Cumulative Benefits of Retirement Income Solutions in Our DC System

The advantages of institutional retirement income for sponsors, participants and society

IRIC

INSTITUTIONAL RETIREMENT INCOME COUNCIL

Introduction

In 2014, Prudential Insurance stated the following conclusion from their research and findings regarding participant behavior:

> *Our research found that plan participants with in-plan guaranteed retirement income options were more inclined to stay invested during market turmoil, were better diversified and contributed more than participants without guaranteed retirement income.*[1]

As we fast-forward seven years, a preponderance of research and articles continue to tout the benefits of including income solutions in our defined contribution (DC) industry. Certainly, the primary beneficiaries of in-plan income solutions are the plan participants as cited in the Prudential study, but additional thought leadership in academia and trade associations and with policymakers in our government have found benefits for the plan sponsor, as well as societal benefits, in addition to the benefits made available to participants who have access to institutional income products within their DC plans.

This article seeks to summarize the primary benefits of in-plan income solutions and will break down the benefits by participants, sponsors, and the societal benefit of enhanced retirement security achieved through the adoption of guaranteed income options within our DC system.

Plan Participant Benefits

1. **Higher allocation to equity with insured income**

   From an investment perspective, a participant's risk tolerance toward equity exposure should change/increase once that participant's retirement balance is insured and future guaranteed income is provided to him or her. The benefit of diversification is indisputable. This paper is not advocating for a reduction in diversification; however, we must recognize that by adding guaranteed income to a participant's retirement portfolio, the participant can afford to increase his or her risk assets/equity exposure during the saving years, as more income is guaranteed to the participant. This is important because of the disparity in the historical returns between stocks, bonds and risk-free investments (money market/short-term treasuries) as demonstrated in Figure 1.

   A 0% weighting in stocks and a 100% weighting in bonds has provided an average annual return of 5.4%, while a 100% weighting in stocks and a 0% weighting in bonds has provided an average annual return of 10.2%. Finally, a risk-free portfolio provides approximately a 2.6% to 2.7% long-term annual return.[2]

   Figure 1. Average Annual Rate of Return by Investment Type

Investment	Historical Average Annual Rate of Return
Equity index	10.2%
Bond index	5.4%
Risk-free investment	2.6% to 2.7%

   If participants can increase their equity exposure in the late stages of their careers (when their account balance is highest) due to the guarantees in their plan/investments, they will likely increase their overall retirement security due to the guarantee and the higher equity exposure the guarantee enables them to take. Maintaining that equity exposure throughout

The Institutional Retirement Income Council drafted this paper with the help of its members as well as others in the industry. IRIC would like to personally thank the following contributors to this effort:

- **Douglas McIntosh,** Prudential
- **Jenifer Glowacki,** AIG
- **Ahmet Kamil,** Pacific Life
- **Abhinav Dendukuri,** Pacific Life
- **Jack Muskett,** EY
- **Peter Carlson,** EY
- **Christine Sanford,** Prudential

[1] Better Participant Outcomes – Through In-plan Guaranteed Retirement Income. Christine Marcks and John Kalamarides – 2014.

[2] See Historical Returns of Different Stock and Bond Portfolio Weightings, financialsamurai.com.

retirement can not only sustain a level of retirement preparedness but also improve overall retirement satisfaction. Fulfilling goals such as estate or bequest planning, maintaining purchasing power against inflation, can also be achieved in parallel to the main objective of not outliving one's income.

2. **Stay the course**

According to DALBAR, the Boston-based research group that has analyzed investor behavior for more than two decades, the average investors tend to sell securities after a market decline and then wait until the market recovers before reinvesting. By trying to time the market, investors, in effect, sell low and buy high. Studies done by DALBAR and Prudential show that participants with a guarantee are more likely to resist these temptations to sell during market volatility due to the guarantees and the downside protection. According to Prudential:

> *In examining our book of business, we found that during the down market from 1Q/08–2Q/09, plan participants invested in in-plan guaranteed retirement income were 2.5 times more likely to stay invested in equities than participants without an in-plan guaranteed retirement income option.*[3]

Participants with guaranteed income stayed the course.

This phenomenon proved to be true again as the COVID-19 pandemic caused a precipitous drop in the market in March of 2020. Participants with guaranteed income stayed the course. The guaranteed income eliminated part of the risk aversion and loss aversion that caused participants to invest emotionally. Participants with guarantees who did not sell their equity positions were able to recoup all loses as the market fully recovered through 2020 and 2021.

