Defined Contribution
Institutional Investment Association

DESIGN MATTERS: THE RETIREMENT TIER
GLOSSARY OF TERMS | PAPER #7

MAY 2021

Design Matters: The Retirement Tier Glossary

Contributors

Vidya Rajappa, American Century Investments

Daniel Yem, BlackRock

Elizabeth Heffernan, Fidelity Investments

Jodi Epstein, Ivins, Phillips & Barker

Arin Bratt, Legal & General Investment Management America

Aruna Hobbs, MassMutual Financial Group

Philip Michalowski, MassMutual Financial Group

Jody Strakosch, Strakosch Retirement Strategies

Pam Krueger, Wealthramp

Introduction

Defined contribution (DC) plans are beginning to evolve from savings plans focused on accumulating assets to retirement plans incorporating strategies geared to converting these assets into income in retirement. In the past, many American workers had defined benefit (DB) pension plans, which traditionally were designed to replace a "defined" percentage of pre-retirement salary as monthly payments in retirement[1], but fewer and fewer workers today have a DB plan. For most workers today, their DC plans are now a key source of retirement income (along with Social Security).

For these DC plan participants, determining how and when to withdraw their DC assets, how to make those assets last, and how to create an income stream in retirement can be overwhelming, particularly when they are accustomed to thinking of the assets in these plans as investments to conserve rather than a benefit to be distributed. Policymakers and academics are therefore encouraging plan sponsors to think about incorporating and facilitating retirement income (in the form of products, solutions, tools, and services) into their DC plans. Recent legislation and regulations have tried to clear some technical impediments to doing this.

The 2019 DCIIA series **"Design Matters: The Retirement Tier"** provides a blueprint for DC plan sponsors to assist their plan participants in successfully transitioning into and navigating their spending in retirement. This DCIIA series explores how sponsors can evaluate their plan's distribution policies and potentially establish a "retirement tier" in the plan's structure. The series' glossary—the subject of this paper—defines many of the terms related to retirement income that are referenced throughout the Retirement Tier series.

WHAT IS A RETIREMENT TIER?

DCIIA defined the term, Retirement Tier, as a range of products, solutions, tools, and services, all of which allow a DC plan sponsor to broaden their plan's goal from one wholly focused on saving to one that can transition to support benefit distribution for participants who are near, entering, or in retirement.

PARTICIPANT'S LIFECYCLE

Let us start by identifying the main phases in the timeline of a participant's involvement with a DC plan:

Accumulation Phase:

The accumulation phase is the period during which an individual is actively employed and saving a portion of their earnings for retirement. Based on the tenets of lifecycle finance[2], individuals in this phase generally have low financial capital (e.g., retirement savings balances), but high human capital (expected future earnings potential), given the lengthy time horizon they may have to earn wages and save for retirement. Accordingly, during this phase, the commonality of this goal applies broadly to most participants through the majority of years of plan participation.

Transition Phase:

The transition phase is the period during which an individual is approaching or entering retirement. During this phase, individuals are still actively employed and still deferring a portion of their earnings into the DC plan for retirement, but typically may begin to make complex decisions in preparation for the distribution phase. These decisions include what age to retire, when to claim Social Security benefits, and how and when to draw down income from retirement savings. Some of these decisions may be irrevocable, or not easily reversed or modified. In addition, at this phase participant financial circumstances, investment goals and potential income needs reflect decades of living and are more divergent than during the accumulation phase.

Distribution Phase:

Typically, the distribution phase is the period during which an individual is no longer actively employed and therefore, no longer making contributions to a workplace retirement plan. During this phase, individuals are relying on their retirement savings and other income sources, such as Social Security, to meet their spending needs. Typically, this is also when the participant is drawing on his/her DC account and, if applicable, any individual retirement account (IRA) balances.

What follows in this supplement to the Retirement Tier Series is a glossary that focuses on defining the terms included in the Series that are relevant to a participant's transition phase and distribution phase.

GLOSSARY OF TERMS

Account Consolidation

A participant with multiple DC or IRA accounts may choose to consolidate their accounts with fewer providers, in part to streamline managing their retirement portfolio. Although there are exceptions, these rollovers, as described below, can often be accomplished without tax consequences. Note that a "rollover out" can be expected to be followed by a "rollover in." For DC plans, plan sponsors and/or their record keepers determine whether and to what extent such options are made available at the plan level.

