

IRIC

INSTITUTIONAL RETIREMENT INCOME COUNCIL

Retirement Income Reimagined: How Systematic Withdrawals are Reshaping DC Plans

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Introduction

As retirement planning evolves and the vast cohort of baby boomers leave the workforce, industry focus is shifting towards creating sustainable income to support retirees throughout their golden years. While various forms of annuitization have traditionally been a focus, “systematic withdrawal” from DC savings plans is today emerging as a core component of retirement income strategy, providing a structured, tax-advantaged method of generating income in retirement while at the same time giving retirees flexibility and control.

The T. Rowe Price 2024 DC Consultant Survey¹ explores the increasing interest in systematic withdrawal. The study cites consultants and retirement advisors who ranked the top retirement income strategies as:

- Self-determined periodic distributions (simple systematic withdrawal)
- Managed accounts with a retirement income feature
- Target Date Funds with a built-in retirement income payment feature

This paper will explore these options as well as Required Minimum Distributions.

Self-Determined Periodic Distribution Options

Periodic distribution options within a DC plan offer a flexible way for retirees to receive income directly from their retirement accounts without rolling over to an IRA or purchasing an annuity. This in-plan feature allows retirees to take regular, periodic distributions from their DC plan based on their income needs, life expectancy, and market conditions.

Today, recordkeeping systems, responding to growing interest in periodic distribution options, include withdrawal options as a standard component of DC plans.

Types of Periodic Distribution Strategies Often Used

- Fixed Dollar Withdrawals: Annual, monthly, or quarterly withdrawals of a set amount.
- Percentage-Based Withdrawals: Annual withdrawals are based on a percentage of the account balance—for example, the “4% withdrawal rule” for annual retirement income.
- Life Expectancy-Based Withdrawals: Distributions are calculated based on the retiree's life expectancy.

1 T. Rowe Price 2024 DC Consultant Survey, exploring systematic withdrawal strategies in retirement planning

Industry Statistics on Periodic Distribution Options

Industry trends highlight the growing popularity of periodic distributions. As this data shows, periodic withdrawal options are becoming an increasingly important part of retirement income strategies for many DC participants.

- According to a 2021 study by the Plan Sponsor Council of America² 70% of 401(k) plans offer a periodic withdrawal distribution option.
- A survey by Vanguard³ found that among plans offering a periodic withdrawal option, about 15% of DC participants utilize this option for at least a portion of their withdrawals.
- The Investment Company Institute⁴ reports that systematic withdrawals account for roughly 20% of all distributions from defined contribution plans annually.

Periodic distribution options offer retirees a flexible, customizable way to generate income directly from DC plans. However, like any strategy, they have advantages and challenges.

Advantages of Periodic Distribution Options

- **Flexibility:** Retirees can adjust withdrawal amounts and frequencies based on changing financial needs, allowing for more control over income.
- **Control Over Assets:** Retirees maintain ownership of their assets, which allows them to react to market conditions or changes in their financial situation.
- **Potential for Growth:** Because the funds remain invested, continued market growth is possible, which can help sustain income levels over time.
- **Cost-Effective:** Typically, these strategies' fees are lower than purchasing annuities or other income-guaranteeing products.
- **Liquidity:** Retirees have direct access to their funds if unexpected expenses arise, providing more financial flexibility than other income products.

Issues with Periodic Distribution Options

- **Market Risk:** Withdrawals during market downturns can accelerate asset depletion, mainly if the withdrawal rate is high relative to market performance.
- **Risk of Depleting Assets:** Fixed-dollar withdrawals risk running out of money if not carefully managed, particularly during poor market returns or extended retirement years
- **Potential for Overdraw:** Percentage-based withdrawals if not carefully managed could force retirees to take out more than they need, pushing them into higher tax brackets.
- **Complexity in Planning:** While flexibility is a benefit, it can also make it more difficult for retirees to predict long-term income sustainability, especially without professional financial advice.

² Plan Sponsor Council of America, 2021 study on periodic withdrawal options in 401(k) plans

³ Vanguard, State of 401(k) annual report, 2021

⁴ Investment Company Institute, 2021 study of annual 401(k) trends

Managed Accounts with Retirement Income Paycheck Feature

Managed accounts with embedded systematic withdrawal strategies are increasingly popular in DC plans. This strategy appeals to participants seeking a structured approach to drawing down their retirement savings by offering personalized investment and retirement income drawdown advice.

