AON

Retirement Income Solutions (For the Spending Phase of DC Plans)

By Greg Fox, CFA®

What is retirement income for defined contribution plans?

- Retirement income, in the context of a defined contribution ("DC") plan, is anything that can help to shift a participant's account balance into an ongoing stream of income during their retirement years.
- Common ways of expressing retirement income include monthly or annual dollar amounts, but it can also be expressed as percentage of pre-retirement income (e.g., 80% of final pay)
- Retirement income can be generated from various sources, such as withdrawals from investments, annuities, or even from other outside sources like social security.
- Lifetime income is a more specific form of retirement income, which is usually guaranteed in some way to last for as long as a participant may live. All lifetime income is retirement income, but not all retirement income is lifetime income.

Why is retirement income important to participants?

- The average DC plan participant has been conditioned, over the course of their life, to manage their personal finances in a way that's anchored by an ongoing, stable stream of income (usually a paycheck).
- Investing and drawing down on a large account balance is intimidating, even for very seasoned investment professionals and actuarial experts, because the time horizon and cash flows are difficult to project individually
- Having a reliable stream of income allows participants to achieve their retirement goals and maintain a desired standard of living.
- Having opportunities to generate an income stream from an employer-sponsored DC plan allows participants to take advantage of planning tools, education/communication, vetted solutions, institutional pricing and participant experiences that have been thoughtfully selected or developed solely with participants' best interests in mind.

Why might retirement income be important to employers?

- Employers generally seem to want what's best for their employees and former employees, which of course includes favorable financial outcomes in retirement.
- As defined benefits become less prevalent, retirees are increasingly becoming more reliant on defined contribution programs to fund their retirement expenses.
- Retaining retiree account balances in employer-sponsored plans can increase the buying power of the program and push down administrative and investment costs for all participants, including active employees.
- Providing comprehensive solutions for employees to confidently plan for and transition into retirement may allow for more ideal work force management, including:
  - Less retirement-age employees clinging to their jobs
  - Improved attraction/retention of key talent

Why isn't retirement income everywhere already?

- Sequentially, retirement income is the third challenge that the industry is seeking to overcome in the context of defined contribution retirement plans, and not a top priority for all employers.
  - **First Challenge**: Get employees to save enough
  - **Second Challenge**: Get employees to invest those savings appropriately (generating a reasonable return and de-risking as retirement nears)
  - **Third Challenge**: Help employees manage down their accumulated savings in retirement

- Employers have cited various barriers to making retirement income solutions available to their DC plan participants, including:
    - **Fiduciary Concerns –** Offering retirement income solutions would expand the oversight responsibilities for Fiduciary decision-makers. Since a majority of plans don't have these kinds of products, there seems to be a fear of drawing attention from possible plaintiff's attorneys by looking like an outlier.
    - **Administrative Complexity** – Encouraging retirees to stay in-plan longer likely comes with added responsibilities and administrative tasks (e.g., missing participants). Building out the technology and infrastructure to support income-focused products requires careful coordination with recordkeepers, trustees, etc.
    - **Cost Concerns** – There is often a cost to selecting, implementing and monitoring these new solutions. The products themselves can be more expensive than "traditional" savings-focused investment choices. Insurance costs are often less transparent than investment costs, because they tend to be implicit and spread-based.
    - **Limited Adoption** – There aren't many plan sponsors who offer retirement income solutions and plans that have made solutions available to their participants haven't seen many participants opt-in.

What is Aon's point of view on retirement income?

- Aon is supportive of retirement income solutions and believes that more widespread adoption will likely lead to improved participant outcomes
- We recognize that complexities still exist and that not all organizations will align, philosophically, with offering retirement income solutions or prioritizing this topic relative to others.
- The Aon team serves the retirement income marketplace in various ways, including:
    - Providing education, research and thought leadership
    - Evaluating products and services
    - Assisting plan sponsors in settlor and fiduciary decision-making
    - Assessing the financial strength of guaranteed income providers
- We think all DC plan sponsors should, at minimum, educate themselves on retirement income solutions and formulate an informed view on whether or not to take action.
- Further action could mitigate concerns that are preventing fiduciary decision-makers from taking more significant and/or more immediate action.

About Aon

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