The average duration of a bull market far exceeds that of a bear market. Similarly, the potential gain from a percentage basis is exponentially higher than the loss realized in a bear market. For context, the average bull market lasted roughly nine years with an average cumulative total return of 480%. On the other side of the spectrum, the average duration of a bear market was about 1.5 years with an average cumulative loss of 41%.[4]

3. **Cost of self-insuring**

Insurance in all aspects of life can be thought of as freeing up saved assets for consumption and enjoyment. For example, take two carpenters who are self-employed as general contractors. Joe decides to insure his tools (valued at $20,000) and his truck (valued at $25,000) for the full replacement value should they get stolen or destroyed in an accident. Bill, on the other hand, has only liability insurance and does not insure his tools or truck for theft or destruction.

Both Joe and Bill have $60,000 saved for their discretionary use. Joe has always wanted to buy a small plot of land for hunting and aspires of using part of the land for a small Christmas tree farm. Bill, however, could not prudently make a similar purchase. Since Bill is self-insuring his tools and truck, and these represent his livelihood, Bill needs to save his money for that chance that his truck and tools are stolen or destroyed. By self-insuring, he needs to hold onto his assets and keep them liquid so that he can quickly replace his truck/tools if need be.

The same is true with retirement planning and retirement income. Let us take two participants, Sally and Heather. They each have $200,000 in their 401(k) plans. Sally decides to buy an immediate fixed annuity with her retirement nest egg, while Heather wants to manage her own drawdown distribution strategy. They both want to have a high probability that they do not run out of money.

[3] Marcks, Christine C. "Better Participant Outcomes Through In-Plan Guaranteed Retirement Income," PLANSPONSOR.

[4] See: https://www.cascadefs.com/wp-content/uploads/2019/01/Bull-and-Bear-Markets-9-28-18.pdf

Figure 2. Example: Costs of Self-insuring

	Sally	Heather
Balance at age 65	$200,000	$200,000
Annuity payment/Annual payment	$11,000 (5.5% annuity rate for single life)	$8,670 (assumes a risk-free interest of 2% and a 4.25% withdrawal rate of the initial balance; at this rate, her balance would be zero at the end of her 95th year)
Probability of not running out of money (for Sally, the insurer is taking on Sally's mortality/longevity risk, while Heather must plan on living to age 95 — a 21% likelihood, to have a reasonable chance of *not* running out of assets)[5]	100% guaranteed	Approximately 80% chance of having assets last to age 95

By self-insuring, Heather needs to hold back on her consumption of her nest egg in case she lives longer than expected, and her assets need to last approximately nine or 10 years longer (to age 95) than the average life expectancy. Even with the withdrawal amount of $8,670, Heather still has approximately a 20% chance of outliving her assets. If Heather wanted to have a 95% chance of not outliving her assets, the amount she could withdrawal each year would be much lower. Sally, on the other hand, is not self-insuring. Through annuitization, the insurance company is pooling the mortality risk of many participants and can offer a much higher annual payment for plan participants. By annuitizing/insuring her retirement security, Sally can enjoy an annual consumption from her DC plan equal to approximately $11,000, while those who self- insure will not be able to enjoy their retirement with the same level of consumption. Another way to look at a scenario of two investors like Heather and Sally is that Heather needs to manage her consumption and distribution strategy actively all the way through the end of her life, which we know can become more difficult as a person ages and cognitive decline begins to take place. A retiree like Sally, on the other hand, has transferred that element of asset and risk management to an insurance company and can sleep peacefully at night knowing the next check will be there for her.

Through annuitization, the insurance company is pooling the mortality risk of many participants and can offer a much higher annual payment for plan participants.

4. **Guarantees and mistakes**[6]

   Participants make mistakes. When a participant makes multiple mistakes, they can have a devastating effect on that participant's retirement security. A thoughtful addition of a retirement income solution to a DC plan can help participants avoid mistakes. Here is how:

   - **Not having a plan.** Adding income to an investment lineup and having a DC plan focus on the amount of income its balance can generate will subtly compel participants to understand and plan on the amount of income they can expect to receive from their plan.
   - **Drawing down assets too quickly or too slowly.** By purchasing guaranteed income within a DC plan, participants will optimize their withdrawals for the portion of their balance that is annuitized, thereby not withdrawing their retirement assets too quickly or too slowly.
   - **Delay savings or under saving.** Participants who can estimate their income in retirement will be more prone to save at higher levels ensuring a secure retirement. Participants who do not understand how much income their accumulated balance can generate often overestimate the security they will have and are blinded by the wealth effect of their retirement balance.

