Retirement preparedness: Would income projections affect employee saving behavior?

The Institutional Retirement Income Council has released a new paper that recommends plan sponsors provide retirement income projections to plan participants, calling it an important element of retirement preparedness.

By Lynn Cavanaugh | July 30, 2024 a

How can employers enhance employees' preparedness for retirement?

The Institutional Retirement Income Council (IRIC) has recently released a new paper, "From Savings to Income: The Critical Role of Retirement Income Projections in DC Plans," in which it argues defined contribution (DC) plan sponsors should provide retirement income projections to plan participants, calling it an important element of retirement preparedness. The paper highlights the necessity of transitioning the focus from total savings to periodic income projections for effective retirement planning. The paper also emphasizes the importance of DC plans in generating sustainable retirement income. It details how integrating income projections, retirement planning tools, and various retirement income products can enhance participants' preparedness for retirement.

The report also underscores recent research indicating a growing interest in retirement income offerings among plan sponsors and participants, and legislative reforms mandating the inclusion of income projections in DC plan statements. This comprehensive approach aims to align retirement planning with retirees' preference for predictable, periodic income, ensuring a more secure and manageable financial future.

We talked to the author of this paper, IRIC Executive Director Kevin Crain, about the importance of retirement preparedness.

Q: Why should defined contribution (DC) plan sponsors provide retirement income projections to plan participants?

A: Providing retirement income projections aligns with how individuals think about their post-retirement life. Post-retirement, individuals think about the amount of income they can live on monthly or annual, not what their total 401(k) balance is. Also, providing retirement income projections allows individuals to do integrated retirement income planning. Combining DC plan retirement income projections with Social Security projections. DC retirement income projections aligns with how individuals get information about other sources of retirement income. Social Security information is based on projected monthly income.

Plan sponsors benefit as this will encourage younger generations to appreciate and accumulate more assets in the plan. It will increase younger generations' satisfaction with the benefit. And motivate them, particularly since younger generations are questioning whether Social Security will be there at retirement. For middle to older generations, information on projected retirement income will allow plan sponsors to improve pre-retiree education programs as well as help pre-retirees do robust retirement income projections. This aligns with recent industry studies that show plan sponsors feel more responsible for participants staying in plan post retirement.

Q: How important is transitioning the focus of retirement savings from total savings to periodic income projections for effective retirement planning?

A: It is very important. It is hard for participants to convert total balance information into projected retirement income amounts. Also, it is critical to provide similar information across key pillars of retirement income — 401(k) plans and Social Security. This will allow individuals to make a more informed decision about the critical issue of when to elect Social Security. Currently, about 40% of individuals elect Social Security at the earliest date – age 62. Only 10% elect at its maximum benefit value – age 70. If the individual waits until age 70, the benefit is 70%+ higher than age 62. With DC plan retirement income projections, individuals can make an informed decision about whether to first use DC plan assets to fund their initial retirement, allowing them to delay taking Social Security.

Q: How important is it for DC plans to generate sustainable retirement income?

A: This is a critical trend for DC plans. To offer participants "in-plan retirement income options" along with retirement income projections. More than 60% of participants believe their DC plan will be a primary source of retirement income. 70% or more of participants want "in-plan retirement income" options. Meanwhile, almost three in four plan sponsors feel responsible for providing these options. And 40% or more of retired DC plan participants "stay in plan" at least three years with their plan assets. All of this supports why there is an aggressive trend in the industry for creating guaranteed and non-guaranteed retirement income in-plan options.

Q: What retirement planning tools and various retirement income products can enhance participants' preparedness for retirement?

A.There is a robust inventory of retirement income in-plan products available. Hybrid target date funds, hybrid managed accounts, managed accounts with retirement paycheck features, Annuities for use with distributions, Installment payments and others. Plan recordkeepers are implementing these solutions on their platforms. Investment and insurance firms are creating products. Consultants and advisors are beginning to help plan sponsors on how to evaluate and select in-plan options. The Institutional Retirement Income Council, of which I am Executive Director, is very active in the industry working with the institutional constituents to increase plan sponsor comfort and knowledge with the offerings. The end goal is to drive great adoption.

Q: Which legislative reforms mandate the inclusion of income projections in DC plan statements?

A: The recently enacted SECURE 2.0 Act mandated that DC plans provide participants with an annual estimate of projected monthly retirement income that their current balance would provide. The DOL provided additional guidance post SECURE 2.0 passage about how the information should be calculated and reported.

Q: What is the best strategy to align retirement planning with retirees' preference for predictable, periodic income, ensuring a more secure and manageable financial future?

A: It is critical for plan sponsors to enhance their financial wellness programs to include robust pre-retiree education, including retirement income projection tools. Also, plan sponsors should provide education about Social Security and Medicare. In fact, pre-retiree education should be offered to participants at younger ages — 50 or 55. Plan sponsors should not wait to offer this education until participants are close to retirement. This will allow participants to have time to continue to accumulate assets before retirement and be well prepared when it is time to retire. Financial wellness studies have indicated that participants are not well informed about Social Security and Medicare and they would like their employers to help them with that before they retire.