Rollover out:

Typically, this is a transfer out of one DC plan into another DC plan or IRA. In this case, the retirement assets of the participant are being distributed out of one retirement vehicle and directed into another retirement vehicle.

Rollover in:

Typically, this is a rollover from an IRA or a DC plan into another tax-advantaged plan, with the participant's retirement assets being deposited directly into a DC plan or an IRA.

Annuity Rollover Service

An annuity rollover service/platform exchange is a service that compares the prices of annuities outside the plan from multiple insurance companies (or insurers). This service is may or may not include transactional or implementation assistance.

Fiduciary

A fiduciary has a legal or ethical obligation to act in the best interests of someone else. For example, a 401(k) Plan Committee is a fiduciary and, per the Employee Retirement Income Security Act of 1974 (ERISA), has to act for the exclusive benefit of the plan's participants and beneficiaries. An investment fiduciary (for a person or a plan) must, for example, provide investment advice or investment management that is in the best interest of the individual or the plan's participants.

Financial Wellness

In the 2017 paper "A Financial Wellness Primer: Why Financial Wellness?", DCIIA defines financial wellness from an employee's perspective as the ability to meet ongoing financial responsibilities while following a plan to create a secure financial future for themselves.

From an employer's point of view, a financial wellness program does not just involve creating a plan; ideally, it also involves showing active and retired employees how to make decisions about their financial situation and how to manage their own financial-wellness plan over time. It includes giving participants perspective on balancing the opportunity to consume and to enjoy life today with the goal of maintaining a comfortable lifestyle in the future—all while minimizing overall financial stress.

Health Savings Account (HSA)

An HSA complements a qualifying High Deductible Health Plan (HDHP), as defined in the Internal Revenue Code, with a tax-exempt trust or custodial account to pay for qualified medical expenses. The HSA is an individual health account that is owned by the employee and is intended to be used for medical expenses not covered by their HDHP. An employee must be covered by an HDHP, and no other type of health plan, in order to be eligible to make contributions to an HSA.

Individuals or employers may contribute to an HSA on a pre-tax or post-tax basis. Funding options include pre-tax contributions via payroll deduction or by direct deposit into the account via check or electronic funds transfer, as well as post-tax contributions. An HSA is similar to an IRA in that the participant owns it and directs the investments. Balances in the HSA continue to accumulate in the account and earnings grow on a tax-deferred basis.

Pre- and post-tax contributions and earnings used for eligible healthcare expenses are tax-free to the accountholder.

In-Plan Solution and Out-of-Plan Solution

In-plan solutions are generally characterized by the fact that assets remain in the plan, either as investment assets or, if in a guaranteed product, as a group annuity contract held by the plan. Retirement income is paid from the plan assets to retirees. The underlying assets are included as a part of the plan's assets for the purpose of government reporting and are covered by the plan fiduciary's oversight.

Out-of-plan solutions are generally characterized by the transfer of participant assets from the plan directly to a selected financial institution or institutions—typically an insurance company, mutual fund company, or brokerage firm—that generates guaranteed or non-guaranteed income for the retiree from the amounts transferred.

- The plan sponsor or record-keeper may be involved in identifying these institutions, communicating them to plan participants, and facilitating the transfer of assets out of the plan upon retirement. Once assets have been transferred, the plan has no ongoing involvement with the retiree, with respect to the transferred assets. Also, the transferred assets are not included in the plan's ongoing government reporting.
- In the case of plan-distributed annuities, the products may be supported under a group contract, but assets leave the plan at the point of annuitization.
- The above two options are not to be confused with a traditional IRA rollover, in which the plan transfers assets to a financial institution identified by the retiree, as such transactions have not been analyzed or facilitated by the plan sponsors.

Institutionally Priced

When describing an insurance or investment product available through a DC plan, "institutionally priced" means that the product, program, or fund is typically offered at a lower cost than a similar product, program or fund offered on a general retail basis. In general, institutional pricing reflects the lower cost associated with group distribution rather than the higher marketing and sales costs associated with an individual sales process. In the case of an annuity product, an institutionally priced program is offered either without the distribution costs typically incorporated into a retail annuity program.

