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Retirement Income Solutions: A Guide for Plan Sponsors

Considerations and case studies to help employers understand and evaluate retirement income options

Retirement Income Committee | Contributors

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UBS Asset Management
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Plan Sponsors | Case Studies

Advance Publications
Federal Retirement Thrift Investment Board
Gwinnett County, Georgia
Health Care Service Corporation (HCSC)
Pacific Gas & Electric
Target Corporation
UTC (UT Investment Management Co.)

DCIIA
Defined Contribution Institutional Investment Association

Contents

INTRODUCTION

Individuals would like to have retirement income that covers their anticipated living expenses,[1] including housing, utilities, transportation, food, health care and entertainment. Although the need for retirement income is clear, people face substantial challenges in determining how best to transform their retirement savings into a regular paycheck in retirement.

DCIIA believes that helping defined contribution (DC) plan participants improve their financial security in retirement should be a primary goal of DC plans. Retirement income strategies can be a key part of achieving this goal. Fortunately, the financial services industry has produced a variety of retirement income solutions, including both guaranteed and non-guaranteed strategies, intended to provide participants with a range of options to facilitate the drawdown of assets in retirement. These solutions range from tools that help participants determine how much to save, to in-plan and out-of-plan options that are designed to provide guaranteed or non-guaranteed income streams for life.

In addition to providing practical assistance with the challenges of transitioning from saving to spending, retirement income solutions may serve as effective workforce management tools. Retirement income products can make retirement readiness less dependent upon factors beyond participants' control, such as market returns, and more reliant on factors participants and plan sponsors can control, namely contribution and savings rates and retirement ages.

A guide to the pages ahead

With this paper, DCIIA describes many of the tools and withdrawal strategies (both guaranteed and non-guaranteed) that support plan participants' income needs as they move toward and live in retirement. Our goal is to provide a useful resource to help plan sponsors to understand and evaluate their options for providing retirement income. The paper addresses the following:

- Support from policymakers
- Reasons plan sponsors have adopted retirement income solutions
- Participant risks that may be addressed with retirement income solutions
- Various implications—fiduciary, operational, administrative and communications related—that retirement income holds for plan sponsors
- Building the business case for retirement income
- An overview of the types of retirement income approaches currently available to DC plans
- Best practices for plan sponsors evaluating and adopting retirement income solutions

Plan sponsors have already acted, adopting a variety of retirement income solutions based on their participants' specific needs. In the pages ahead, we will profile some of those plan sponsors, showing how they have implemented solutions that are appropriate for their organization and their participant base. The case studies include the following:

- **Gwinnett County, Georgia**, offers both a managed account program and a guaranteed lifetime withdrawal benefit (GLWB).
- **Health Care Service Corporation** introduced a lifetime income solution that can be converted into a guaranteed lifetime income stream.
- **Target** offers a three-pronged approach, which is supported by a robust communications program.
- **United Technologies Corporation** replicated a DB pension with a GLWB embedded in a managed account solution.
- **Pacific Gas & Electric** gives employees access to multiple income products, including a defined benefit (DB) cash-balance plan and a DC plan managed account program based on personalized, income-driven portfolios.
- Participants in the federal government's **Thrift Savings Plan** have access to an immediate income stream, including a variety of income benefit forms and other withdrawal strategies.
- **Advance Publications** offers employees a tool that allows them to input their current savings balance and see how much retirement income that amount could produce.

SUPPORT FROM POLICYMAKERS

Over the past five years, regulators have indicated their support for lifetime income solutions within DC plans. The Department of Labor (DOL) and the Department of the Treasury (Treasury) have made a concerted effort, through different initiatives, to support plan sponsors' adoption of retirement income solutions:

2010

In January, DOL and Treasury jointly issued a Request for Information (RFI) on lifetime income options reflecting their interest in and support of these efforts. The RFI solicited input on the advantages, disadvantages and barriers to incorporating lifetime income options into a DC plan and educating plan participants on their DC plan lifetime income options.

2012

In February, Treasury issued a guidance package on lifetime income that included proposed regulations on longevity annuities and partial annuitization in plans and revenue rulings to clarify spousal protection rules for lifetime income solutions.

2013

In May, DOL released an Advance Notice of Proposed Rulemaking (ANPRM) to request feedback about how to communicate DC plan account balances as a lifetime income stream on participants' benefit statements; this request included an example and an online calculator. According to the DOL's regulatory agenda, this initiative remains a priority.

2014

In July, Treasury issued final regulations regarding qualified longevity annuity contracts (QLACs), making them accessible to the DC and individual retirement account (IRA) markets.

In October, Treasury issued Notice 2014-66, which clarified certain questions pertaining to tax law compliance (e.g., Benefits, Rights and Features) when offering annuities within target date fund structures. As a companion piece, DOL, in an intra-agency letter, further clarified that plan sponsors may use a 3(38)* investment manager to assist in the selection of an insurance product and clarified the identity of the investment option as a QDIA (thus with attendant fiduciary safe harbor).

2015

In July, DOL issued Field Assistance Bulletin 2015-02 to help clarify for plan fiduciaries how to exercise fiduciary responsibilities in selecting and monitoring annuities in plans.

***3(38) Investment Manager:** A discretionary investment advisor that can serve as an independent fiduciary through a delegation of authority from the plan's named fiduciary.

REASONS PLAN SPONSORS HAVE ADOPTED RETIREMENT INCOME SOLUTIONS

Plan sponsors adopting retirement income solutions have expressed several motivations:

- Supporting participant retirement outcomes and transition to retirement
- Workforce management, including attracting top talent and rewarding long-term employees
- Meeting other corporate goals, such as adapting to changes in existing benefit programs and retaining assets in the plan.

Within a particular company, stakeholders might find one reason, or a combination of them, especially compelling. Consider the following motivations an employer might have for adopting a retirement income solution:

Participant support. A plan sponsor may have an altruistic interest in helping participants improve their retirement outcomes, with specific objectives such as:

- Emphasizing good savings behavior. Many plan sponsors feel a responsibility to encourage participants' efforts to prepare for retirement.
- Changing the framing of the goals and objectives for the DC plan. If plan sponsors identify the DC plan as the primary retirement income generator for their employees, outside of Social Security, it helps them design their plans more effectively to support participants' retirement goals.