The primary goal of a systematic withdrawal strategy is to provide retirees with a consistent and predictable income stream, helping them manage their savings efficiently throughout retirement.

- **Withdrawal Planning:** Managed accounts develop a personalized withdrawal plan based on the participant's age, account balance, life expectancy, market conditions, and income needs. The strategy typically aims to balance withdrawals with the remaining portfolio to reduce the risk of depleting funds prematurely.
- **Payment Frequency:** Income can be distributed monthly, quarterly, or annually, based on the retiree's preferences. The managed account adjusts the withdrawal amounts dynamically, considering factors such as investment returns, inflation, and longevity risk.
- **Investment Adjustments:** The managed account continuously adjusts the underlying investments to support the income stream. This might involve shifting to more or less conservative assets as the participant ages to capture growth opportunities while minimizing risk.
- **Tax Efficiency:** These accounts often include tax optimization strategies, drawing from tax-deferred, taxable, or Roth accounts to minimize the retiree's overall tax impact.

How Managed Accounts with Retirement Drawdown Strategy Pay Participants

- **Automatic Disbursements:** Managed accounts are evolving to automate income distribution directly to participants' bank accounts or another specified account. This helps retirees maintain consistent cash flow without the need for manual intervention.
- **Rebalancing Investment Portfolios:** The accounts regularly rebalance investments to maintain the desired asset allocation while supporting withdrawals. This process ensures the portfolio aligns with the participant's risk tolerance and income goals.
- **Income Monitoring:** Managed accounts providers often offer ongoing monitoring and adjustments, where withdrawal rates can be modified based on market performance, account balance changes, and participant needs, helping to mitigate the risk of running out of funds.

Managed Accounts with Retirement Drawdown Strategies

Industry Utilization Statistics

24%



Adoption Rates: Managed accounts with systematic withdrawal features are still emerging, but adoption is increasing. According to a 2023 Cerulli Associates report,⁵ approximately 24% of plan sponsors now offer a managed account service within their DC plans, with an increasing emphasis on retirement income solutions.

20%



Participant Usage: A report by Alight Solutions⁶ found that about 20% of participants using managed accounts are engaging with systematic withdrawal strategies for retirement income. This number is expected to grow as more baby boomers enter retirement and seek reliable income sources and guidance.

50%



Market Penetration: Vanguard reported in its 2023 annual State of the 401(k) report⁷ that managed accounts are offered in over 50% of its retirement plans, and systematic withdrawal strategies are becoming a core component of its income solutions.

12.5%



Projected Growth: The managed account market, including accounts with retirement income features, is projected to grow at an annual growth rate of 12.5% from 2024 to 2030, driven by participant demand for personalized advice and income management.

⁵ Cerulli Associates, 2023 Report on Managed Accounts and Retirement Income Solutions

⁶ Alight Solutions, 2023 Survey on Participant Use of Managed Accounts for Retirement Income

⁷ Vanguard, State of 401(k) annual report, 2023

Benefits of Managed Accounts with Retirement Drawdown Strategies

Peace of Mind



Participants benefit from a predictable income stream without managing investments or making complex withdrawal decisions.

Personalization



Managed accounts offer tailored investment strategies and financial planning services provided to participants based on their unique circumstances, goals, and financial needs. Unlike one-size-fits-all investment options like target-date funds, managed accounts customize the participant's investment portfolio, often using a broader range of inputs.

Issues with Managed Accounts with Retirement Drawdown Strategies

Market Risk Exposure



Because funds remain invested, retirees are still exposed to market downturns, which could affect their payout amounts or long-term income sustainability.

Fees



Managed accounts fees can be higher than other types of investments, given the personalized investment allocation.

Lack of Guarantees



Unlike annuities, there is no guaranteed income level, and payouts could fluctuate based on market performance.

Target Date Funds with a Retirement Income Payment Feature

Target Date Funds (TDFs), which have emerged as the default allocation for the vast majority of plan participants over recent decades, are today evolving to provide sustainable income during retirement.

This new breed of TDFs incorporates a retirement income payment feature designed to provide a steady payout stream post-retirement without requiring participants to purchase an annuity.

- Traditional Target Date Funds with a retirement income feature typically adjust their asset allocation over time, shifting strategies from aggressive to more conservative as the participant nears retirement.
- TDFs with a retirement income feature continue this evolution post-retirement by providing systematic payments to the retiree.
- Unlike annuities, the participant remains invested in the market, with the growth potential, while receiving periodic payouts designed to last for a specific period or through the retiree’s lifetime.

