RETIREMENT INCOME INSTITUTE
Alliance for Lifetime Income

Who Should Read This Insight:
Retirement plan sponsors

Institute Research Agenda Topic:
Optimizing annuities in a retirement portfolio

Definitions of **bold key terms** are at the end of this article.

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Authors, Titles and Publication Dates of the Articles Addressed in the Insight
Pfau, Wade D., Joseph A. Tomlinson, and Steve Vernon. 2017. "Retirement Income Programs: The Next Step in the Transition from DB to DC Retirement Plans." Journal of Retirement *4 (3):11–27.*

Insight: HELPING PLAN SPONSORS PROVIDE A FULL MENU OF RETIREMENT INCOME OPTIONS TO THEIR PARTICIPANTS

IDEAS IN THE INSIGHT YOU CAN PUT INTO ACTION

This Insight provides guidance to plan sponsors about building a menu of tools to help their participants create effective retirement income plans. In addition to traditional investments, the authors suggest including annuities, investment funds that also manage distributions for retirement spending, and a fixed income tool that can support delaying Social Security benefits.

PRINCIPAL INSIGHTS

As society has transitioned from traditional company pensions that provided a lifetime income to their employees to new **defined-contribution plans** like 401(k) plans, employees are losing access to some of the tools they need to build an effective retirement plan. Instead, plan participants in the new regime must both select investments and self-manage market risks, including the risk of outliving their assets. The basic task for plan participants is to figure out how much to withdraw from their investment accounts while managing unknowns related to how long they need the money to last and how many market downturns they will experience during retirement. Goals for their retirement assets include maximizing spending power while ensuring that there are not too many fluctuations in the amount that they can spend, not outliving their assets, and maintaining liquid reserves to cover unexpected expenses in retirement.

Plan sponsors can help their participants achieve greater success in meeting these goals by providing a retirement income marketplace with a full menu of tools to manage these various retirement risks. It is important that plan sponsors help make the tools available for their participants to build these more-effective retirement income plans. In addition to the traditional stock, bond, and other asset class investment **options** provided to plan participants, they also need access to the following:

- **Annuity** options that provide protected lifetime income, where income benefits can either start immediately or be delayed to a future date.
- Investment options that provide a managed payout by using an aggressive asset allocation and managing distributions for participants to cover their discretionary expenses in a sustainable manner.
- A Social Security delay bridge tool that will help participants safely defer claiming Social Security benefits if they retire before age 70.

An effective retirement income plan will enable a participant to cover basic retirement expenses with optimized claiming of Social Security benefits and regular income from traditional pensions, and then fill any remaining spending gap with an annuity that provides protected lifetime income.

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With regard to optimized Social Security claiming, Wade D. Pfau, Joseph A. Tomlinson, and Steve Vernon's article finds that the best way to help manage the risk of outliving assets is for a single individual (or the high earner in the couple) to delay taking Social Security retirement benefits until age 70 to take advantage of the significantly increased monthly benefits that result from waiting. This delay in claiming Social Security benefits is advantageous for those who live past about age 80, which is probable for people who reach their 60s. It is important to understand that the decision to retire is different from the decision to begin receiving Social Security benefits.

But for those who are already retired, it can be risky to spend more from fluctuating investments to fill the gap in income before Social Security begins. To properly delay Social Security, retirees need a tool that will support their missing Social Security benefits with safe assets such as cash, CDs, bonds, or period-certain annuities.

Participants have the capacity to be more aggressive with their remaining investments because Social Security and annuities will provide a safe income that will protect their basic lifestyle no matter how financial markets behave. If participants follow this strategy, they should let this more-discretionary spending from their investments fluctuate with overall market performance by either spending a fixed percentage of remaining assets each year or by using the IRS rules about required minimum distributions to guide this spending.

These strategies can better support spending during market downturns, can support higher average spending when markets do well, and can also support a greater legacy with more assets left for heirs. Spending for core retirement expenses is usually fixed, while spending for other discretionary activities will fluctuate but can be expected to be higher on average. This is the idea behind the efficient frontier for retirement income described in the article.

Beyond this core menu of options, plan sponsors could also consider including deferred annuities in the asset allocations for their target date fund options, offering deferred annuities with lifetime income protections, and offering qualified **longevity annuity** contracts. Plan sponsors could also create a few packaged options that balance these tools in single offerings, as well as creating a default package of tools. A default option could be to place employer contributions into a **deferred annuity** and to place employee contributions into a balanced investment fund that will provide distributions following the required minimum distribution rules.

With a more creative approach, plan sponsors can better assist their participants in meeting their retirement goals.

To learn more, visit the Retirement Income Institute at
www.allianceforlifetimeincome.org/retirement-income-institute

KEY TERMS ARE SOURCED FROM THE ALLIANCE FOR LIFETIME INCOME'S ANNUITIES LANGUAGE GLOSSARY AND INVESTOPEDIA

Annuity: *A financial product that can offer protected lifetime income and even potentially grow your money.*

Deferred annuity: *A type of annuity that delays payments until you choose to receive them, while providing an opportunity for growth or income during the deferral period. Payments can be installment or lump-sum.*

Defined-contribution plan: *A defined-contribution plan is a retirement plan that's typically tax-deferred, like a 401(k) or a 403(b), in which employees contribute a fixed amount or a percentage of their paychecks to an account that is intended to fund their retirements.*

Longevity annuity: *Annuity with delayed payments starting in the future.*

Option: *A feature that can provide benefits or protection to you or your beneficiaries at an additional cost.*

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