[5] Steve Vernon, "Living too long is a risk!" 2014: A 65-year-old woman has 42% odds of living to age 90 and 21% odds (more than one in five) of living to age 95 — nine years beyond her life expectancy.

[6] Selena Maranjian, "12 Costly Retirement Mistakes to Avoid," 2018.

- **Social Security optimization.** Understanding the amount of income Social Security provides is critical — especially the additional income or credits that are afforded to folks who delay the receipt of income until their full retirement age or even to age 70. For many Americans, using your DC plan balance (or part of the balance) to bridge the gap to age 70 generally provides additional income from our Social Security system and additional security for most Americans.
- **Estimating your life expectancy.** Many participants underestimate their life expectancy and thus plan for a retirement that is often shorter than what really occurs. Having guaranteed income as part of a DC plan will correct this misperception and provide participants income for the rest of their lives.
- **Surprises.** Even the best planners and budgeters get financial surprises in retirement. Health care costs, unexpected taxes, home value that is lower than projected, etc. are all costs that could be overlooked. But, by partially annuitizing a person's retirement balance, the annuity portion will provide to that participant guaranteed income for all of life's planned expenses and, with the part of savings that is not annuitized, a rainy-day fund for those unpleasant financial surprises.
- **Inflation.** Participants often underestimate the corrosiveness that inflation has on the buying power of their retirement assets. For example, if your annual annuity payment is $50,000 per year at age 65, and we experience 3% inflation on average over the next 30 years, the $50,000 annual payment today will have the purchasing power of $20,600 in 30 years — when you are 95 years of age.[7] Annuities can provide a hedge against inflation. Variable annuities can provide upside market participation that will often outpace inflation, and fixed annuities may offer a cost-of-living adjustment or an annual increase (for example, a 3% annual increase) in the annuity payout rate. Annuities can be a great hedge against the risk of deterioration of purchasing power due to inflation.

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5. **Peace of mind and financial stress**

According to a report from the American Psychological Association,[8] out of the top eight sources of stress in America, five are financial. Additionally, the American Psychological Association reports that 72% of adults feel stressed about money, with 25% experiencing extreme stress about money. Employees not only face financial stress now but also seek solutions for it; of those workers whose financial problems have affected their productivity at work, 81% want help achieving financial security.

In a more recent survey (2020), John Hancock[9] found that before the pandemic 43% of plan participants reported feeling moderate or extreme financial stress, but during the pandemic three out of four participants reported moderate to severe stress. In the same survey, 95% of participants agreed that getting projections of their retirement income during their employment would greatly help in their retirement planning and would help reduce their stress levels. Incorporating retirement income as part of a retirement plan's benefit offerings enables participants to better estimate their retirement income and will help participants work in an environment with less financial stress.

The stress reduction realized by participants with an income offering and income projections is realized by a twofold progression:

- The simple knowledge of their approximate income works to relieve uncertainty and a feeling of unpreparedness.

[7] Inflation Calculator - Save Enough to Account for Inflation, buyupside.com.

[8] American Psychological Association, "Stress in America: Paying With Our Health," February 4, 2015.

[9] 2020 Financial Stress Survey – John Hancock.

- Participants who know their approximate retirement income, and have a guaranteed income solution, increase their savings level by a greater amount than participants who do not have guaranteed income.[10] The higher levels of savings (and by extension, guaranteed income) provide to participants the peace of mind needed to be productive employees with less financial stress.

6. **Cognitive risk**

Cognitive risk is the degradation of the ability to make sound financial decisions as a retiree gets older.

A study done by State Street Global Advisors[11] found that older Americans with some mental degradations are more likely to be targeted by financial fraud and more likely to lose money once they are targeted. In the U.S. alone, financial fraud among the elderly is estimated to be at $3 billion. This figure could be significantly higher due to underreporting from embarrassment by the seniors or their family. The study also found that investors who begin to experience cognitive decline but have no plan for financial decision-making are the most vulnerable to financial fraud.

An earlier study[12] by The Journal of the Economics of Ageing confirmed this risk and found significant changes and deterioration in financial wealth following declines in cognitive test scores by subjects who were part of the study. Interestingly, the study further found that wealth reductions were less sizeable among those with pension/annuity income and those receiving help with finances from their children.

Employees who buy income/annuities while working and in their 50s and 60s do so with no degenerative decision-making capability. By annuitizing part of their retirement nest egg during their preretirement years, they have taken a prudent step toward warding off the possibility that they will be the victim of fraud or the victim of poor decision-making in the event their cognitive capability declines during their retirement years.

