Questions and Answers from Webinar held March 16, 2010 - The New Realities: Independent Consultants Analyze DC Income Solutions

Q1: (What do you think about) 1) fear/distrust that money placed with an insurer that will not be solvent 30-40 years from today 2) low payout from immediate annuity with historically low interest rates current(ly) today?

A1: Plan sponsors have a fiduciary responsibility to use a prudent process, make an informed decision, and continue to monitor, similar to the current standard for selecting an investment fund. The added element with insurance guarantees is to determine whether the cancellation provisions support a reasonable exit strategy should the insurer no longer be considered suitable. This includes evaluating what guarantees participants have already paid for that will be lost or reduced in the transition. The current low interest rates are illustrative of the risk faced by retirees who do not have an in-plan solution and are exposed to spot interest-rate risk at the time of annuitization. We think the ability to dollar-cost average through incremental purchases of deferred annuities or future guarantees helps mitigate this risk for participants.

Q2: How do you overcome the fact that the selection of an income product basically assumes a very long-term relationship? (What about) innovations/enhancements (that) are bound to be made (in the future)?

A2: We agree the expectation is the relationship with the insurer will be of a long duration. We also agree retirement income solutions are changing rapidly. That said, we think there will always be product evolution, which is a good thing, so waiting for the "finished product" is futile. Attention should be focused on whether the retirement income solutions being considered have the potential to address current and future needs and how the retirement income products are positioned for future enhancements. Waiting for the next generation of product needs to be balanced against the cost of doing nothing.

Q3: How would one become a member of the IRIC? I am interested in becoming deeply immersed in this topic.

A3: Primary considerations for the selection of advisers include ensuring complimentary professional skills and representation of different market segments, including the types of clients served and the type of organization, e.g. national firms and regional boutiques. Also, the ability to contribute significant time and work collaboratively is necessary. Currently the number of advisers is limited to approximately 15 to ensure focused effort and minimize the management effort. You can also be a supporting member and receive automatic updates from IRIC. If you have further interest, please contact us via the website.

Q4: Will this presentation be archived? (e.g. available to replay later)?

A4: Yes, the slides and a recording will be available following the presentation.

Q5: Understanding the credit quality of the insurance company issuing the product will be very important. (Also) understanding what is going on with the underlying investments and the asset allocations, style exposures, expenses, portability ... wow the issues?

A5: The plan sponsor should perform the necessary due diligence as they would with any other investment in the plan. The advantages and disadvantages of the guarantees and underlying investments should be evaluated. The focus should be on helping secure the retirements of plan participants.

Q6: Will you talk about specific RIS (Retirement Income Solution) products today?

A6: Please refer to our product evaluation section of our web site which explains the product types in detail. Additional information will be available in the coming months.

Q7: Are plan sponsors also asking "who" (i.e., waiting for big plans to lead the way)?

A7: Many plan sponsors are in the early stages of determining their interest or needs for adding retirement income solutions to their DC plan. In addition, many recordkeepers are determining their level of support for the various retirement income solutions. As a result, many plan sponsors are choosing to wait and not be an early adaptor.

Most of the adoption to date by plan sponsors has been at the small-end of the DC market where a retirement income product is offered through a recordkeeping distribution channel. In addition, it is our understanding there are several large plan sponsors considering adding a retirement income solution to their DC plan in the near future.

Q8: In-plan guarantees (or out of plan guarantees) are nice when you have enough saved to convert it to income (you are paying a price for the guarantee). If the average person has saved $46k (13K median) does the product become too expensive?

A8: We think the relevant number is not average 401(k) balance, which is frequently cited as about $45,000, but the average balance for those nearing retirement, which is frequently cited as about $125,000. That said, we also think it important to recognize that people with small account balances have even less capacity to absorb market volatility and longevity risk. If the retirement income solution is institutionally priced, the fee is asset based, and the account balance exceeds the minimum requirement, then there are no structural barriers for these participants. However, we think there is a behavioral barrier in that the participant will likely be discouraged by the small amount of retirement income the small account balance will support and there is a greater perception of wealth if they continue to control the account balance, and therefore, retirees with small account balances are less likely to utilize the guarantees.

Q9: If the "Solution" remains a plan asset, including custody not with the provider, does not the business risk (and attendant fiduciary risk) disappear?

A9: Not sure what is meant by this question.

Q10: Will the IRIC be submitting a response to the DOL/Treasury RFI on Income Solutions?

A10: Yes, and we will post the responses to our web site, iricouncil.org.

Q11: Will IRIC respond to the current DOL RFI on retirement income?

A11: Yes, and we will post the responses to our web site, iricouncil.org.

Q12: Why spend so much time and energy helping facilitate the conversion to DC Plans or developing new products for existing DC plans when it seems like the ideas are basically to make DC Plans look like DB Plans? Is there a benefit to trying to re-change the culture to make DC plans once again "supplemental?

A12: We do not believe DB plans will be making a comeback due to funding issues. As participants live longer, it is up to us to make the DC plan more attractive for the participant.

Q13: Will you discuss the fiduciary liability of plan sponsors for offering an out-of-plan solution? What due diligence is required?