CASE STUDY: GWINNETT COUNTY

Age-Appropriate Investment and Income Options

Gwinnett County, Georgia, helps participants make smart retirement decisions

As Georgia's Gwinnett County transitioned to a defined contribution retirement plan from a defined benefit offering nearly 10 years ago, the plan sponsor discovered that most participants had opted to put their savings in a stable value fund. Participants may have considered it a safe option, but it wasn't necessarily a prudent one.

That's especially true considering that many employees are firefighters, police officers and other public servants who typically start working at an early age and stay in the workforce until retirement. "We hire a lot of young people, and we wanted to do what we could to help them have a better chance of having money in retirement," says Debbi Davidson, director of benefits for Gwinnett County. The county has auto-enrolled all new employees into the DC plan since 2007.

To help steer the county's 4,400 participants toward choices that better aligned with their needs, Gwinnett County implemented two programs: a managed account strategy in 2008 and a lifetime income option in 2011. Though executed independently, the offerings work together to help participants plan for a more secure future. "Before we began offering the managed account option, we kept hearing that participants didn't know where to put their money because they didn't understand the stock market," Davidson says. Now, nearly 95% of new participants enroll in the managed account program.

The managed account offers three levels of account management, ranging from a do-it-yourself option (which includes access to the managed account provider's research) to a truly managed account, in which decisions are made by an investment manager based on the individual's projected retirement date.

Participants' portfolios are also more age appropriate: Whereas 50% of the funds in Gwinnett County's plan had been invested in the stable value fund before the managed account option became available, today that figure is down to just 28%. "It's made a big difference in our participants' retirement readiness," Davidson says. "It's helped our employees, even if they don't know they're being helped."

The same instinct—to improve retirement readiness—led Gwinnett County to introduce a guaranteed lifetime withdrawal benefit (GLWB). "This was a way to offer what we knew participants wanted—steady income in retirement," Davidson says.

The GLWB is available to participants regardless of their age or whether they've chosen the managed account service. When managed account participants are within 10 years of their target retirement age, the managed account service may begin to allocate assets into the GLWB product. Advisor representatives discuss with managed account participants how the lifetime income option might factor into their retirement savings plans, as well as a potential schedule for contributing to the GLWB product, when deemed appropriate for that individual.

The lifetime income option is not presented as a one-size-fits-all solution, however. Advisor representatives ask two specific questions to help determine the optimal allocation to the GLWB for each participant: Do you anticipate using your DC balance for retirement income, or for a large purchase? And do you expect your life expectancy to be substantially shorter or longer than average? "The service makes intelligent assumptions to help guide participants, but we always make sure to give them an option to revise the assumptions or to opt out," Davidson says.

The combination of managed accounts and the GLWB makes Gwinnett County administrators comfortable that they're doing right by employees. "As we transition into a defined contribution world, participants are increasingly having to take care of themselves," Davidson says. "We're still a little paternalistic—we want to make sure we're offering the tools and guidance that allow us to help our people out as much as we can."■

Workforce management. Some plan sponsors may see retirement income solutions as a useful tool for managing their employees, including:

- Helping employees transition to retirement. Individuals who lack sufficient retirement income may delay retirement longer than is desirable from the employer's point of view.
- Rewarding employees. In the absence of defined benefit plans, employer-sponsored retirement income solutions can provide a substantial incentive for employees to create their own pension-like income streams.
- Attracting top talent. While retirement income solutions may be a new addition to benefits packages, it may provide employers with a competitive advantage when it comes to talent acquisition.

Meeting other corporate goals. Retirement income solutions can also help plan sponsors meet other goals related to corporate culture and benefits strategy, including:

- Adapting to changes in the existing benefits structure. If a firm is freezing its defined benefit plan or closing it altogether, the addition of a retirement income solution can help meet participants' needs for assistance in creating a retirement income stream. It may also help combat negative perceptions about changes made to the defined benefit plan.
- Retaining assets. Some retirement income solutions retain retirees' assets in the employer plan—an objective of many plan sponsors.
- Aligning with corporate culture. Some employers place a premium on adopting cutting-edge benefits, including for competitive reasons.

■ CASE STUDY: HEALTH CARE SERVICE CORPORATION

Creating a Soft Landing

As Health Care Service Corporation consolidates legacy retirement plans, it maintains both a defined benefit plan offering and adds a lifetime income option for the DC plan

Over the last 15 years, Health Care Service Corporation (HCSC)[2] has expanded significantly. Faced with a much larger employee and plan participant base, HCSC needed to consolidate various pension, thrift and retirement savings programs to deliver a more streamlined path toward retirement security.

The task was to consolidate 8-10 plans while creating a reasonable, affordable, less volatile soft landing for participants. The challenge was finding a way to retain and incorporate some defined benefit features, including a savings plan, into a new plan structure.

To determine the best way forward, HCSC convened its plan administrative committee (made up of members of the human resources, finance and legal departments) in 2000. The group considered everything from basic concepts to long-term objectives, including plan design, product design and plan specifications. Their objective was to create a set of plans that included DB-like retirement income features accessible to all employees. This was especially important since the former DB program would close to new employees and be replaced with a cash balance feature. The committee reviewed a number of industry products that differed in delivery and flexibility.

After successfully migrating the major DB plans component, in 2007 HCSC continued to strengthen its DC plan, incorporating features related to immediate eligibility, shorter vesting, auto enrollment, default deferral elections, maximizing match, focused education and risk-based allocation tools. The organization also adopted a leading-edge, reasonably priced lifetime income option, which is DB-like in that the available account balance can be converted into a guaranteed lifetime income stream.

