



The Three Pillars of an Effective Decumulation Solution

Introduction

Retirement income is a popular topic for Defined Contribution (DC) plan sponsors. Not only do DC plans now hold the lions' share of Americans' retirement assets, the widespread decline of traditional pensions, which simplified retirement planning for prior generations of retirees, leaves today's workforce with questions around generating a retirement income paycheck. While the rise of DC plans has been effective in helping participants accumulate assets, the task of turning wealth into sustainable income is more complex.

The need for retirement income solutions presents sponsors with a unique set of opportunities to stand out in a competitive market for talent. However, meeting this need also comes with challenges, such as the thorny questions involved in selecting, monitoring, and educating participants about a retirement income solution.

Our experience suggests that there are three critical components to a comprehensive solution: product selection, participant education and effective planning support. Together, these mutually reinforcing pillars enable a participant experience capable of delivering results across a broad range of circumstances.

Why Offer a Retirement Income Solution?

Survey data underscores the fact that many participants, intimidated and unprepared for the challenge of decumulation, are turning to their employers for financial guidance. According to a 2024 Cerulli study, 63% of 401(k) participants do not work with a financial advisor to plan for retirement and/or manage retirement assets.¹ Out of those participants, most use their 401(k) provider as their primary source of retirement planning and financial knowledge.² Active workers are more likely to go to their 401(k) provider than retirees, and retirees are more likely to have no source of retirement planning and financial guidance.³

Against this backdrop, it stands to reason that decumulation support is likely to be very popular among employees, increasing the capacity of employers to attract and retain talent in a competitive market. In fact, the Morgan Stanley State of the Workplace 2024 study found that 91% of employees reported that they would consider changing—or keeping (89%)—jobs to gain access to the financial benefits they need.

¹ Cerulli Associates, Cerulli Report: US Retirement End Investor 2023

² Cerulli Associates, Cerulli Report: US Retirement End Investor 2023

³ Cerulli Associates, Cerulli Report: US Retirement End Investor 2023

Providing support for decumulation may also lead to more assets staying in the plan. This can potentially reduce per-participant plan expenses, as higher plan balances give sponsors better negotiating leverage with plan providers. Beyond the recruitment and retention benefits of passing cost savings on to participants across life stages, a comprehensive and competitive retirement plan may meaningfully improve employee well-being and satisfaction by addressing what is often a major source of anxiety.

Recent legislation, such as the bipartisan SECURE and SECURE 2.0 Acts, suggests that retirement income is likely to be a growing focus of future policymakers and regulators, and the policies include a clear focus on making DC plans a more viable and transparent steward of participants' retirement assets.

Obstacles Facing Sponsors

Of course, the considerable challenges involved in delivering an effective retirement income solution have thus far discouraged many sponsors from expanding their offering. Chief among these obstacles is the weight of their fiduciary obligations.

Sponsors typically have well-established processes for meeting this fiduciary standard in an accumulation-oriented context. For example, sponsors often approach selection and monitoring decisions for traditional investment solutions with reference to relatively straightforward benchmarks. A small-cap equity manager, for example, is readily compared to a market index and peer universe, against which sponsors can measure, attribute, and evaluate a manager's value-added and fees. This also helps sponsors establish standards for when it is appropriate to replace an underperforming manager.

Retirement income products, however, are not often suited to evaluation in this manner – especially when it comes to guaranteed lifetime income annuity products. While most accumulation-centric investment products are highly liquid and easily substituted, annuities may not be.

What's more, not all recordkeepers are equipped for all families of retirement income products. Most major recordkeeper platforms were originally built to accommodate mutual funds and collective investment trusts (CITs). While many recordkeepers are beginning to introduce proprietary income products, the gap between the availability of '40 Act funds and retirement income products remains wide.⁴

Another major obstacle is the increased need for participant engagement and education. Participants typically must do more than simply select a plan's retirement income product for effective results. Rather, they often must navigate questions such as how their personal circumstances impact their allocation decisions, how much they can sustainably spend during retirement, and the tax implications of their withdrawal strategy -- not just in qualified accounts, but also other asset pools and sources of income such as Social Security. Ensuring the proper use of a retirement income product therefore requires effective guidance for participants regarding all these factors.

A Framework for Building a Robust Decumulation Solution

While we appreciate the scale of these challenges, we believe that a thoughtful and comprehensive decision-making framework can empower sponsors to deliver a competitive retirement income offering to their participants.

