

IRIC

INSTITUTIONAL RETIREMENT INCOME COUNCIL

From Savings to Income: The Critical Role of Retirement Income Projections in DC Plans

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Introduction

Retirement planning is a critical aspect of financial security, and retirees typically answer the question of “How much is enough?” in terms of periodic income, not total savings. This paper argues that providing retirement income projections to plan participants is an important element of retirement preparedness.

Further, this paper argues that Defined Contribution (“DC”) plans play a critical role in generating retirement income when participants engage with retirement income projections and utilize in-plan retirement income offerings.

The Broad Spectrum of Retirement Income

Projecting and generating retirement income relies upon a broad approach encompassing:

Income Projections: This provides participants with potential retirement income estimates based on current and projected savings. It is enhanced by integrating outside assets and Social Security to deliver a comprehensive retirement income projection.

Retirement Planning Tools: These resources allow participants to simulate various retirement scenarios and income outcomes, including retirement age, spousal retirement savings, Social Security claiming dates, future income, and other assets.

Retirement Income Products: Access to a suite of solutions that might include Guaranteed and Non-Guaranteed solutions:

Guaranteed Solutions:

- Single annuity at the time of distribution
- An annuity “supermarket”
- Target Date funds with embedded annuities
- Managed Accounts with embedded annuities

Non-Guaranteed Solutions:

- Installment distributions
- Managed Accounts with systematic withdrawals
- Required Minimum Distributions

Recent Industry Research Findings

Recent research indicates a growing interest among DC plan sponsors and participants in retirement income offerings.

- A 2024 PIMCO¹ survey revealed that nearly 90% of large institutional consultants consider income solutions for retirement as a top priority for their clients, a 21% increase over the previous year.
- A 2024 study by LIMRA² noted that 43% of plan sponsors feel obligated to help employees generate income post-retirement.
- The 2023 “Workplace Benefits Report” from Bank of America³ reported that 81% of 401(k) plan sponsors said they would offer an in-plan retirement income option in the next 1-3 years.
- A 2023 study by T. Rowe Price⁴ found that systematic withdrawal capability is the most appealing option for plan sponsors, with a significant increase in the share of clients offering or planning to add a retirement income solution.
- The 2023 Bank of America “Workplace Benefits Report”⁵ also reported that 63% of 401(k) participants would invest in an in-plan Guaranteed Income option.

DC Plan Retirement Income Planning Parallels with Social Security

Retirement income planning in DC plans parallels nicely with Social Security. Social Security benefits are communicated to individuals as projected monthly benefits. Employers can leverage this similarity with DC participant statement income projections to educate participants about generating retirement income from their savings and illustrate DC plan retirement income strategies in combination with Social Security benefits.

Regulatory and Legislative Reforms in Support of Retirement Income Projections

Recent regulatory and legislative reforms have mandated that all DC statements communicate projected retirement income on participant statements. The Department of Labor's interim final rule requires defined contribution plans to include two-lifetime income illustrations on participants' statements at least once every 12 months. This move aims to help participants better understand how their account balance translates into monthly income in retirement and encourages them to think about their savings in this context.

¹ PIMCO Retirement Income Survey, 2023.

² LIMRA, May 2024 “Powering Forward: In-Plan Annuities Gain Momentum”

³ Bank of America, 2023 “Workplace Benefits Report”

⁴ T. Rowe Price Retirement Income Solutions Study, 2023.

⁵ Bank of America, 2023 “Workplace Benefits Report”

Participant Behavioral Preferences for Retirement Income Information

Understanding participant behavioral preferences is crucial in designing retirement income strategies that resonate with their financial planning habits. Retirees generally consider their post-retirement assets not as aggregate pools of wealth but as periodic income flows. This perspective aligns with the common budgeting practice of managing expenses on a monthly or annual basis, which continues into retirement.

Aligning with Expense Management

Retirees often prefer to match their income streams with their expected expenses, creating a mental accounting framework that simplifies financial management. This approach mirrors the structure of annuitization, where the focus is on consistent income streams rather than the total value of assets.

Industry Research Findings

The Society of Actuaries has found that retirees value the predictability and stability of income that annuitization provides⁶. Similarly, Fidelity's Managed Cash Flow withdrawal strategy⁷ reflects participants' preference for regular payments and ongoing liquidity while maintaining a positive lifetime asset balance. These preferences underscore the importance of offering retirement income solutions that provide periodic income.

Legislative Support

Recent legislative reforms, such as the SECURE Act, have recognized and encouraged this behavioral preference by mandating the inclusion of projected retirement income on DC statements. This further emphasizes the importance of communicating retirement savings as income, not just an aggregate balance.

Conclusion

The behavioral preference of retirees to view their assets in terms of periodic income flows rather than aggregate sums supports the importance of primarily communicating and educating DC plan participants about retirement income projections. This preference, industry research, and legislative backing bolster the argument for integrating income projection strategies into retirement and financial wellness communications and planning. By providing employees with integrated retirement income planning tools that incorporate Social Security benefits, other retirement savings, and other assets and focusing on sustainable income streams, DC plans can better align with retirees' financial management practices and provide a more straightforward path to a secure retirement.

⁶ Society of Actuaries, Retirement Income Research Report, 2023.

⁷ Fidelity Managed Cash Flow Withdrawal Strategy Analysis, 2023.