Uptake to the DC-based retirement income option thus far has been relatively small, as most of HCSC's retirement-age participants are eligible for the legacy DB plan. Because DB participants are offered an attractive lump sum, the committee decided to build into both the DC and DB plans a feature allowing qualifying participants a 90-day window to roll their DB lump-sum payment directly into HCSC's 401(k) plan upon retirement, thus giving them access to the lifetime income option. This gives them the opportunity to place the lump sum somewhere where it can be professionally managed while also providing access to the market value and a death benefit.

Meanwhile, the company continues to focus on educating the broader base of employees who participate in the combined 401k/cash balance approaches, which includes a large group of Millennial employees. HCSC prioritizes helping these participants understand the importance of and options for lifetime income sources.

As participants approach retirement, HCSC increases the frequency of communications. Saving, investing and lifetime income products can be complicated to understand, no matter how many explanatory materials are provided. That is one reason that enrollment in the lifetime income option is designed to be retractable, if necessary. While staying with it provides the best opportunity, the HCSC design provides a reasonable in-and-out if participants' needs change.

While HCSC believes that its income offering is a solid choice for many participants, the Company is careful to allow participants to make their own decisions. HCSC's approach is not to push or sell the lifetime income option, but instead to provide education and hope for uptake.

To other plan sponsors, plan administrator Gene George recommends having a firm grasp of the population you're serving before offering a lifetime income option to participants: "Understand your population, as well as how they're going to use the product," he suggests. "Don't be forced into it—make sure to fit it and size it to your population and your needs."■

PARTICIPANTS' RETIREMENT INCOME RISKS

Today's reality is that many plan participants are ill-equipped to face the complex challenges of retirement income planning. Their dilemma is further complicated by behavioral biases that can lead to procrastination and poor choices. Access to professional advice is not always readily available, and the cost of this service may be prohibitive for some. Meanwhile, to plan appropriately, participants must consider the entirety of their household balance sheet, which may include multiple retirement plans, IRAs and other accounts that may be available to generate income in retirement.

Thoughtful planning for retirement also involves understanding and preparing for the multitude of risks that threaten the sustainability of retirement income, including:

- Longevity risk. The risk of living longer than expected, and not having sufficient assets to support the extended time horizon.
- Market risks, including:
  - Market losses. The risk that large market losses will diminish the value of assets needed to fund retirement income.
  - Return sequence. The risk of experiencing an adverse market environment near retirement or in its early years. Assets might be sold at a low point in the market, thus "locking in" losses and impairing the portfolio's ability to provide retirement income.
- Inflation risk. The risk of losing purchasing power over time.
- Consumption risks, including:
  - Overspending. The risk of withdrawing assets at higher rate than is sustainable, resulting in the premature depletion of assets.
  - Unanticipated expenditures. The risk of having elevated, unanticipated costs for example, healthcare related expenses including prescription medicines, illness and/or long-term care.
- Lifestyle risk. The risk of not having enough income in retirement to lead the desired lifestyle.
- Cognitive risk. The risk of declining mental capacity, which impairs the ability to make sound decisions and address complex issues.

No single retirement income solution can address all the risks participants face; a given strategy will offer greater protection in some areas and less in others. Likewise, each solution offers a different combination of benefits and tradeoffs for a given participant base. While there are additional considerations at the plan sponsor level (see next section), for participants each retirement income solution will offer tradeoffs among the following factors:

1. Adequacy: The level of income provided
2. Certainty: The level of predictability of the income amount
3. Liquidity: The level of access the participant has to his or her assets
4. Service: The level and type of support the provider offers to participants, and its appropriateness to the product under consideration

Currently available retirement income options are addressed later in this paper, but it is worth noting here that each solution will stack up differently based on these four considerations. For example, income annuity products guarantee retirement income (they provide a great deal of certainty), but those guarantees often limit participants' flexibility with their assets (so they may limit liquidity). Alternatively, investment products such as managed payout funds and managed accounts come with fewer restrictions, but may not guarantee income.

IMPLICATIONS FOR PLAN SPONSORS

Though selecting and implementing a retirement income solution is manageable, it can be more complicated than making other changes to plan design. Employers first must address a philosophical question: Where does the plan's responsibility for retirement income end, and where does the participant's responsibility begin? There is no single correct answer to this question. What's more, plan sponsors may not be able to answer this question quickly, or in isolation from other discussions about corporate culture and resources.

As with many plan design decisions, a plan's demographics will be a critically important consideration when deciding whether to pursue a retirement income solution, and if so which type to select. For example, a plan with a mature, tenured workforce, whose older participants may have significant account balances, may find investment and insurance solutions especially attractive. Conversely, a plan supporting mostly short-service, largely transient participants may prefer to offer planning and referral services to help ensure that employees have access to quality guidance and solutions.

Further complicating matters, there are an array of products to choose from, each of which offers a slightly different solution to the problem at hand. As a result, the process of evaluating and selecting a retirement income solution may be more complex than, for instance, updating an investment menu or changing record keepers.

Yet the challenges are readily addressed, as the case studies included in this paper demonstrate. This paper can provide a path to follow in addressing them. Following is an overview of the factors plan sponsors may take into consideration when contemplating adopting a retirement income solution:

Fiduciary obligations

Like the selection of any investment option, the choice of a guaranteed or non-guaranteed retirement income solution generally involves a fiduciary decision, meaning plan fiduciaries should follow prudent procedures as outlined in the Employee Retirement Income Security Act of 1974 (ERISA).

For guaranteed solutions, one step in the process is the selection of insurance-backed products, such as annuities. In these cases, this task may be perceived as more daunting to some plan fiduciaries who may be less comfortable assessing an insurer's financial health and reviewing or negotiating specific product terms. Plan fiduciaries may also wish to consider counterparty risk—the chance that the insurer could become insolvent. Some plan fiduciaries have addressed this risk by using multiple insurers to spread the risk across them. Also bear in mind that if an insurer does enter insolvency, the policyholders are often protected by the insurance guaranty association of the state in which they reside. While current regulations permit the use of retirement income solutions within an employer-sponsored DC plan, many plan fiduciaries feel that policy makers need to more clearly define key aspects of the process for selecting and monitoring retirement income solution providers.