Money-Out Report

A money-out report is an in-depth review of participant withdrawal behavior that is provided by the recordkeeper. It includes a summary of each withdrawal transaction allowed under plan rules, with total transaction counts and total assets by transaction type. The report tracks each activity type by individual and not by frequency; for example, a monthly automatic withdrawal would be counted as one type, no matter the frequency of payments per year. It also includes the destination for rollover transactions. DCIIA recommends that money-out reports be used in conjunction with plan demographic analysis, which help sponsors understand how many participants may be nearing retirement and recent retirement patterns. Taken together, these reports may help sponsors better understand how a retirement tier might strengthen their plan.

Participant-Directed Withdrawal/Distribution *(these terms are often used interchangeably)*

Participant-directed withdrawals from plans may be non-periodic ("ad hoc") or periodic, as specified by the terms of the plan. Periodic withdrawals may be referred to as systematic withdrawals or automatic distributions. While the nomenclature varies, the withdrawal type will typically fall into one of the categories summarized in the chart below. Such ad hoc or periodic withdrawals may be assessed a fee by the record keeper or its banking institution.

WITHDRAWAL TYPES	DEFINITION
Full-Payout, Full Cash-Out, or Lump-Sum	Lump-sum payments can be paid as a rollover or as a full cash-out. This payout will typically close the account.
Partial Withdrawal	Partial withdrawals allow participants to specify an amount, or percentage of the account balance, to be distributed from the plan. These payments can be distributed as a rollover or as a cash-out.
Age-Specific (In-Service) Withdrawal	Plan documents may allow active participants access to their account balances at pre-determined ages; this is often age 59.5 but could be other designated ages based on plan document rules. In this type of withdrawal, a participant may be able to specify an amount, or percentage of the account balance, to be distributed from the plan. These payments can be distributed as a rollover or as a cash-out.
Required Minimum Distribution (RMD)	The RMD can be calculated by dividing the participant's tax-deferred retirement account balance as of December 31 of the previous year by their life-expectancy factor. RMD withdrawals can be set up as periodic payments throughout the year or taken as partial withdrawal(s). The required amounts will vary year to year.
Periodic Payment(s)	Periodic payments may be referred to as systematic, installment or automatic withdrawals, and allow participants to receive regular payments from their account at a frequency they request. Various options may be available from your recordkeeper: **Fixed Dollar Amount:** Each withdrawal has the same dollar amount over time, based on the specific amount elected. This may result in the account running out of money at some point. **Fixed Time Frame:** Each withdrawal is based on the number of payments remaining within the time period elected. The amount of each withdrawal will change over time. The account balance will be zero at the end of the timeframe elected. **Fixed Percentage:** The participant selects an annualized fixed percent (e.g., 3%) to withdraw each period from their total account balance. Depending on the percentage selected, market conditions and other factors, the actual amounts received every period may increase or decrease over time but will always represent a percentage of the remaining account balance. **Life Expectancy:** Each withdrawal is based on a combination of the account balance as of December 31 of the previous year, an age-based life expectancy factor, and the number of payments selected by the participant to be received each year. The amounts received will vary over time. **Interest Only:** Each withdrawal is based on the interest income generated by the portfolio. The amounts received will vary depending on the interest income. **Other:** This is an area of continued discussion and innovation.

WITHDRAWAL TYPES	DEFINITION
Withdrawal Source by Plan	**Pro Rata:** The amount of withdrawal liquidates across all holdings in a pro-rata weighted fashion. **Source Specific:** Many plans have multiple sources of money, some with unique withdrawal rules and options specific to that source. Participants may be able to set up a specific withdrawal from a specified source, or they may be able to exclude a specified source. **Fund Specific:** Participants may be able to identify a specific investment option within the plan from which the withdrawal should be liquidated.
Multiple Plans and Distributions	If a plan sponsor has multiple plans, the participants will generally need to elect withdrawals from each plan separately.

Qualified Default Investment Alternative (QDIA)

A QDIA is an investment option that complies with the Department of Labor's regulations for being a default when a participant does not have a valid investment election in place. The plan Committee (or a delegated investment manager) bears the responsibility of selecting and monitoring the QDIA. A QDIA could be a balanced fund, a target date fund series, target risk fund family or a managed account.