Automating finances is an approach in which the handling of an individual's day-to-day expenses is done in a manner in which the person does not have to actively engage to ensure things are done correctly. This same approach should be taken when addressing the budgeting and income aspect of retirement. We all know Social Security and pension benefits are a way to ensure that some of a person's basic living expenses are accounted for. It is no surprise that there is still a gap that needs to be filled that can prove to be problematic from a financial budgeting perspective for someone who is in a state of cognitive decline. Guaranteed lifetime income, especially at the later years in life, have been shown to be a valuable asset, as there is very little risk of financial fraud or cognitive decline leading to a mismanagement of assets, which can have detrimental effects on one's retirement strategy.

7. **Investment advantages of replacing bonds with annuities in a portfolio, mortality credits, sequence of return risk, dollar-cost averaging and cost savings of Institutional investments**

- **Long-term investing by insurers.** For fixed annuities, insurers try to match the liabilities they assume with guaranteed lifetime payments with underlying investments that support and reserve for that liability. So, when participants purchase a deferred fixed annuity in the DC plan, they are indirectly investing in long duration bonds through the insurer offering the annuity. Since long duration bonds pay higher interest rates than shorter-term or intermediate-term bonds that would normally be part of a participant's portfolio, bond interest is enhanced and increased by the longer time horizon of the insurer. (We recognize that rising interest rates and an inverted yield curve can cause

[10] Guaranteed Lifetime Income and the importance of plan design – Prudential 2017.

[11] The Impact of Aging on Financial Decisions – SSGA – October 31, 2020.

[12] "Cognitive decline and household financial decisions at older ages," The Journal of the Economics of Ageing, May 2019.

longer-term bonds to underperform shorter-term bonds based on these unusual market conditions.)

- **Mortality credits.** Many retirees who rely on bond laddering or certificate of deposit (CD) laddering will not be able to provide sufficient retirement income in today's low interest rate market. Additionally, bonds will lose value if interest rates rise and return to normal. One way to add to a participant's overall return is through mortality credits. Mortality credits represent the additional income/return participants can achieve when they purchase an annuity. Premiums paid by those who die earlier than expected contribute to gains of the overall pool and provide a higher yield or credit to survivors than could be achieved through individual investments such as bonds or CDs.

- **Sequence of return risk.** The sequence of returns risk is the risk and impact of market downturns shortly before or soon after a retiree begins to withdraw from his or her investments in retirement. Losses due to stock market volatility soon after retirement will likely never be recouped due to the sequence of return. For example, assume you retire in the year 2000. In the three years after you retire (2000, 2001 and 2002), the stock market suffered three straight years of double-digit losses. If your portfolio suffered three years of significant losses early in your retirement, and you withdrew money from your retirement balance further depleting your account, it is likely that you would need to lower your future withdrawals to have your nest egg last for the duration of your retirement. On the other hand, if the markets performed well during the early years of your retirement, even with reasonable withdrawal rates, your portfolio could be worth more three or more years into retirement due to the growth of your investments. In these two examples, the first employee had an unfortunate sequence of returns while the second participant had a favorable sequence of returns. Annuities that are purchased during a participant's saving years prior to retirement lock in the amount of income the participant will receive. Through these purchases, the sequence of return risk is effectively transferred from the participant to the insurer, thereby ameliorating this risk for the participant. Let's consider an example (Figure 3).[13]

Figure 3. Example: Sequence of Return Risk

	Scenario A Returns	Scenario B Returns*
Year 1	25%	–20%
Year 2	15%	–5%
Year 3	5%	5%
Year 4	–5%	15%
Year 5	–20%	25%

*Note: Scenario B returns are the same as Scenario A returns but in reverse order.

If two different retirees with $100,000 withdrew $10,000 per year for these five-year periods, their outcome would be very different even though their average return would be identical. The only difference is that Scenario B experiences negative returns at the beginning of retirement while Scenario A experiences positive returns early in retirement, with negative returns occurring later in the five-year period.

After five years, a retiree under Scenario A would have a remaining balance in excess of $70,000, while a retiree under Scenario B would have a remaining balance of less than $47,000. If retirees under Scenario B purchased deferred income annuities, they would have mitigated the sequence of return risk and have a more secure retirement by this risk mitigation.