Fortunately, DOL's recent guidance clarifies that plan sponsors may engage a 3(38) investment manager, as defined by ERISA, to evaluate and select insurers and specific products if they do not wish to make this decision on their own[3]. In this scenario, the plan fiduciary is responsible for selecting and monitoring the 3(38) investment manager who acts as an independent fiduciary. The plan fiduciary can delegate responsibility for selection and monitoring of the insurer and the specific insurance products to the 3(38) investment manager as the independent fiduciary. (Seeking outside independent investment expertise could also be helpful for plans sponsors putting together other types of retirement income solutions for their plans.)

Operational and administrative considerations

The variety of available retirement income options means that there is not a one-size-fits-all list of operational and administrative tasks. A plan that adopts and makes available a retirement income projection tool, for instance, will have a much shorter to-do list than one that adopts a guaranteed in-plan solution. Bear in mind that record keeping requirements may vary for different income products. Regardless of the specific product they choose, plan sponsors must have strong lines of communication with their record keeper and income solution providers, as well as a clear understanding of the necessary data requirements.

One consideration for a guaranteed in-plan retirement income solution to be workable is for it to be portable, both at the plan level (meaning the plan sponsor can switch record keepers or freeze and replace its existing retirement income solution if necessary) and at the participant level (participants can retain their retirement income benefits if they change jobs).

Plan-level portability
Plan sponsors that adopt an in-plan retirement income solution may want to have the flexibility to switch record keepers while retaining the income solution they have chosen.

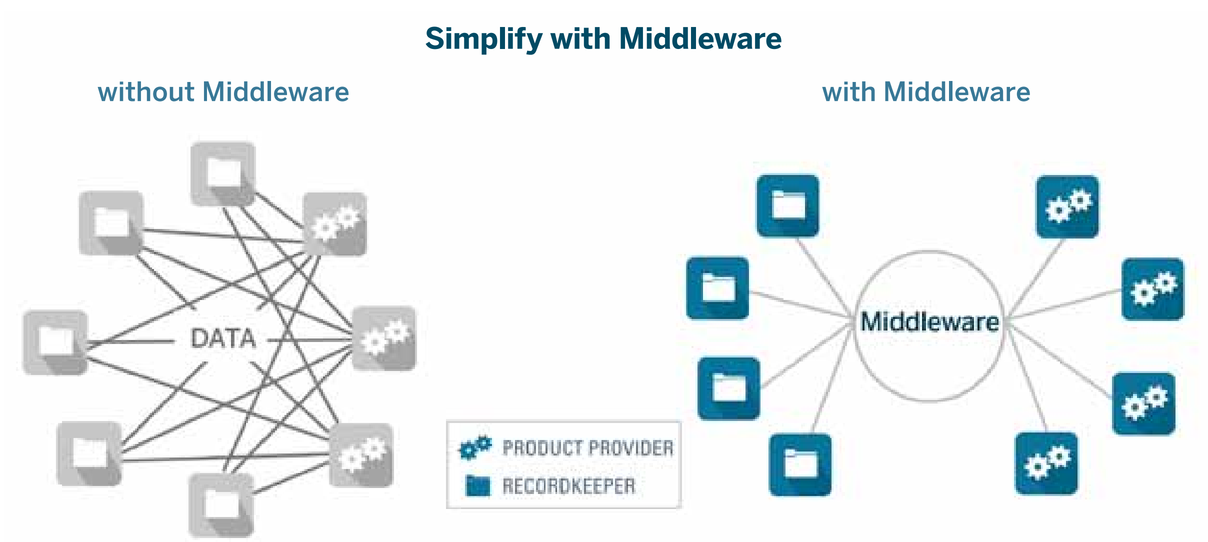
Two recent developments have the potential to make it easier for record keepers to address these issues:

1. Common data standards — Retirement income solution providers have worked with the Society of Professional Asset-Managers and Record Keepers (SPARK) to develop universal data standards, making it easier and more cost effective for record keeping platforms to support multiple products. The release of SPARK's Data Standards for Retirement Income Solutions has enhanced plan sponsors' ability to change record keepers and continue offering the retirement income solution they've chosen.
2. Middleware — Middleware service providers act as a clearinghouse for retirement income-related participant data. Previous approaches required record keepers to develop and support a separate accounting and calculation system for each retirement income solution provider. The centralized middleware model translates the necessary participant information from the provider into a format that integrates seamlessly with the record keeper's existing systems. In addition, the participant's calculated benefit resides with the middleware provider who can track and move the benefit across record keepers thus simplifying plan portability. By eliminating the need to build proprietary feeds, solution providers and record keepers improve the accuracy of data, reduce costs and the time needed to develop and implement income solutions.

Both SPARK data standards and middleware services are driving consistency in the administration of guaranteed retirement income solutions, reducing cost and development time for record keepers, and enabling the open architecture that plan sponsors desire.

Participant level portability. Participants will want to understand what happens to the portion of their plan assets devoted specifically to a retirement income product if they leave the organization prior to retirement. This question is important for plans that adopt in-plan guaranteed products. As yet, there is no uniform standard for participant portability, though retirement income providers do offer some options. For instance, the provider of a deferred income annuity might allow terminating employees to keep their assets in the plan, and provide them with a certificate promising a future payout. An insurer that offers guaranteed minimum withdrawal products may offer terminating employees a rollover into an IRA.

Fees. Evaluating fees is a key part of the due diligence process. The evaluation process can create new questions for retirement income solutions rather than those for conventional investment products, particularly when the solutions involve an insurance component. Reframing DC plans as being designed to provide lifetime income can be



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helpful in establishing the questions to be asked. Plan sponsors could thus evaluate relative value: Do the fees make sense given what's being provided? Retail pricing may be a useful benchmark: An institutional retirement income solution may offer a substantial discount compared to the cost that an individual would pay to purchase a similar product in the retail marketplace.

