

# RETIREMENT INCOME OPTIONS

## in Employer-Sponsored Defined Contribution Plans

### THE AMERICAN ACADEMY OF ACTUARIES SUPPORTS POLICY AND EDUCATIONAL INITIATIVES THAT INCREASE THE AVAILABILITY OF RETIREMENT INCOME OPTIONS

within employer-sponsored defined contribution (DC) plans. Such options, based upon actuarial principles such as longevity pooling and other risk mitigation strategies, can help retirees manage their financial security over their remaining lifetime.

Retirement income options could improve retirement security for millions of Americans by providing more predictable income in retirement; some solutions can also relieve retirees of the burden of managing investments, a task for which many may not be well-equipped. By taking advantage of longevity risk pooling and institutional pricing beyond what may be available in the individual market, employer-sponsored DC plans can offer these options in a cost-effective manner.

By offering retirement income and longevity risk management options in DC plans, employers can give working Americans additional tools to enhance their retirement security and financial well-being. **The American Academy of Actuaries supports this goal through the development of related solutions, tools, policies, and education and stands ready to assist policymakers in their development.**

### The Value of Retirement Income Options

There is a clear public interest in broad retirement security across the population. Historically, defined benefit (DB) plans were a key component of employer-provided retirement benefits, under which the employer made all or most of the contributions, investments were managed by the plan sponsor, and benefits were provided as guaranteed lifetime income. By pooling the longevity risk of its employees, an employer's contributions could be efficiently converted into lifetime income for employees by assuming the *average* life expectancy for the group of employees as a whole—benefits that were not paid to those who did not live as long as expected were available to pay to those who lived longer than expected.



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## POSITION STATEMENT

With the shift to DC plans as the primary, and in many cases, the only source of employer-provided retirement benefits, participants typically receive benefits in the form of a lump sum of the accumulated account value at retirement. This requires individuals to manage their own lifetime income, investment, and longevity risks.

The [Actuaries Longevity Illustrator](#) (jointly sponsored by the American Academy of Actuaries and the Society of Actuaries) shows that the likelihood of any one individual living much longer than his or her life expectancy is significant. Without longevity risk pooling, an individual planning for this possibility would need to plan for a longer-than-average lifetime and potentially have significantly less monthly income in retirement. Similarly, without the benefit of institutional pricing, the costs to provide the desired level of income would be greater (or equivalently, the amount of income that could be obtained with a fixed account balance would be smaller).

### Needed Solution

Although there is no single solution to the challenge of Americans' retirement financial security, DC plan participants could benefit from lifetime income or longevity management options with respect to at least a portion of the account balance. These options could be permitted or encouraged through guidance from the Department of Labor (DOL) and provided by employers, insurance companies, fund managers, and others.

One of the principal risks in managing retirement income—longevity risk—is that income might not last a lifetime. An annuity option that provides a lifetime income—a specified income as long as the retiree lives—addresses this risk precisely. Such an approach not only provides longevity protection but also typically relieves the retiree of investment risk. Another approach to lifetime income is an option to withdraw specified amounts or percentages of the account balance annually; however, the retiree bears some risk that the assets may be depleted or the amount of the income may be unpredictable. These “structured withdrawal” programs, although not specifically incorporating longevity risk pooling, can include features that provide cost-effective flexibility and income management, such as periodic re-evaluation and adjustment, discipline, and institutional pricing.

Safe harbors, enabling legislation, and other regulations are needed to cover areas such as selecting providers, developing solutions, educating employees, and implementing income strategies to minimize plan sponsor fiduciary concerns. Providers and employers will need to partner to develop appropriate solutions and educate employees about the options and opportunities available to them.

Although the DOL currently offers safe harbor guidance for including annuities within DC plans, many plan sponsors believe the guidance still exposes them to some fiduciary risk and, consequently, have not taken advantage of this guidance. There are currently no DOL safe harbors governing structured withdrawal programs. Clear safe harbors could encourage more employers to include income options within DC plans.

## POSITION STATEMENT

### Benefits of Income Options in DC Plans

Although retirees can obtain the income options described above by rolling DC accumulations into individual retirement accounts (IRAs), there are significant benefits to making the options available inside employer-sponsored DC plans. Some of these benefits include:

#### **Pricing efficiency.**

Employers that maintain DC plans have access to institutionally priced financial products and services. The lower costs provide greater net benefits.

#### **Ease of transaction.**

A retirement income option can be elected without the need to perform an IRA rollover or seek out potential providers.

#### **Provider and product due diligence.**

Plan fiduciaries are capable of providing thorough due diligence beyond that which an individual is capable of performing. This scrutiny can help minimize poor choices in provider selection, product selection, and strategy implementation.

#### **Guidance on retirement income planning and longevity risk management options.**

While some employees may have external financial advisers to help them through the decision process, many individuals do not have this support nor the financial literacy to analyze the choices on their own. Employer- or plan-provided educational materials and tools could efficiently fill this gap.

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