Retirement Risks

A participant faces risks to effectively saving during the accumulation phase that are well understood. For example, in the accumulation phase, a participant may face risks such as a savings shortfall or a growth risk by not investing to maximize growth assets relative to risk management assets. Auto features have been widely deployed to help participants to address these risks. Similarly, a participant also faces significant risks in obtaining optimal lifetime income throughout their transition and distribution phases. For example, in the distribution phase, "retirement" risks become paramount, and include the following:

Cognitive risk:

The risk of declining mental capacity, which impairs a person's ability to make sound decisions and to address complex financial issues.

Longevity risk:

The risk that a retiree will simply outlive his or her money. As life expectancy increases, the planning horizon extends for most American workers, complicating the spending decisions required to make savings last a lifetime, rather than simply long enough to meet the average life expectancy reflected in RMD formulae.

Macro-economic risk:

- **Inflation risk:** This is the risk that rising inflation may erode the purchasing power of a participant's savings over time.
- **Interest-rate risk:** This is the risk that as rates rise portfolio values fall, since most portfolios typically de-risk away from equity and into fixed income. Low interest rates pose a challenge to the generation of adequate income in retirement.
- **Global risk:** Global-risk events, such as pandemics, geo-political concerns, financial crises, and cybersecurity intrusions, may also have adverse impacts on the valuation of the participant's portfolio as well as their ability to withdraw income.

Market risk:

Generally, market risk is the risk that large market losses will significantly reduce the value of assets needed to fund retirement income. Market risk can increase the uncertainty in portfolio outcomes, especially in retirement when earned income has stopped and there are no ongoing contributions to the portfolio. In addition, the following risks can be categorized under market risk:

- **Sequence of returns risk (Sequencing risk):** This is the risk of a market downturn occurring at the time when income is needed from the plan. If a benefit distribution is required there is a risk that taking withdrawals in bear markets may deplete retirement savings faster and negatively impact the ability to generate appropriate levels of income in retirement. This is a key risk that has a significant impact, particularly for those participants in the first few years of retirement (or when transitioning into retirement), as participants have accumulated their highest savings at that point.

- **Tail risk/Black swan event:** This is the risk of a sudden, extreme drop in market prices. Exposure to tail-risk events approaching retirement can disrupt investment outcomes.

Market timing risk:

This is the risk of getting in and out of the market at the wrong times, tied to counterintuitive investing and inappropriate withdrawal behaviors. These behaviors can disrupt a longer-term investment strategy by buying high, selling low, or engaging in panic-induced selling that locks in losses.

Personal consumption risk:

This encompasses behavioral and other risks that could impact retirement, such as:

- **Overspending:** The risk of withdrawing assets at a higher rate than is sustainable, resulting in the premature depletion of assets.
- **Unanticipated expenditure:** The risk of having unanticipated costs, such as healthcare-related expenses or housing issues.
- **Lifestyle risk:** The risk of not having enough income in retirement to lead the desired lifestyle.
- **Underspending risk:** The fear of running out of money may mean that individuals curtail their lifestyle expenditures and deprive themselves when it is not necessary to do so.

Retirement Savings Vehicle / Solution

Some of the popular investment vehicles found in a DC plan include balanced funds, target date funds (TDFs) and managed accounts (MAs). These vehicles are typically used as a QDIA within a plan and were created with an emphasis on the accumulation phase, when participants are saving. They can also be integrated with an income solution(s), thereby potentially providing distribution as well. Current integrated lifetime-income strategies in the marketplace incorporate retirement income in a variety of ways.

Managed account:

A managed account is a personalized investment portfolio tailored to the specific needs of the account holder. A managed account can be tailored to an individual participant's income objectives in the distribution phase using allocations across the existing funds in a DC plan. For example, if longevity risk is a significant concern and the plan does not offer an annuity-based retirement-income solution, a MA may allow participant-directed optional annuity purchases.

Target date fund:

A target date fund (TDF) is an investment portfolio that shifts its asset mix from a more aggressive risk profile to become more conservative over time, as the participant cohort ages. The target date year to which the fund name generally refers is the anticipated retirement year. There is generally an industry consensus that the target date is the date when a participant should begin to withdraw or "spend" their assets. However, in TDFs, unlike in other structured payout solutions, this may not always be the case and assets may be consumed in later periods.

Like MAs, when a TDF is designed to invest throughout a participant's lifetime, it may seek to support a sustainable annual payout for an estimated life expectancy. For example, annuity solutions may also be incorporated into TDFs.