Communications considerations

Being prepared to communicate clearly with participants about the chosen retirement income option(s) is also a factor. In many ways, this task is similar to all participant communications tasks: Plan sponsors can choose how to segment participants appropriately given the parameters of the product they have chosen. The complexity of some retirement income solutions may make that task more of a challenge. Retirement income providers and plan consultants may be able to offer assistance in creating these materials, including how to educate participants about an income product's benefits and tradeoffs.

■ CASE STUDY: TARGET

A Series of Touchpoints

Target prioritizes efforts to educate participants about retirement income

In recent years, Target has focused closely on the income options available to participants in its retirement plans. The retailer offers a defined contribution to defined benefit rollover option, which gives participants a relatively easy way to annuitize their DC savings. "The move to DC has made us even more interested in people having lifetime income options, especially after we closed the DB plan to new entrants in 2009," says Jeff Bailey, Target's senior director of financial benefits and analysis. Target has introduced a range of complementary income strategies, including the rollover option in 2006, an independent multi-issuer annuity platform in 2011, and most recently, a retiree managed account product.

Participant education had always been important, but providing a suite of lifetime income choices made it a higher priority. "Considering that there are many more choices when it comes to DC plans, we wanted to expand those education efforts," says Kari Steen, Target's group manager of financial well-being. Working with its record keeper, the company begins sending targeted retiree communications to participants starting at age 50—a significant change from the days when participants themselves reached out to the benefits team at 90 days prior to retirement. In 2015, the firm began targeting participants who are turning 50 to remind them about the opportunity to make catch-up contributions.

Education efforts have also become more diverse: Participants receive phone calls from representatives, mailings, and invitations to seminars, all aimed at helping them determine their income needs. "We ask questions that give us a sense of what their retirement will look like," Steen says. "Do they plan to spend their time gardening at home, or do they want to travel the world? How will they pay themselves? That will impact how much they might want to annuitize."

While Target's education efforts are aimed at helping people make smarter choices, the company is also committed to finding solutions that work best for participants—which means finding a delicate balance between paternalism and autonomy. "We try to keep in mind that we don't have a 360-degree view of our participants' situations," says Bailey. "Because we only see a portion of that family's household income, we don't want to be too rigid in our recommendations."

With that in mind, Target measures the success of its operations by taking a long view: Over a given amount of time, how many pre-retirees participated in a conversation about annuitization? How many asked for a quote? In addition to monitoring those statistics, Target hosts regular participant focus groups centering on lifetime income. "We ask if they feel confident knowing where their family's money will come from going forward," says Steen. "It's about that sense of confidence—not just about the purchase of an annuity."

Ultimately, Target's communications infrastructure helps the company feel confident that it's doing well by participants. "I believe we have the obligation to provide a low-cost, high-quality product, and communicate that to the best of our ability," says Bailey. "Of course, you can lead the horse to water but you can't make it drink. That said, if you put the right tools and education in place, it makes it much easier for participants."■

BUILDING THE BUSINESS CASE FOR RETIREMENT INCOME

Plan sponsors that are considering adopting a retirement income solution should follow a thoughtful process, which is laid out in the next section. Begin by defining your objectives—what is your company hoping to accomplish by adopting a retirement income solution?—then build the case to move forward.

Before you go far down this road, it's critical to identify the internal and external stakeholders who should be part of the retirement income conversation. Involving stakeholders early, and incorporating their feedback throughout the process, can smooth the path to adopting a retirement income solution, as several case studies indicate.

■ CASE STUDY: UNITED TECHNOLOGIES CORPORATION

Better Than a Pension

United Technologies Corporation (UTC) swings for the fences with its lifetime income option

In June 2012, UTC began offering an in-plan secure lifetime income option as the default in its defined contribution plan. Just over two years later, over 24,000 participants—including more than 5,000 who have opted in—have taken advantage of the offering, investing approximately $800 million in the program as of October 31, 2015.

UTC executives specifically wanted to go beyond adding a lifetime income component to their DC plan. Instead, they wanted to create something that would essentially replicate— and even improve upon— a defined benefit pension. "We saw where peer companies were going, and wondered what would happen if UTC no longer offered a defined benefit plan," says Kevin Hanney, director of portfolio investments for UTC's DC plan. "So we asked ourselves, if the DC plan is going to be the primary retirement benefit, what features does it need to offer to act like a traditional pension?"

Thanks to the work of UTC's Pension Investments, HR Benefits, and Legal groups, along with the support of their strategic partners, much of the legwork necessary to establish the lifetime income option had already been accomplished when UTC closed its defined benefit plan to new employees in 2009. After considering options ranging from annuities to systematic withdrawal plans, UTC adopted a guaranteed lifetime withdrawal benefit (GLWB) embedded in a simplified managed account because it provided the best of both worlds, offering degrees of flexibility and certainty that would work for participants.

To make the new option a reality, UTC had to get internal stakeholders on board. In a key development, UTC gathered leaders from various functional areas and asked them to list their primary objectives for the retirement income solution. "We used those first principles as a reality check," Hanney says. "Every time there was a fork in the road, we went back to them, because they were what the organization had agreed was important."

Implementing the plan also meant reassuring service providers that UTC was truly committed to lifetime income—while also addressing any issues a particular service provider raised in order to satisfy internal stakeholders. "It was a process of ongoing reassurance for those areas that saw this as new territory," Hanney says.

More than three years in, the lifetime income option is succeeding beyond expectations. UTC has seen significant growth in assets and participants. And if contribution rates continue in the direction they are going, the program could achieve 75% income replacement with Social Security providing another 25%; participants might be looking at 100% income replacement or more in retirement.

