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Perspectives of Plan Sponsors and Service Providers on Retirement Payout and Support Options: An Interview with Neil Lloyd

By Anna Rappaport

This issue of *Retirement Section News* is focused on retirement income and support options. Neil Lloyd is responsible for research for the Defined Contribution and Financial Wellness practice of Mercer; he chairs the Retirement Income Committee of the Defined Contribution Institutional Investments Association (DCIIA); and he is the research chair for the Employee Benefits Retirement Institute. In 2018, he testified to the ERISA Advisory Council on retirement income and the employer on behalf of DCIIA. *Retirement Section News* interviewed Neil to learn about his views about plan sponsors and how they are responding to the need to help their employees manage during retirement.

Anna Rappaport (AR): What is your impression of how much plan sponsors are doing to encourage and provide options for the post-retirement period that provide for the regular payout of income?

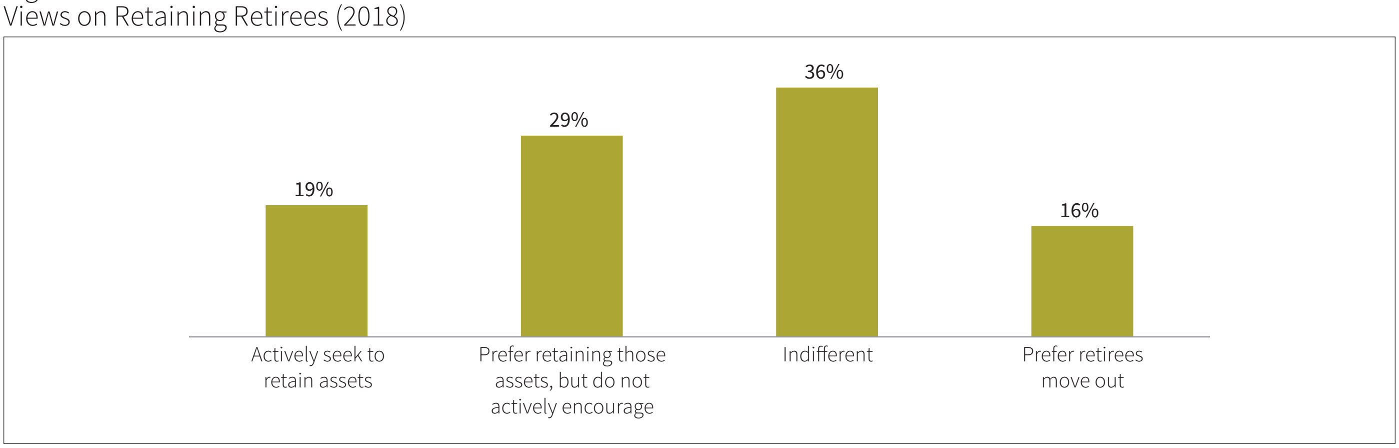
Neil Lloyd (NL): Our experience is that there is a general realization that for the retirement system to be successful, retirees need assistance. Retirees see a multitude of options facing them, and it is pretty clear that retirees need help if they are going to maximize the retirement resources they have, which in many cases is less than would be ideal.

Many plan sponsors have been actively focusing on encouraging retirees to stay in the plan after retirement, and as part of that evolution, we are seeing more plan sponsors allowing partial withdrawals to be taken from the plan. Arguments in support of encouraging retirees staying in the plan and taking partial withdrawals include:

- Larger asset base generally translates to lower asset management costs for all participants; the younger age cohorts also benefit from the scale of the retained older cohorts' assets.
- Retirees can access the same robust plan governance and low costs they had when employed by retaining assets in the employer's plan, which may improve retirement income.

However, it's important to be aware that not every plan sponsor has the same view. The "PIMCO Defined Contribution Consulting Support and Trends Survey" (See Fig. 1) in 2018 showed these varying views. While the survey suggested that 38 percent of plan sponsors supported retaining retirees, 36 percent were indifferent and 16 percent preferred retirees to move out.

Figure 1
Views on Retaining Retirees (2018)



Source: *PIMCO Defined Contribution Consulting Support and Trends Survey*, April 2018

Probably the biggest reason mentioned as to why a plan sponsor would not want to encourage retirees to stay in the plan is that the employer would be assuming continuing fiduciary responsibility for retiree assets for a group of people who are no longer producing for the company. The other practical reality is that employers only have so much time to devote to their plans, and they may be focused on other issues.

AR: So, what are some employers doing?