Retirement System

Two main types of employer-sponsored retirement plans comprise the US Retirement System:

Defined contribution:

These are plans where the amount of money that goes into the plan is identified in a participant account. Some DC plans only provide for employee contributions (whether pre-tax, Roth, or after-tax). Other DC plans only contain employer contributions (such as profit-sharing contributions). Some DC plans include both employee and employer contributions (such as plans that include employee contributions and an employer match).

Defined benefit:

These are plans where the amount of money that comes out of the plan is projected to the time of retirement. A DB plan pays a benefit that is determined by a formula, typically based on age, salary, and years of service.

There are also two main types of retirement savings vehicles that individuals typically establish outside of the workplace:

Traditional IRA:

This is an individual retirement account (IRA) that is generally funded by tax-deductible contributions[3]. When funded with deductible contributions, the accumulated funds (including contributions and earnings) are subject to income tax when they are distributed. Required minimum distributions apply to traditional IRAs.

Roth IRA:

This is an individual retirement account (IRA) that is funded by non-tax-deductible contributions. There are income limits set by the IRS that determine the allowable contribution to a Roth IRA. The accumulated funds (including contributions and earnings) are not subject to income tax when they are withdrawn. Roth IRAs are not subject to required minimum distributions.

Sources of Income

Sources of income in a DC Plan are either guaranteed or non-guaranteed. Each is covered in more detail below.

Guaranteed Products

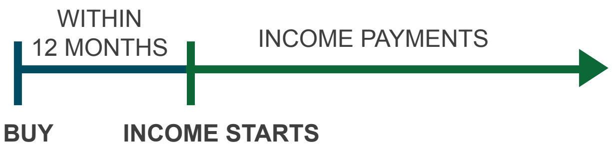
Guaranteed products are insurance-based products that offer a guaranteed income over a specified period and/or a floor of minimum returns associated with a product. Generally, the products offered by a plan sponsor in-plan will provide protected lifetime income from a specified start date. Types of income annuities and variable annuities are described below.

Income annuities:

Income annuities can play an important role in a retirement income plan, providing predictable guaranteed income that can be aligned to cover necessary expenses for as long as someone lives.

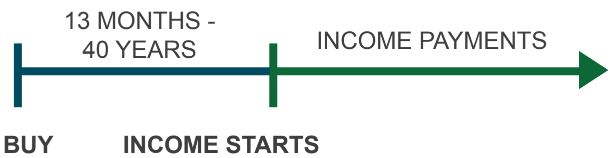
- **Fixed income annuity:** This is an insurance contract that guarantees the insurance provider will make a series of fixed payments (annuity payments) to the purchaser over a specified period, in exchange for an irrevocable up-front principal payment. Annuity payments are expressed as a fixed percentage of principal (annuity rate) and may begin immediately upon purchase (immediate annuity) or at a future date (deferred annuity). Annuity rates are determined by the insurance provider at the point of purchase and typically take into consideration the features of the annuity contract, such as the contract's duration and/or the length of the deferral period (if applicable), as well as a number of economic and demographic factors including, but not limited to, interest rates and credit spreads, age and gender of the purchaser, and mortality expectations (if applicable). There are some environments where gender-neutral rates apply, such as plans that come under ERISA purview. Higher interest rates and credit spreads, shorter contract duration and longer deferral periods result in higher annuity rates.
  - Immediate fixed income annuity (Single premium immediate annuity/SPIA): A SPIA is a contract that pays a guaranteed income for the rest of someone's life and that starts immediately (or within 12 months of purchase).
  - Deferred income annuity (DIA): A DIA is a contract that pays a guaranteed income for the rest of one's life but starts at some future date.

Immediate Income Annuity:
Lifetime Income Starting Now



- Ability to begin income immediately or within 12 months of purchase.
- Income payments are fixed and not subject to market volatility.
- Guarantee a stream of income for your lifetime, or a set number of years.