That said, the design is continuing to evolve as improvements are made and cost savings factored in; UTC sees the plan's development as an iterative process. "We didn't want perfection to be the enemy of the good," Hanney says. "We thought we were going to launch this with one structure underneath. Instead, we ended up with something very different, which was ultimately cheaper, simpler, and more effective than we could have imagined...but we're not finished yet."■

RETIREMENT INCOME APPROACHES FOR DC PLANS

Retirement income solutions cover a wide spectrum of insurance and investment products that can address different participant needs whether they are in the savings or spending phase. The solutions are intended to help participants while maintaining the benefit of institutional oversight and pricing. Plan sponsors also may adopt income tools and calculators, offer systematic withdrawal programs, or engage rollover or distribution consulting services to provide institutional or retail options for participants who are transitioning into retirement or otherwise separating from service. Following, we provide an overview of some of the various options available to plan sponsors—including some examples of how retirement income solutions have been incorporated into plan design.

- In-Plan solutions are generally characterized by the fact that assets remain in the plan, either as investment assets or, if a guaranteed product, as a group annuity contract held by the plan. Retirement income is paid from plan assets to retirees, and the underlying assets are included as a part of the plan's assets for the purpose of government reporting[4].
- 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 broker firm, that generates guaranteed or non-guaranteed income for the retiree from the amounts transferred. The plan sponsor 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 and the transferred assets aren't included in the plan's ongoing government reporting. This is not to be confused with a garden-variety IRA rollover, where 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[5].

In-Plan: Non-Guaranteed Solutions

Annuity Tracking Asset Classes
An annuity tracking asset class allows participants to estimate their future income needs and invest in packaged liquid bond funds that are designed to track annuity prices. The invested amounts are fully liquid until the participant is ready to retire. The product is designed to increase the probability that it can make distributions consistent with a desired income level, or an ability to purchase a specific amount of income (like an annuity), without making a long-term financial commitment or being subject to surrender charges. Associated tools can show participants how to choose solutions that help meet their needs and monitor progress over time.

Managed Accounts
A managed account program, either in the accumulation or decumulation phases, manages allocations across the existing funds in a DC plan, based on the individual participant's income objectives. If longevity risk is a significant concern and the plan doesn't offer an annuity-based retirement income solution, a managed account may allow participant-directed optional annuity purchases outside the plan. Participants have access to their liquid assets at any time, as provided under the plan's rules, and may be able to develop a systematic withdrawal program (SWP; see below) to provide a steady, although not guaranteed, income stream. Managed account programs can also be combined with other types of retirement income solutions.

Managed Payout Funds
There are two common types of payout funds available to participants at retirement:

- Defined period funds pay out principal and earnings for a specific period of time (e.g., 10 or 20 years). When the period expires, the remaining balance is distributed in full. In defined period funds, the time period is set but the amount is not; the participant's payout varies according to the account's value.
- Defined payout funds pay out a specific income amount for as long as funds remain. The targeted income amount is reset periodically and is not guaranteed.

With both types of funds, it is possible to exhaust the underlying account balance during the participant's retirement.

Systematic Withdrawal Program (SWP)
An SWP provides a more defined approach to spending down a retirement account balance than simply taking withdrawals as needed. The SWP allows a retiree to choose a specific payout amount (dollar or percentage of assets) at predetermined intervals, such as monthly, quarterly, semiannually or annually. Note that most SWP programs currently draw from all plan investments, not just a select number of investments.

Target Date Funds
Similar to managed accounts, many target date funds are designed to invest throughout a participant's lifetime and produce a sustainable annual payout for an estimated life expectancy. Pairing funds like this with a participant-generated systematic withdrawal program may result in a regular payment for participants that could last the rest of their lives. While not as individualized as a managed account solution, plans' existing target date funds may serve as a good first step toward offering a retirement income provision to participants.

■ **CASE STUDY: PACIFIC GAS & ELECTRIC**

Keeping It Simple

Pacific Gas and Electric finds an in-plan income solution that works

Pacific Gas and Electric Company (PG&E) has long offered employees a route to retirement income, first with a defined benefit plan that offers payouts based on final average salary and more recently with a cash-balance option that became the default for new employees as of January 2013. The cash-balance plan allows participants to choose to take a lump sum or receive annuity payments over time. Employees also have access to a defined contribution plan with a retirement income feature, with new employees being defaulted in at an 8% deferral rate.

PG&E added a managed account program to its DC plan in an effort to create an additional retirement income option for its employees. Still, says Ted Huntley, PG&E's director of investments and benefit finance, the approach was "nice to have but not necessary," given that PG&E was already providing retirement income for employees.

When it came time to pursue the new option, "We didn't want to go the annuity route with an insurer because of counterparty risk," says Huntley. Instead, PG&E opted for a managed account program based on personalized, income-driven portfolios. It had introduced online advice in the early 2000s, and then added managed accounts to its investment menu in 2009. The retirement income solution, added in late 2012, was simply an extension of those programs.

Workers using the retirement-managed account are moved to a much higher bond allocation using liability-driven investing techniques, which facilitate consistent monthly payouts. However, the portfolio still holds an allocation to equities, so participants can potentially receive a raise if the market performs strongly for a sustained period.

Beyond the fact that it helps participants handle the retirement income challenge, Huntley and his colleagues value the managed account solution for its ease of administration. "Because the investment advisory firm that provides the plan is a fiduciary, there weren't a lot of red flags for our legal department to run down," Huntley says.

PG&E's income option also keeps retirees in the plan—something the company sees as a significant advantage given the plan's very low fees. However, even despite the myriad benefits, PG&E still had to work with its record keeper to get the option implemented. "It did take some prodding on our part," Huntley admits. "But they're on board now, and it's working out fine."

Although the retirement managed account option is still relatively new for PG&E participants, Huntley has been encouraged by their response. Participants seem to appreciate the security it provides, as well as the human touch it offers. "New retirees want to have someone walk them through the process, particularly when it comes to making decisions about Social Security," Huntley says. "Our income solution means we can offer that." ■

In-Plan: Guaranteed Solutions

Deferred Income Annuities

As an in-plan option, deferred income annuities are designed to provide a fixed future income stream to individuals for as long as they live (subject to the insurer's claims-paying ability). A participant's purchase of this type of annuity locks in a set amount of future income regardless of market fluctuations, similar to a benefit accrual in a defined benefit plan. Deferred income annuities can be offered as stand-alone investment options or they can be embedded within another investment vehicle, such as a target date fund. While most deferred income annuities contemplate income beginning at retirement (age 65), we may see new product development that relies upon the recent QLAC regulation to incorporate longevity annuities (payments beginning no later than age 85).

