 70% higher than costs for participation in defined contribution plans.

Citation: Towers Watson, *Prevalence of Retirement Plan Types in Fortune 100*, 2011

Citation: http://www.bls.gov/opub/btn/volume-1/retirement-costs-for-defined-benefit-plans-higher-than-for-defined-contribution-plans.htm

The importance of retirement income in defined contribution plans has not gone unnoticed by the DOL. In May of 2013 an "advance notice of proposed rulemaking" was issued that would require plans governed by ERISA to illustrate a participant's account balance as a stream of lifetime payments. As more and more retirees must rely primarily on defined contribution plan payments for income this topic will almost certainly garner more government attention.

In recognition of the government's significant investment in defined contribution plans (through tax benefits for employers and employees), these plans must deliver on their promise to successfully convert accumulated savings to retirement income. If they do not, the industry leaves itself vulnerable to legislative action that may force a less cost-efficient and less business-friendly model on employers

Conclusion

Adoption of a retirement income solution is a fiduciary decision. But so is the decision NOT to adopt. Plan sponsors who want to maintain a cost-effective retirement program, manage their workforce, provide a competitive benefit, and reduce the risk of government mandates will want to give serious consideration to providing their employees with a retirement income solution.

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