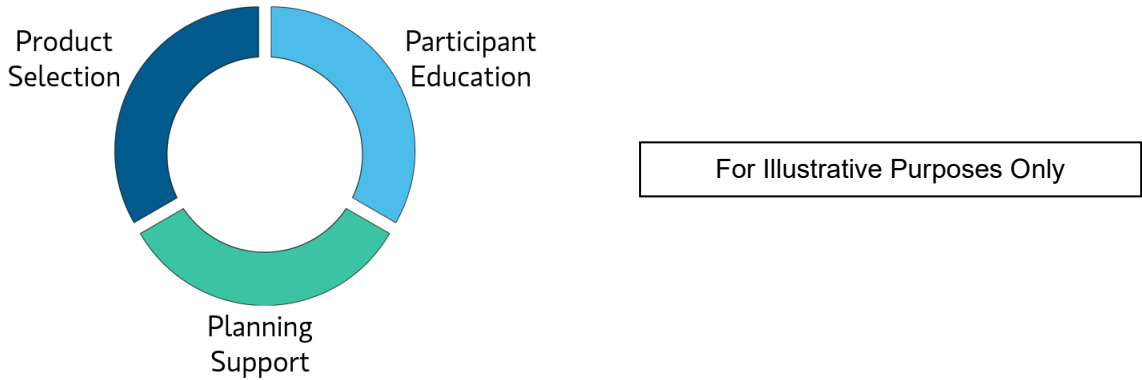
Our framework consists of three mutually reinforcing pillars:

1. A decumulation specific product selection and monitoring process,
2. Synergistic participant engagement and education, and

⁴ In-Plan Annuity Offerings Gain Steam with Recordkeepers | PLANADVISER; <https://www.planadviser.com/plan-annuity-offerings-gain-steam-recordkeepers/>

- 3. Planning support, tools, and resources that meet the participants where they are.

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Source: Morgan Stanley Wealth Management Global Investment Office, 2024

The product selection process begins with assessing the participant base and determining their needs. Factors to consider include representative earnings and net worth profiles, savings behavior, retirement age, investment acumen, and risk aversion. Other financial benefits such as defined benefit offerings, deferred compensation, employee stock ownership, life insurance, health insurance, and health savings accounts (HSAs) should also be considered as a component of needs assessment. What’s more, these factors may vary widely across all participants.

This information can help to establish which category of retirement income product is most appropriate for their participants across two axes of differentiation: high/low participant-level customization and whether annuity products, capable of delivering guaranteed income for the life of the participant, are included.

For example, retirement income target date fund-type products and managed payout products typically offer lower levels of customization than managed account-based solutions; while annuities can be utilized both in turnkey-style products and through experiences that permit greater degrees of customization.

Annuities can provide substantial benefits for participants in many circumstances: They can help mitigate longevity risk and sequence-of-returns risk, or the possibility that market drawdowns occur near retirement and have an outsized impact on the sustainability of a participant’s retirement income plan. Research suggests that they may help deliver behavioral and wellness benefits to participants as well: A Rand Corporation study analyzed the 25 years’ worth of data from the University of Michigan’s Health & Retirement Study (HRS) and found retirees with a high percentage of annuitized income are significantly happier in retirement than their non-annuitized peers.⁵

The flip side of these benefits is that they usually require a decrease in the liquidity profile of the portfolio, which can reduce financial flexibility overall. Also, annuity expenses tend to be higher than standard investment products to cover the costs associated with their underlying risk pooling structures.

There are considerations for plan sponsors when it comes to annuities as well. They will want to carefully consider portability at the plan level and participant level. At the plan level, a new recordkeeper may not be

⁵ <https://www.tiaa.org/public/plansponsors/insights/tmrw/edition-2/retirement-happiness-factors-and-annuities-benefits> (October 2023)

equipped to maintain the product or offer a viable substitute. At the participant level, lifetime income guarantees may or may not be easily rolled into an IRA or different employer plan. While portability risk is likely to decrease as providers continue to expand their retirement income capabilities, it remains an important factor for plan sponsors to consider.

Participant Education and Planning Support

Whatever type of retirement income product a plan offers, we believe it's necessary to offer decumulation-specific education that is complimentary to the solution of choice. For instance, highly liquid and non-customizable retirement income products, such as an income vintage of a target date fund, typically entail greater longevity and behavioral risk for participants than less liquid and more customizable alternatives. However, these risks can be mitigated when participants are educated about them and given the support to enable a disciplined approach to spending and investment strategy.

Access to planning tools and human support are also critical to help participants understand how the product choices on the platform can be configured to meet their individual needs. Examples of tools that can be critical in this regard are retirement spending calculators, Social Security optimizers, and, especially, in-depth financial planning.

That said, participants often don't understand how to use these tools, where they are found, or, in many cases, whether they even exist. An advisor or institutional consultant can help sponsors design an educational program that enables participants to use these tools most effectively.

Conclusion

In sum, designing and implementing a successful retirement income offering requires a thoughtful approach of product selection, participant education tailored to the participant base, and a suite of supportive resources and tools. Participants have made it resoundingly clear they want guidance in generating reliable retirement income. Sponsors that meet the moment stand to deliver tangible benefits for participant satisfaction, cost efficiency, and their ability to attract and retain talent.

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If you are investing in an annuity through a tax-advantaged retirement plan such as an IRA, you will get no additional tax advantage from the annuity. Under these circumstances, you should only consider buying an annuity because of its other features, such as lifetime income payments and death benefits protection.

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