- **Dollar cost averaging (DCA).** DCA has long been touted as an **investment strategy** that aims to reduce the impact of volatility on large, one-time purchases of financial assets

[13] Rob Berger, Benjamin Curry, "How To Understand Sequence of Returns Risk," Forbes, July 2021.

such as equities. With DCA, you divide up the amount of money you invest and buy small quantities of the asset over time at regular intervals. This decreases the risk that an investor might pay too much for an investment before market prices drop, and it avoids a "point in time risk" where you may purchase an asset at or near the investment's price high point.

DCA can be apply to annuity purchases in the same manner as other investments. For example, many participants who do not have the ability to purchase an annuity within their DC plan will often take a lump-sum distribution and purchase, with the help of an advisor, an annuity at a point in time shortly after their retirement. For these participants, if they happen to retire during an extremely low interest rate environment, their annuity rate will likely be lower than they expected. However, if participants can purchase income through a deferred fixed annuity over the last 10 or 15 years of their career, they will be buying income over different economic cycles and through different interest rate cycles. Thus, participants will no longer worry about the point-in-time risk for their retirement security as they will be purchasing income through different interest rate phases during the preretirement years and will know the level of income they will receive as they approach retirement.

- **Enhanced retirement security through lower-cost investments and lower-cost income solutions.** Employers and employees underestimate the effect less expensive investment products will have on a participant's retirement security. In a 2021 study,[14] the Institutional Retirement Income Council (IRIC) demonstrated the additional income and security a participant receives through the DC system with lower investment fees and better retirement income products that are made available to DC plans versus their retail equivalents. For example, when IRIC assumed a 20-basis-point advantage for a participant's investment, a participant received an additional $268,000 in savings and income through his or her retirement. When that cost advantage is changed to 60 basis points, the additional income/benefit over the life of the participant is $797,000.

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Benefits to Plan Sponsors

As we stated in the introduction, participants are the primary beneficiaries and recipients of retirement security for those plans that have added retirement income as a feature to their plan design and investment menu. However, as demonstrated below, a plan sponsor should add a retirement income product or solution only if the solution proves to have benefits for the employer in addition to the benefits for the plan participant as described above. In other words, like any other enhancement of a benefit plan, the employer analyzes the effect such an enhancement will have on employee morale; productivity; attractiveness of the organization as a career choice for new, highly talented employees; retention of current employees; and helping the organization manage the cost of their most precious resource, their human resources. The next section will demonstrate the benefits that adding a retirement income solution to a plan will have in creating a plan that aligns to the organization's goals while also enhancing the tools an HR department has in effectively managing its human resources in support of such goals.

1. **Attract and retain**

   According to a recent survey by Willis Towers Watson,[15] retirement income is now part of 30% of all DC plans in the large market. However, of those plans that added income, 17% added a guaranteed income option to their plan. This design usually takes the form of a target-date fund or a balanced fund — with an insurance feature built in, such as an annuity or guaranteed minimum withdrawal benefit.

[14] "Delivering Additional Income Through Lower Cost," IRIC, March 2021.

[15] "Lifetime income solutions: Progress, with work ahead," Willis Towers Watson, 2019.

The type of income product or solution employers should add is beyond the scope of this paper. However, IRIC has addressed this subject in a separate 2021 white paper titled, "Exploring the Process of Adding an Income Solution to Your Retirement Plan."

What is important to consider when adding a retirement income option is the receptivity of the product/solution by existing and new employees. In that regard, most participants have a clear preference for guaranteed income. From an employer's perception of the desirability of income, 86% of sponsors who offer in-plan guaranteed income options consider them to be highly valuable for employees and 71% think the average employee would be highly interested.[16] From an employee's perspective, seven in 10 participants would consider a program that offered ways of obtaining guaranteed income to be extremely or very valuable.[17] Lastly, employers that have not yet added a retirement income solution need to think through the purpose of their plan and its goals. In that regard, the goal of a DC plan is no longer focused on asset accumulation. Surveys of plan sponsors suggest that the ability of a DC plan to generate income — and preferably guaranteed income — is now the primary purpose of their DC plan. In fact, in a recent TIAA survey,[18] sponsors saw adequate retirement income as the main purpose of their retirement plan. In that survey, employers stated:

- The primary purpose of a DC plan is to help employees with their savings and accumulated balance (12%).
- The primary purpose of a DC plan is to provide employees with secured retirement income throughout retirement (38%).
- Both of the above purposes, accumulation and income, are of equal importance (50%).