A13: Yes, this will be forthcoming during 2nd quarter 2010 (Fred Reish).

Q14: Does your definition of "In-Plan" include post retirement as well? (i.e. the RIS solution is not rolled over) If so, what motivation does a sponsor have to keep it in-plan other than negotiating leverage with providers?

A14: Yes, our definition includes post retirement as well. It does provide economies of scale so large balances are not rolling out of the plan. We expect higher usage of retirement income options if the participants are introduced and invest prior to retirement. Additionally, in-plan solutions are lower cost versus out of plan retail solutions.

Q15: What level of combined employer and employee contribution to DC plans do you see as a requirement to replace the income replacement benefits of a traditional DB plan using a 2%/year factor based upon highest 5 yrs of earnings?

A15: The percent of pay needed to be contributed to a DC plan to replace a 2% FAP DB benefit depends on the assumptions you use and the scenarios modeled. One of the most important aspects is the age at which contributions begin and when retirement commences. Many people do not save enough in their 20's and 30's, and as a result, have to save a much higher percentage of their income in later years, work longer, or both, to reach their retirement income goals. Estimates for what percentage of pay is required to provide a 60% replacement of income at retirement range from 10% to 16% for employees who begin saving in their late 20's or early 30's and retire at 65.

Another key element in any analysis of this nature is the level of security desired and provided for by the plan. It is important for investors to understand that the more they save and the less likelihood of success they require, the better their chances of meeting their objectives. Understanding that investors desire security in retirement, increased savings, along with the use of guaranteed income products, may be attractive.

Q16: User experience and education out to the market place is dependent upon the service provider. Do you advocate that an investment advisor should be involved?

A16: Investment advisors for participants can add value especially if it can be done objectively and cost effectively. However, many participants do not have an investment advisor to advise them on their balances in the DC plan.

It is important that the services offered be fully integrated with the plan to maximize effectiveness. Plan sponsor communications, needs assessment and required savings calculations, along with the presentation of secured vs. non-secured income must be delivered using consistent assumptions and relevant participant level information.

Q17: The key question is how a participant may offset investment risk to some 3rd party, probably an insurance co. In many cases the cost of an insurer taking on this risk makes the purchase not worth it. (Do you think) the participant could do better investing on his own?

A17: Guaranteed income products allow employees to shift investment and longevity risk to an insurance company who will pool that risk efficiently with other plan participants. While it is true that some individuals may be able to construct a diversified portfolio and manage a structured payout scheme, the only way to avoid outliving ones' assets without a guaranteed income product, e.g. to self-insure against longevity risk, is to have saved more money than is needed to generate the income and die with assets remaining. Unfortunately, today's reality is retirement savings are insufficient to allow this buffer in most instances. Further, many retirees feel a need to hire professional advisors for assistance in managing their portfolio and structuring their payout scheme, a need which increases significantly as the retiree ages. We think many participants would be better served by having access to institutionally priced funds and paying fees for institutionally priced income guarantees rather than paying fees for wealth management expertise, which still leaves them exposed to market volatility and the risk of outliving ones' assets.

Q18: Are there any multi-insurer products that are portable available in the market right now?

A18: Currently, no plan sponsors have added a retirement income product to their plan that is backed by multiple insurers. There are two product offerings available (or soon to be available) in the market today that will be backed by multiple insurers. As the retirement income market evolves we expect to see additional products made available that will be support by multiple insurers.

Q19: Is there a shorter term solution - not 30 years?

A19: While the short answer is yes, this is not without trade-offs. Also, we feel it is important not to isolate any one product and/or service as “the” solution. From IRIC’s perspective, funding a successful retirement requires a combination of available products and services, coupled with sound investment and savings advice. Certainly, investors are not required to begin this process or lock up assets for 30 years; however, the earlier one begins their planning and execution, the less capital intense their retirement should be. In addition, sacrificing liquidity in exchange for security may be attractive to many investors. Traditional, non-qualified assets have no horizon requirements or liquidity restrictions. They also do not offer the downside protection and guaranteed income benefits of annuity structures.

Q20: Do any middle ware providers currently exist, and if so, who are they?

A20: The need for integration between the recordkeepers and insurers will be critical to the success of the retirement income products. The integration to date has been a significant effort for the recordkeepers that are supporting any of the products. A middleware product standardizes the process and allows a recordkeeper to support multiple retirement income products. DST Systems has developed a middleware product that allows insurers to interface seamlessly with recordkeepers for all the retirement income products in the market today and is flexible to support the integration as the products continue to evolve.

Q21: The common thread of retirement income solutions seems to be the emphasis on longevity risk. That is the focus on guaranteeing AN income over a lifetime. How does IRIC intend to address the issue of guaranteeing ENOUGH income over a lifetime?

A21: IRIC agrees ensuring participants accumulate sufficient assets during their working years is a serious issue, however, it is outside the scope of IRIC's core mission. IRIC is focused on improving the level of retirement income security provided by retirement savings. We recognize the impact fees can have on the accumulation of assets and the resulting income level that it will support, which is why we strongly advocate institutional solutions.