Industry Utilization Statistics

The use of Target Date Funds with retirement income features is increasing.

15%



A 2022 study by the Defined Contribution Institutional Investment Association (DCIIA)⁸ found that approximately 15% of plan sponsors offer TDFs with built-in retirement income features, and adoption is expected to grow as retirement income solutions become a greater focus for both sponsors and participants.

50%



Vanguard reports⁹ that about 50% of participants invest in TDFs, and many plan sponsors are considering adding income-generating features.

10%



According to a survey by Alight Solutions¹⁰, nearly 10% of participants nearing retirement are considering using TDFs with retirement income payment features.

⁸ DCIIA 2022 Custom Target Date Fund Study

⁹ Vanguard, State of 401(k) annual report, 2023

¹⁰ Alight Solutions, 2023 Survey on Participant Use of Managed Accounts for Retirement Income

Advantages of Target Date Funds with Income Feature

Convenience



TDFs automatically adjust pre- and post-retirement asset allocation, simplifying the management of retirement investments and income for participants.

Income Stability



Including systematic withdrawal features provides a predictable income stream in retirement, offering peace of mind.

Growth Potential



TDFs can remain partially invested in the market, providing potential for continued asset growth.

Personalization



Payments can often be adjusted to account for changes in market conditions or individual financial situations.

Issues with Target Date Funds with Income Feature

Market Risk Exposure



Because funds remain invested, retirees are still exposed to market downturns, which could affect their payout amounts or long-term income sustainability.

Potential for Exhausting Assets



Participants may outlive their savings without careful management, especially if withdrawals are too high or investment returns are lower than expected.

Lack of Guarantees



Unlike annuities, there is no guaranteed income level, and payouts could fluctuate based on market performance.

Limited Customization



While TDFs offer simplicity, they may not be fully tailored to an individual's unique financial situation or changing needs, unlike more personalized investment strategies.

Required Minimum Distributions (RMDs) as a Retirement Income Strategy

Required Minimum Distributions (RMDs) are a foundational example of systematic withdrawal strategies within DC plans. As mandatory withdrawals under U.S. pension regulations, they provide a built-in, systematic approach that retirees must adhere to once they reach the required age (currently 73, as of 2023).

RMD as a Systematic Withdrawal Strategy

- **Structured and Predictable:** RMDs are calculated based on life expectancy and account balance, providing a predictable periodic withdrawal amount.
- **Adapts to Longevity:** The annual recalculation adjusts withdrawals to match the retiree's life expectancy.
- **Tax Planning and Impact:** RMDs may help spread the tax burden over the retiree's lifetime, preventing significant lump-sum tax hit.

RMD Utilization Trends in 401(k) Plans

**5
Million+**



Over 5 million individuals take RMDs annually from DC plans.

**\$300
Billion**



The total amount distributed through RMDs across various retirement accounts, including DC plans, is approximately \$300 billion annually.

Advantages of RMDs as a Systematic Withdrawal Strategy

Simplicity



RMDs provide a straightforward, calculated approach to withdrawals.

Compliance



Automatically meets IRS requirements for distributions.

Longevity Protection



Designed to pace withdrawals over the retiree's lifetime.

Tax Planning



Provides a structured approach to managing tax liabilities in retirement.

Issues with RMDs as a Systematic Withdrawal Strategy

Lack of Flexibility



RMDs prescribe a mandatory minimum distribution amount that may not align with income needs.

Market Risk Exposure



Because funds remain invested, retirees are still exposed to market downturns, which could affect their payout amounts or long-term income sustainability.

Potential for Excess Income



May force withdrawal amounts beyond what's needed, potentially pushing retirees into higher tax brackets.

Conclusion

Systematic withdrawals—including periodic distribution options, managed accounts, Target Date Funds with retirement paycheck features, and Required Minimum Distributions—represent powerful and flexible retirement income strategies within DC plans, with the understanding that the strategies have a level of variability and do not provide guaranteed income. By leveraging these structured withdrawal methods, retirees can create sustainable and tax-efficient income streams that adapt to their needs throughout retirement. As the retirement landscape evolves, embracing in-plan strategies like systematic withdrawals offers retirees a practical, adaptable way to manage their retirement income, ensuring financial security and peace of mind in their golden years.