Depending on the offering and the contract structure with the annuity provider, participants may be able to lock in future cost-of-living adjustments when they initially purchase the annuity. If the product is provided through a target date fund, the annuity portion can provide lifelong income while the remaining assets in the fund offer continued liquidity after payments have begun.

Guaranteed Lifetime Withdrawal Benefit (GLWB)

A GLWB is an insurance contract offered by an insurer and typically includes an asset allocation portfolio like a target date fund, balanced fund or managed account. It incorporates a group variable or group fixed annuity contract structure that is designed to deliver certainty of outcome with greater liquidity than a standalone annuity. The GLWB feature of a deferred savings annuity offers the ability—but not the obligation—to withdraw a defined amount from an investment portfolio throughout the retirement years. Even if those withdrawals exhaust the investment portfolio, the guarantor (the insurer) will pay the defined amount to the investor for as long as the investor lives (subject to the insurer's claims-paying ability).

Immediate Income Annuities
An immediate fixed income annuity offered to participants as a qualified plan distribution annuity option (the plan sponsor selects the insurer or platform provider) enables the participant to convert some or all of his or her plan balance into a fixed stream of payments. Annuity strategies can be based on single or joint lives, and payments can be made for life, a designated period or a combination of both. Like the deferred income annuity, an immediate income annuity allows participants to create an income stream similar to those provided by defined benefit plans.

■ **CASE STUDY: THRIFT SAVINGS PLAN**

Ahead of the Curve on Lifetime Income

Thrift Savings Plan's longstanding annuity option

Participants in one of the nation's largest defined contribution plans, the federal government's Thrift Savings Plan (TSP), have access to multiple lifetime income benefit forms, including single and joint life annuity options. Credit for the existence of TSP's plan distribution annuity option goes to an unlikely source: the U.S. Congress. When TSP was formed nearly three decades ago, federal law required that it offer an annuity option at retirement. That's because TSP was part of a program that replaced a defined benefit-only plan, and lawmakers wanted to ensure that participants' income could continue to be annuitized. "Even a generation ago, there were members of Congress who were concerned about longevity and wanted to make sure the plan included a mechanism to help people avoid outliving their assets," says Greg Long, executive director of the Federal Retirement Thrift Investment Board, which administers the TSP. Thus TSP's annuity option was born.

In the decades since it was introduced, the annuity option has been revised in accordance with participants' needs—allowing TSP to remain ahead of the curve when it comes to lifetime income options. A little more than a decade ago, TSP decided that the annuity option's all-or-nothing design wasn't optimal, since it intimidated participants who were concerned about putting all their eggs in one basket. As a result, and with Congress's approval, TSP moved to a partial annuitization plan. Now, if participants want to annuitize just enough to create the minimum cash flow they expect to need in retirement, they can do so. The change caused a meaningful spike in annuitization rates—a clear indication that additional flexibility with the lifetime income option increased its attractiveness to participants.

Making the annuity more appealing to participants requires more than just tweaking plan design. In addition, plan sponsors must consider how they frame the impact of contributions on retirement income, and how they communicate that information to participants. To make the numbers real for participants, Long decided to include a "lifetime income snapshot" on every annual statement TSP sends. The snapshot includes an estimate of the lifetime income each participant would receive if he or she chose to annuitize his or her current account balance. The idea was to put the long-term implications of saving into concrete terms, and to start conversations with participants. The strategy worked—about 12 percent of participants increased their contribution rates because they were inspired by the lifetime income snapshot, according to a recent TSP survey.

TSP implemented the lifetime income snapshot prominently on participant statements within nine months of deciding to pursue the new approach—even though the speed of implementation made Long's record keeping team nervous. "The upshot is that a change like this is doable," says Long. "If your record keepers say it's impossible, go back and ask again."

Long recommends that plan sponsors who are considering a retirement income option first consider to what degree they feel responsible for their participants' post-retirement decisions. If they care about the choices their former employees make, then they should begin working toward a specific income solution.■

Out-of-Plan Solutions
At the time of retirement or separation from service, participants can access various retirement income solutions outside of the plan, usually via an introduction from the plan sponsor or an IRA provider. Like in-plan solutions, these out-of-plan options can be guaranteed or non-guaranteed.

- Immediate income annuities convert a single payment—i.e., a premium—into an income stream either for life or for a designated period. Income payments begin within a year of the purchase date.
- Deferred income annuities convert a single premium or multiple premiums into an income stream, but payments are deferred until a later date (from two to 30 years or longer after the purchase).
- Qualified longevity annuity contracts (QLACs) let participants move 25% of their plan assets, up to $125,000, into an individual retirement annuity that typically begins making distributions at or before age 85. There are no required minimum distributions until that point.

- Depending on how they are structured, some IRA mutual fund managed payout funds pay out principal and earnings for a specific period of time, or pay a specific income amount indefinitely or until the investment is depleted.

Other Methods of Support

Lifetime Income Disclosures
Consider partnering with your record keeper to add this disclosure, which shows how a participant's current plan balance translates to income in retirement. DOL is expected to issue final guidance on the parameters for lifetime income disclosures to be included on participants' statements in late 2015.

Calculators and Retirement Income Projection Tools
Plan sponsors can help employees reframe the role of their DC plan by adopting and promoting the existence of calculators and other tools that translate current and future savings rates into a retirement income stream. These tools can be hosted on an organization's intranet or at an external plan service provider's site.