Deferred Income Annuity:
Lifetime Income Starting When You Need It



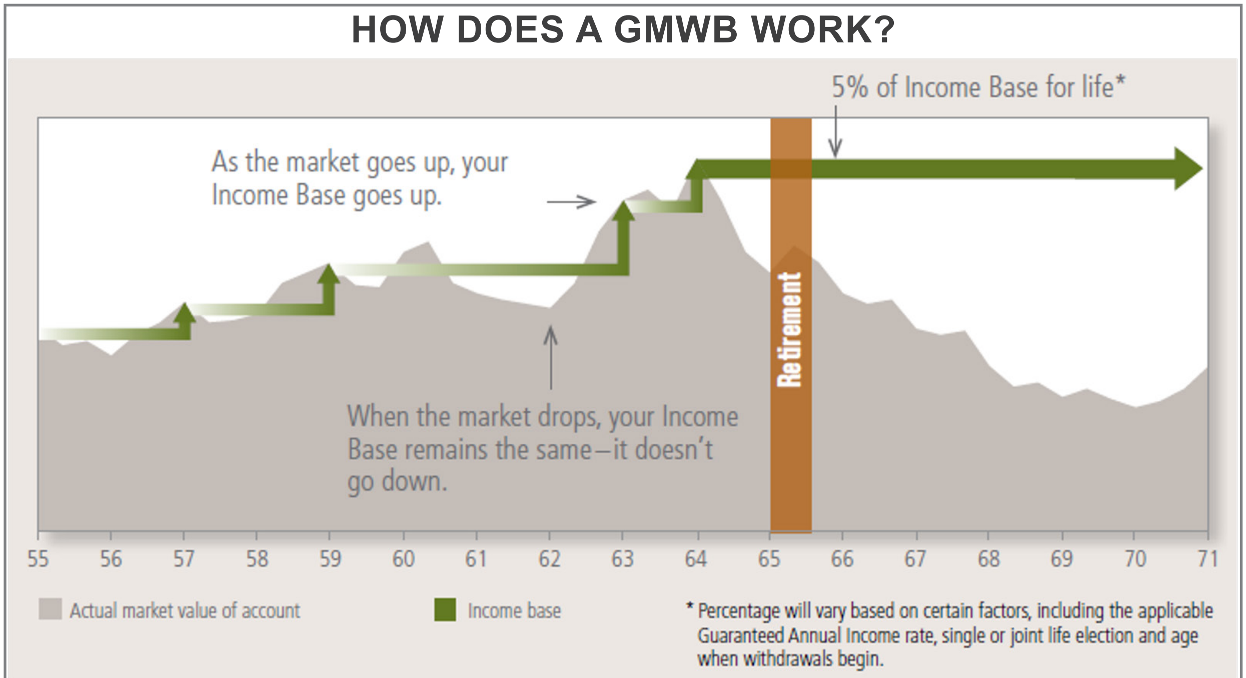
- Flexibility to choose when your income begins
- Requires a smaller up-front investment than an immediate annuity.
- Reduces the risk of market volatility by guaranteeing a future stream of income.

- **Longevity annuity:** This is a deeply deferred annuity where the income start date is much later in life--for example, age 80 or 85. In a qualified plan, typically the Qualified Longevity Annuity Contract (defined below) is utilized instead of a longevity annuity. A primary advantage of longevity annuities is that their starting date provides a defined time horizon for managing the balance of participant assets, which enables a more efficient investment strategy and better optimize returns.
- **Qualified Longevity Annuity Contract (QLAC):** This is a longevity annuity funded by assets from a qualified DC plan or an IRA, thus allowing the participant to acquire longevity protection but at the same time reduce their required minimum distribution (RMD) and defer tax liabilities. There are IRS restrictions attached to this product that need to be considered. For example, the IRS limits the amount of qualified DC plan or IRA assets that an individual may use for a QLAC. As of 2020, this limit was $135,000.

Annuity Distribution Details:
Annuities can be distributed from a plan as a Qualified Plan Distributed Annuity (QPDA). Income benefit forms include distribution details such as whether the vehicle is a Single Life Annuity (SLA) or a Qualified Joint and Survivor Annuity (QJSA). An SLA pays a monthly benefit for the participant's lifetime, with payments ending when the participant dies. A QJSA pays a monthly benefit for the participant's lifetime and then continues making monthly payments to the surviving spouse. The SLA and QJSA are the default payment form in defined benefit plan (DB) plans (the SLA for unmarried participants and the QJSA for married participants). They are less commonly offered in DC plans, although most money purchase pension plans include an annuity as the 'normal' form of distribution and require SLA and QJSA support.