Supporting the above finding is a MetLife survey that found a growing number of plan sponsors believe that the primary purpose of their DC plan is to provide sustainable retirement income.[19]

Guaranteed retirement income is no longer a cutting-edge benefit. Indeed, organizations that peg their benefit program to be at the 50th percentile of their peers/competitors are now starting to consider adding a guaranteed income product or solution, as the employee benefit pioneers (first to market) have already added such a benefit, and the fast followers have likewise added income or are in the process of adding income to their plan. Attracting and retaining top-tier talent will require sponsors to keep their benefit plans current and fresh, and adding a guaranteed income option can help retain and attract top talent.

2. **Managing human resources**

Human resource departments strive to manage their workforce effectively so that the organization goals are met through the successful deployment, utilization and retirement of their most precious resource — their human resources. HR managers are continuously evaluating and modifying their programs with various features to ensure improvement of their plans and the competitiveness of their overall compensation package. Over the past five years, HR departments have given considerable focus to the DC plan with the intention of enhancing their plans to improve the retirement readiness for their workforce — especially near retirees who aspire to leave the workforce and move into their retirement years. Adding a guaranteed retirement income solution is the most cost-effective way for an employer to manage its human resources.

As noted above in the paragraph, Enhanced retirement security through lower cost investments and lower cost income solutions, we cite the additional income participants

Adding a guaranteed retirement income solution is the most cost-effective way for an employer to manage its human resources.

[16] The TIAA Retirement Insights Survey – Feb. 2021.

[17] Ibid.

[18] Ibid.

[19] A Met Life white paper, "Defined contribution plan design: why income should be the outcome," summarizing a 2018 Met Life survey indicated that 85% of plan sponsors believe that the primary purpose of a DC plan is to provide retirement income; just seven years ago, Met Life found only 9% of plan sponsors identified retirement income as a DC plan's primary objective.

can receive through both lower-cost investment options and lower-cost income options. Employers can use the clout and bargaining power of their plan to provide inexpensive investments and lower-cost income solutions. When left to their own volition, participants as individuals cannot receive as much income due to higher costs and often must use a broker or advisor to access such products — especially guaranteed income products. As noted above, when a plan provides just a 20-basis-point advantage for a participant's investment, a typical participant received an additional $268,000 in savings and income through his or her retirement. When that cost advantage is change to 60 basis points, the additional income/benefit over the life of the participant is $797,000.

Participants who could not comfortably retire with higher cost investments and income solutions may find that institutionally priced investments and income products greatly improve their retirement readiness and may find that they can retire earlier than they expected.

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This is important for those organizations that are experiencing the following costs and challenges with their human resources:

- Wages for employees who are near retirees are generally higher than their similarly skilled younger counterparts. The average salary by age as of the second quarter of 2020 as compiled by the BLS is shown in Figure 4. Employers that reap the same or similar productivity from younger less expensive workers will see the most benefit from the higher retirement readiness that a guaranteed income product provides, while employers that need the deep knowledge and relationships of their experienced workforce will reap less of a benefit. And, for this to work, it needs to be a win-win for both the employer and the employee — meaning that employees who "retire in place" generally would rather retire and enjoy their senior years. Employers stand to benefit by helping the "retire in place "employees to have the financial security needed to move into their retirement years by leaving the workforce.

Figure 4. Average Salary by Age as of Q2 2020

Age Group	Average Salary
16–19	$26,312
20–24	$33,280
25–34	$47,736
35–44	$59,020
45–54	$59,488
55–64	$56,680

Source: BLS

- The cost of most benefits (health insurance, vision/dental insurance, life insurance, disability insurance) are higher for near retirees than they are for their younger counterparts. According to the National Compensation Survey's Employer Costs for Employee Compensation, the average cost of benefits in the United States is $21,726 per employee per year, so that benefits make up about 30% of the total cost of keeping a worker on board. This is a significant cost. According to TheStreet, in a 2019 benefit cost study,[20] the cost of health insurance for a 64-year-old employee is three times the cost of that for a 24-year-old employee. Other insurance/benefit plans likewise cost significantly more for older aging workers when compared with their younger counterparts. Enabling older employees to retire helps them enjoy a secure retirement while providing employers lower costs for the benefit plans they offer.