■ CASE STUDY: ADVANCE PUBLICATIONS

The Right Tool for the Job

Advance Publications adopts a retirement income tool to suit its participants

In recent years, Advance Publications has undertaken a major effort to streamline its defined contribution offerings, moving from more than 200 mutual funds available in 47 different plans across the company to 7 funds (counting the target date series as one fund) in one centralized plan (a defined benefit plan is available only at the company's cable division). As part of that process, Advance began offering a simplified investment menu that boasts fees of just 20 basis points. The investment menu's centerpiece is a series of target date funds with conservative glide paths that are suitable for the company's 16,000 participants, who tend to skew older—many are 50 or above.

"In our reporting, we found that we had a lot of participants taking careless withdrawals," says Paul Visconti, Advance's Manager of Retirement Benefits. "That concerned us. It was great to get them into the plan and offer a lineup of low-priced investments, but how could we help them with the next steps?"

An in-plan retirement solution was one potential avenue. But the company was cautious about being an early adopter. "We're not typically first movers in these situations," Visconti says, noting that his team ultimately decided to hold off on adding an income product. With the help of an experienced consultant, Visconti discovered a retirement income tool offered by Advance's target date fund manager. "Working with a consultant who had experience with many different products and clients was key," Visconti says.

The tool is both less technical than the options available from Advance's record keeper, and much easier to use. It allows users to input their current savings balance and see how much retirement income that nest egg could produce, or input their desired retirement income and see how their current savings measure up. Unlike many other tools, this one doesn't require that participants input vast amounts of personal information. As a result, Visconti thinks participants will be much more likely to make use of it.

Advance hosts the tool on its local intranet sites, meaning participants see it whenever they log in. Visconti had originally hoped to have Advance's record keeper host the tool, but he's pleased with how things turned out. "From an Advance agenda, having it on the intranet is a great thing," he says. What's more, the lightweight solution was an easy win from a compliance standpoint: Advance's upper management and the legal department were quick to approve the addition. "Everyone thought it was a good idea," Visconti says. "There was really no downside."

Advance started rolling out the tool at the end of 2014, pairing the release with a promotions plan that draws on Visconti's team's vast experience with custom communications. Visconti plans to track user data over time, as well as occasionally surveying participants about both the tool itself and their overall retirement income needs.

Visconti envisions the tool as the first step in Advance's retirement income efforts. "At first, we want people to use this tool directionally, to get a sense of where they stand," Visconti says. "But it also needs to help them determine an action to take, whether that's reviewing their asset allocation or implementing a catch-up contribution. There's plenty we can phase in down the road—but we wanted to give them the tool to play around with as a first step."■

BEST PRACTICES FOR EVALUATING AND ADOPTING A RETIREMENT INCOME SOLUTION

Determining whether to offer a retirement income solution and, if so, which type of product to select, requires a clear understanding of your plan's goals and demographics. With that foundation, you can determine how to develop a retirement income plan that works for your company and your unique participant base. As a best practice, consider how your organization would answer the following questions:

Initial considerations

- What is the typical participant profile (age, contribution rate, tenure)?
- What are the plan's goals regarding income?
- What is the plan's appetite for providing retirement income strategies?

Income solution considerations

- What types of retirement income solutions are available?
- What are the trade-offs among the different solutions?
- How does the product fit the participant population and plan demographics?
- Does the solution qualify as a Qualified Default Investment Alternative (QDIA)?
- Are the fees associated with the product reasonable?
- What support—for instance, planning and tools or access to advisors—is available to participants?

Fiduciary considerations

- How are you planning to fulfill and document your fiduciary responsibilities or will you obtain third-party investment advice or delegate some or all of your responsibilities to a 3(38) investment manager?
- What are the counterparty risks associated with products that have an embedded guarantee? What other risks should be considered?
- What process will you use for ongoing monitoring?
- Is there a benchmark for the product or solution?
- What changes to your plan's Investment Policy Statement, Summary Plan Document, and other plan documents would be appropriate?

Operational and administrative considerations

- Can your current record keeper administer the retirement income solutions you're considering?
- Are solutions portable at both the plan sponsor and participant levels?
- What choices are available if you decide to stop offering the solution or replace the provider?

Participant outcomes

- How will you educate participants about the retirement income solution?
- What is the expected potential impact on retirement outcomes for participants?
- How will you measure success?

AN ACHIEVABLE CHALLENGE

One of DCIIA's core beliefs is that the primary role of DC retirement plans is to create retirement income adequacy. Access to retirement income products, education, planning tools, and advice have the potential to significantly improve participant retirement outcomes. For this reason, we believe plan sponsors' time is well spent giving serious consideration to whether a plan should adopt retirement income solutions.

To be sure, the process of evaluating and adopting a new solution may be a task for many plan sponsors. Yet, the growing availability of resources – including peers and other experts - can ease the effort required. Ultimately, adopting a retirement income solution has the potential to help millions of DC plan participants improve their financial security in retirement—a goal that is well worth the time and effort.

ENDNOTES

[1] "Line of Sight: The Path Forward," Northern Trust, May 2015.

[2] Health Care Service Corporation is a mutual legal reserve company and an independent licensee of the Blue Cross and Blue Shield Association, as well as the largest non-investor-owned health insurer in the United States and the fourth largest overall. It operates through Blue Cross and Blue Shield® plans in Illinois, Montana, New Mexico, Oklahoma and Texas.

[3] "Lifetime Income Provided Through Target Date Funds in Section 401(k) Plans and Other Qualified Defined Contribution Plans," Notice 2014-66, and Employee Benefit Security Administration Information Letter.

[4] "The Next Evolution in Defined Contribution Retirement Plan Design: A Guide for DC Plan Sponsors to Implementing Retirement Income Programs," by Steve Vernon, Consulting Research Scholar at the Stanford Center on Longevity, in collaboration with Dr. Wade Pfau at The American College and the Society of Actuaries, September 2013.

[5] Ibid.

ABOUT DCIIA

The Defined Contribution Institutional Investment Association (DCIIA) is a nonprofit association dedicated to enhancing the retirement security of American workers. Toward this end, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA members include investment managers, consultants, law firms, record keepers, insurance companies, plan sponsors and others committed to the best interests of plan participants.

For more information, visit: **www.dciia.org**.

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