- **Variable Annuity:** A variable annuity is an insurance product that allows someone to potentially grow their money through various market investment options while deferring income taxation. Variable annuities can, but do not automatically, provide income during retirement. These annuities may also offer optional benefits, available at an additional cost, which can protect lifetime income from market downturns, combined with potential growth. An example of such an optional benefit/rider is below:
  - Guaranteed withdrawal benefit rider (GWB)—also known as a guaranteed minimum withdrawal benefit rider (GMWB) or a guaranteed lifetime withdrawal benefit rider (GLWB): A GMWB is an insurance policy for a participant's retirement security. It guarantees an income that lasts for life while at the same time providing liquidity and access to assets. Products that feature a GMWB can also protect one's retirement income from market downturns while allowing their assets to participate in market gains. That is, it provides a way to stay appropriately invested in equities and bonds without too much worry about market volatility due to the protections provided by the insurer. The assets are typically invested in a balanced fund, a target date fund, or a similar investment.

    With a GMWB, a new hypothetical value is calculated for each participant called an income base or benefit base. The income base is reset each period (for example, each year) and is the higher of the market value or the prior period's income base. The income the participant receives is calculated from the income base—and not the market value. Thus, if the market goes down the participant's income base does not go down, thereby ensuring that the participant's income will be guaranteed and will not go below the 'minimum withdrawal benefit'. However, if the market goes up the income base is reset to the new higher market value, thereby providing higher income to the participant. Thus, the GMWB provides downside protection and upside participation.



Source: IRIC (Institutional Retirement Income Council), 2021

At retirement, the participant can elect when to begin income and can elect to include and cover their partner / spouse. If a spouse is covered and if income is started earlier (for example age 55) the guaranteed income will be lower. If a spouse is not covered and income is started later (for example age 70) the income will be higher. Additionally, the participant can access and withdraw part or all their market value; note that any withdrawals may reduce the guaranteed income.

If a participant dies and there is still a remaining market value, the market value will be received by the participant's beneficiaries. If a participant's market value goes down to zero while they are still alive, the insurer will continue to provide the participant their guaranteed income for the rest of their life.

Non-Guaranteed Products and Services

Broadly speaking, "non-guaranteed sources of income" refers to income that is generated from investment options as all or part of a benefit distribution strategy. Currently, some of these strategies are more likely to be found in the traditional IRA market, often involving a financial advisor, although some DC plans offer some of these strategies, particularly Stable Value. Additionally, as DCIIA's Retirement Tier Series makes clear, additional products and strategies designed for DC plans are under development.

Managed payout solution:

As the name suggests, "managed payout" solutions, or simply "payout" solutions, are designed to provide regular periodic payments or offer guidance on how much participants could withdraw. The key distinguishing feature of a managed payout solution relative to a yield-oriented solution is that it targets a specific level of payout. These solutions may be structured to pay out constant dollars (in real or nominal terms), or a constant percentage of the portfolio value, such as 4%. These levels can also be adjusted according to predefined policies (e.g., setting the payout rate equal to the average return over the prior two years). Payout solutions are a broad category and may be constructed for use in the short term, intermediate term, or long term. They can also vary in their level of sophistication and may include considerations of longevity as well as the differing spending patterns of participants. It is important to establish an integration plan with your recordkeeper for this type of product as they will need to have the capability to facilitate the payouts to participants at the appropriate time.

To meet their payout targets, payout solutions can generate income from portfolio yield components, such as dividends and interest payments, as well as from the liquidation of principal. The targeted payout could potentially be designated at a "safe" level below the expected long-run portfolio total return, and while it is possible for these funds to increase their principal over time, the opposite can also occur. Unlike yield-oriented income solutions, where the level of income is driven by investment in high-yielding securities, the capacity of a payout solution to generate income is driven by the total return of its portfolio. Generally, this allows investments in more broadly diversified strategies that are intended to help maintain a stable payout. As with yield-oriented income solutions, investments and income payouts are not guaranteed.

Spending solution/drawdown solution
(these terms are often used interchangeably):

Spending—or, drawdown—solutions are generally fixed-period solutions, although their horizon can vary. They are designed to draw down all, or a predetermined portion, of the initial capital to zero over a given time horizon. They will typically follow the same type of drawdown targets that are seen in managed payout solutions, but at levels which are intended to intentionally deplete the portfolio's principal over time.