- Organizations that have a deliberate and intentional management trainee program want to promote their "A" talented trainees to higher levels within the organization. Promotions are available through growth and/or through the successful retirement readiness of the

[20] Steve Fiorillo "Average Health Insurance Cost by Age and State," TheStreet, 2019.

organization's older employees; however, a recent study by the Boston College Center for Retirement Research[21] found that 50% of households lack the funds, savings and income needed to continue their standard of living once they stop working. As this study occurred just prior to the COVID-19 pandemic, it is likely that the figure has not improved and may have deteriorated. In addition to managing costs of benefit plans as noted in the above paragraph, optimal utilization, retention and promotion of skilled employees is likewise addressed, at least in part, by including a retirement income product/solution within the firm's DC plan. Adding income continues to change the culture of a DC plan from an accumulation vehicle to a vehicle that enables employees to transition successfully into retirement, thereby opening more opportunity for the firm's younger A-rated talent.

3. **Retaining assets within the DC system**

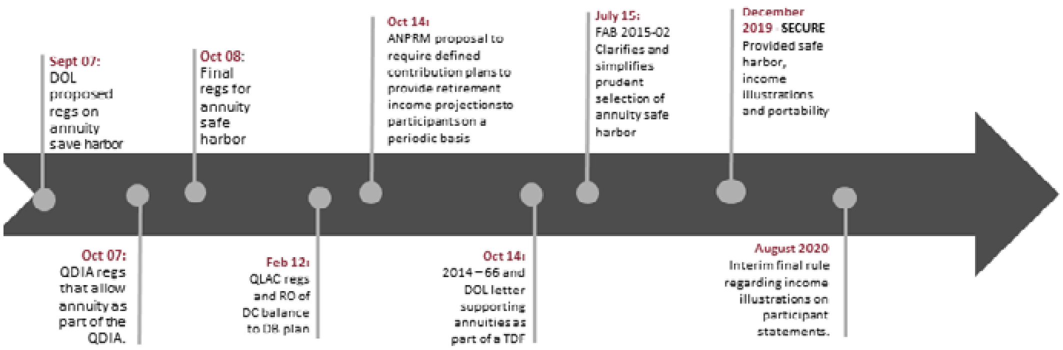
   With baby boomers hitting retirement, DC plans saw approximately 10,000 boomers retire each day with an average account balance of approximately $100,000. That equates to $300 billion to $400 billion each year leaving DC plans and being rolled over to IRA accounts beginning about 10 years ago. Employers no longer want to see this flow of assets out of the DC system. Employers now prefer to keep assets in their plan and no longer want to see participants roll their retirement assets to an IRA. As a general rule, plans with higher asset levels and higher average account balances often will receive lower per-participant pricing from their service providers. Employers that encourage their participants to use their DC plan as a decumulation benefit can hold onto these assets, thereby driving better pricing for both their current and former employees. Some employers also seek to maintain a strong relationship with former employees and will allow former employees to use the DC plan to ensure retirement security through their life by offering a guaranteed product within their DC plan.

   According to Alight's "2019 Hot Topics in Retirement and Financial Wellbeing: Building on the Past, Working Toward the Future,"[22] more than 60% of employers want to keep retirees in their plan, while in their previous survey completed in 2014, only 33% of employers wanted terminated employees to keep assets in their plan. To maintain the plan's bargaining power with providers, employers are adding income options from their DC plan to drive better pricing for both their existing and former employees.

Societal Benefits and Policy Objective

For more than a decade, our policy makers have provided favorable legislation, facilitating regulations and incentive policies, all to promote the use of guaranteed lifetime income in DC plans. The timeline in Figure 5 shows just some of the regulations, revenue rulings and legislation promoting the use of lifetime income in our DC plans.

Figure 5. Timeline: Use of Lifetime Income in DC Plans



[21] How Would More Saving Affect the National Retirement Risk Index?, National Retirement Risk Index, October 2019.

[22] Infographic, "2019 Hot Topics in Retirement and Financial Wellbeing," Alight, https://alight.com/research-insights/building-on-the-past-working-toward-the-future.

This trend will likely continue. There is a current bill (Securing a Strong Retirement Act of 2021, aka SECURE 2.0) that has already received bipartisan support. If enacted, the legislation will continue the promotion of retirement security through adoption of retirement income products in our DC plans as well as the improvement of the distribution guidance and modifications needed in our laws to support income from our retirement plan system. Specifically, with respect to income provisions, the bill would:

- Increase the required minimum distribution age from 72 to 75.
- Provide a technical fix to allow the required minimum distribution (RMD) rules to permit annuities to have, for example, cost-of-living adjustments and return-of-premium features.
- Provide an RMD exemption if DC and IRA savings do not exceed $100,000.
- Include qualified longevity annuity contract reforms, such as repealing the 25% test, increasing the $135,000 limit to $200,000 and clarifying that former spouses can be treated as spouses.
- Permit variable annuities to be based on exchange-traded funds.

Our policy makers have several goals in mind when supporting guaranteed income in our retirement system. From a policy perspective, guaranteed income supports the following societal goals:

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- Guaranteed income keeps seniors from spending their assets too quickly. Seniors without the benefit of a guaranteed source of income can decumulate assets too fast, causing some to fall below the poverty line. According to a study released by the National Council on Aging, over 15 million older adults aged 65-plus are economically insecure, with incomes below 200% of the federal poverty level. The primary drivers of economic insecurity are rising housing and health care bills, inadequate spending on nutrition, lack of access to transportation, diminished savings and job loss. By annuitizing some or all of a participant's DC accumulated balance, seniors are less likely to experience economic despair and less likely to tax the social programs in their late 80s or 90s that are in place to assist them. In short, policy makers are concerned that these social programs will quickly expand and become overwhelmed if our senior citizens spend down their assets too quickly. Annuitization supports the goal of helping seniors spread out their assets through retirement reducing the risk of poverty for a significant growing segment of the American population.
- Guaranteed income keeps spending at an even keel and helps the problem of hoarding savings for those seniors unsure of an appropriate drawdown rate. Similar to the problem of seniors spending too quickly, seniors who hoard their retirement nest egg also create a suboptimal societal utilization of saved assets. According to a Morningstar study,[23] Americans are in the unusual position of under saving where maintaining a current standard of living is not possible for the majority of Americans. In fact, under normal market conditions, the study projects that approximately one quarter (25.6%) of all retirees have accumulated the assets needed to keep their standard of living. In fact, the average participant, even when social security is included, will likely only replace a little more than half (51%) of their preretirement income. With such under preparedness, one would suspect that many retirees would spend their retirement assets too quickly. But that is not the case, at least for a significant portion of recent retirees. When consumption patterns are analyzed, almost 60% of all retirees spent less than they safely could. When retirement assets are measured from just a couple of years after retirement to 18 years past retirement, we see that assets in all cohorts and for all years remain the same or only slightly decline — again intimating a lack of consumption by certain segments of our retiree population.

[23] Steve Wendel, "New Research on Retirement: A Retirement Spending Puzzle" 2019, and "Easing the Retirement Crisis: How Financial Planning and Personalized Advice Can Head Off Extreme Austerity," 2019.

- One interesting note is the spending habits of retirees that have an annuity or pension.[24] For low-income households that do have deficit spending, we find that low-income households having *large* deficits generally occurs when there is *no* regular pension/annuity income. Low-income households that do have an annuity or pension seem to have a positive impact on budget management, as these low-income annuitants either do not have a deficit or, if they do, the deficit is much smaller than their colleagues (low income, no annuity). In contrast, regular pension/annuity payments in high-income households are associated with a slightly higher probability of a budget deficit. The study notes that the budget deficits for these higher-income cohorts may be offset by assets or income not included in the study. In a separate study,[25] consumption patterns were studied for five years after retirement by the Office of Financial Protection for Older Americans. The research concluded choosing a monthly annuity rather than a lump-sum payout is positively associated with retirees' ability to maintain the same spending level for at least the first five years postretirement. Although more studies need to be conducted, it appears there is an emerging case to be made that annuities increase the overall happiness of retirees and society as annuities prevent both underconsumption as well as overspending. Appropriate and sustainable spending should be promoted by policy makers, plan sponsors and providers in order to generate additional economic activity and consumption by retirees that will benefit society. Our seniors will be able to live life to the full and enjoy their retirement while ensuring themselves that they will not overspend when part or all of their assets are converted to guaranteed income. In short, a guaranteed paycheck through an annuity seems to promote appropriate spending habits that have beneficial attributes in terms of economic growth, reducing reliance on social programs and consumption that generally leads to good economic utility for seniors.

Summary

The Institutional Retirement Income Council is pleased to provide this paper to promote the cultural shift of DC plans from supplemental savings programs to programs that provide retirement security through institutional income strategies and products within our DC system. The benefits to participants, sponsors and society are not insignificant. The adoption of this new paradigm will change how we view and appreciate our retirement system. As DB plans continue to fade away, and the solvency problems of our Social Security system go untouched, our DC system will be viewed by many as delivering real funded security through the use of guaranteed products to decumulate our retirement balances.

[24] "The Majority of Retirees Spend Below Their Income, a New Study Finds," PLANSPONSOR in conjunction with EBRI, 2019.

[25] "Retirement Security and Financial Decision-making: Research Brief Office of Financial Protection for Older Americans," May 2020.