Drawdown solutions may be most useful for two types of investors: those who have the means and wish to segregate assets to meet specific cash-flow needs (such as funding the first 20 years of retirement or providing a bridge between retirement and the start of Social Security payments), and those approaching retirement who do not have enough assets to live on portfolio-yield alone. Generally speaking, drawdown solutions provide more income over a shorter time period from the same capital than do yield-oriented or payout solutions; however, they do this by depleting that capital more rapidly. The major risk of such solutions is that they do not address longevity risk (see definition). Therefore, a drawdown solution may best be paired with other strategies that can provide income after the solution has run its course. As with other investment-based income solutions, investments and income payouts are not guaranteed.

Stable value:

Stable value is an investment option available only to retirement plan participants. The investment objectives of stable value are to preserve principal and provide liquidity similar to cash vehicles, but generate returns more consistent with bonds, which is the underlying investment. Stable value investment options are structured in a variety of ways, but in essence they are "fixed income" based investments overlaid with an insurance component that serves to provide benefits of principal stability and to minimize volatility of returns for the participant saving for retirement. While stable value is used by participants during the accumulation phase primarily for safely accumulating a balance, as participants reach the transition and distribution Phases it can be used to prepare the portfolio and generate a stream of income post-retirement through withdrawals. Additionally, some stable value options[4] may offer participants the opportunity to convert their balance under the contract to a defined amount of guaranteed income.

Yield-oriented income solution:

A yield-oriented income solution pays out the portfolio's income from sources such as dividends and interest payments. As a result, the portfolio used for such solutions leans toward higher-yielding asset classes, such as dividend-oriented equities and higher yielding fixed-income securities. Typically, these solutions are designed to maintain a stable payout rate, though this can vary based on market conditions. If the income generated by the portfolio can be accessed by the participant, then the participant can choose to use the portfolio income as payout, preserving the underlying assets from being withdrawn.

In DC plans, dividends and coupons are typically reinvested, so payout strategies cannot be implemented in the same way to withdraw income only, so a less precise method (e.g., basing estimated annual withdrawals on the expected or historic yield on the portfolio) may be considered. Stated another way, an institutional plan strategy of this type would have as its primary investment goal generating income rather than maximizing growth or preserving capital. It is important to note that neither the investments nor the portfolio yield are guaranteed.

Tools

Tools refers to the models, questionnaires, and interactive scenario-building materials often provided by plan sponsors online. These tools can be easy to use and can help participants think through their unique retirement needs. It is particularly important for participants to have access to modeling tools as they transition to retirement and are making complex decisions.

CONCLUSION

DCIIA believes that offering retirement income solutions should be one of the primary goals for defined contribution plans today, given that participants increasingly rely—or will need to rely—on their accumulated DC (as well as IRA) assets to provide them with a critical, if not primary, source of income in retirement. DCIIA offers this glossary as a companion piece to its Retirement Tier Series.

DCIIA remains active in working with plan sponsors, service providers and policymakers to enhance retirement security for America's workers.

The Retirement Tier papers are a multi-part series. Other papers in the series may be accessed through the DCIIA website at **www.DCIIA.org**.

ENDNOTES

[1] Traditional formula DB plans' benefit formulas were typically coordinated with Social Security, so that the combination of the DB plan and Social Security replaced a defined percentage of pre-retirement income. More recent DB cash balance plans operate independently of Social Security, similar to DC plans.

[2] Robert C. Merton is seen as one of the first academics to introduce the term "lifecycle finance" and much of the tenets of this form of finance dates back to his 1969 paper, titled "Lifetime Portfolio Selection under Uncertainty: the Continuous-Time Case"

[3] Contributions to Traditional IRAs are deductible for taxpayers within certain adjusted gross income limits. For taxpayers with adjusted gross income over these limits, traditional IRA contributions are not tax-deductible.

[4] Stable Value is sometimes provided in the construct of a group fixed-annuity contract, which can enable this type of flexibility.

ABOUT DCIIA

The Defined Contribution Institutional Investment Association (DCIIA) is a nonprofit association dedicated to enhancing the retirement security of America's workers. To do this, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA's diverse group of members include investment managers, consultants and advisors, law firms, recordkeepers, insurance companies, plan sponsors and other thought leaders who are collectively committed to the best interests of plan participants. For more information, visit: www.dciia.org.

DCIIA
Defined Contribution
Institutional Investment Association