NL: Last year I represented the Defined Contribution Institutional Investments Association (DCIIA) in providing testimony to the ERISA Advisory Council that was exploring the issue of lifetime income in defined contribution (DC) plans. At the time, we asked a group of plan sponsors about which lifetime income products they offered through their plans. The answers are shown in Figure 2.

It was noticeable that the most common lifetime income options being used were various diversified investment options and managed accounts. Annuities or annuity support services were less than half as popular. We also need to note that this was probably a more engaged plan sponsor group, since they were a group who were engaged with DCIIA and they had responded to the survey (i.e., with a typical group of plan sponsors, utilization was most likely less).

AR: What barriers do you see that are stopping them from doing more?

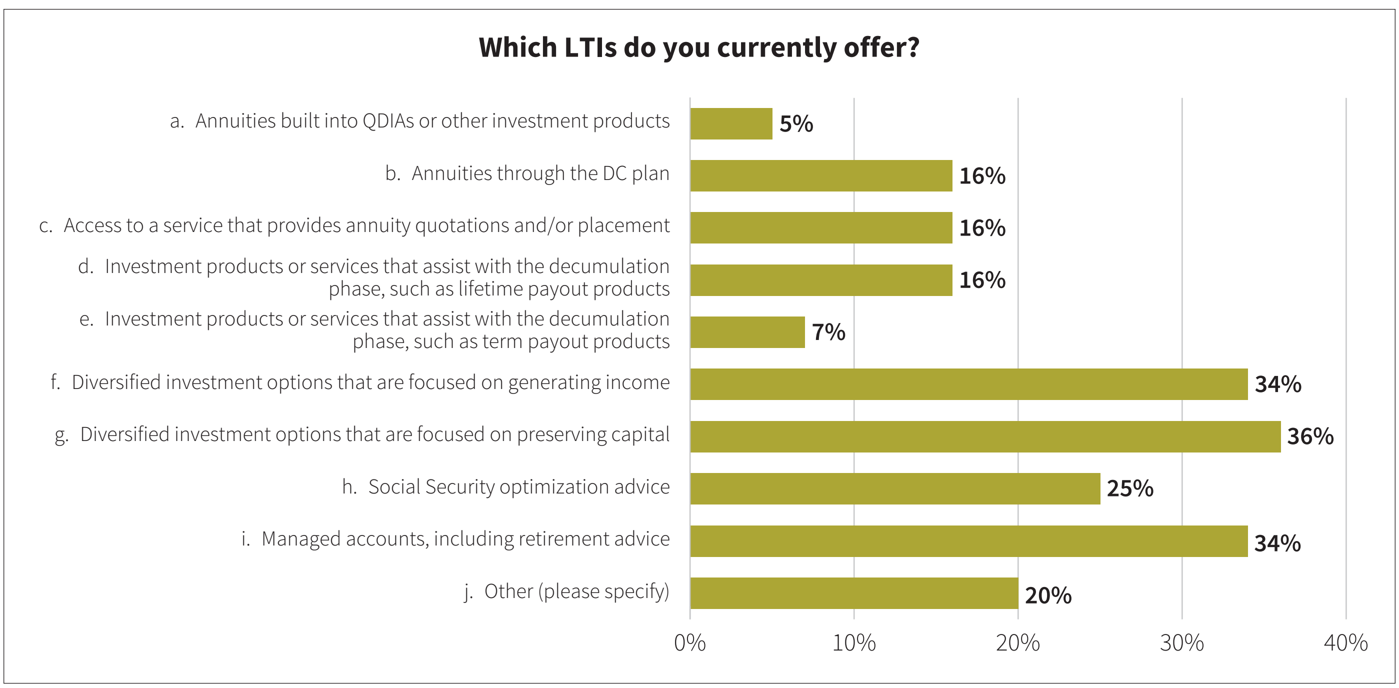
NL: We also asked this question. We actually asked the question of the industry and of plan sponsors and overall the responses were very similar. Figure 3 (Pg. 18) shows the plan sponsor responses.

Unsurprisingly, the biggest deterrent was the absence of a fiduciary safe harbor to implement lifetime income products or services. What is interesting about this is that there are a number of legislative proposals at the moment that would put in place an annuity safe harbor.

In the discussion that took place around these results, an analogy was made with a Matryoshka doll (the set of wooden dolls of decreasing size placed one inside another where you remove one layer only to find another doll). Even if we obtain an annuity safe harbor, there may be another layer of issues to address before widespread adoption. These issues would include high costs, complexity, portability and more.

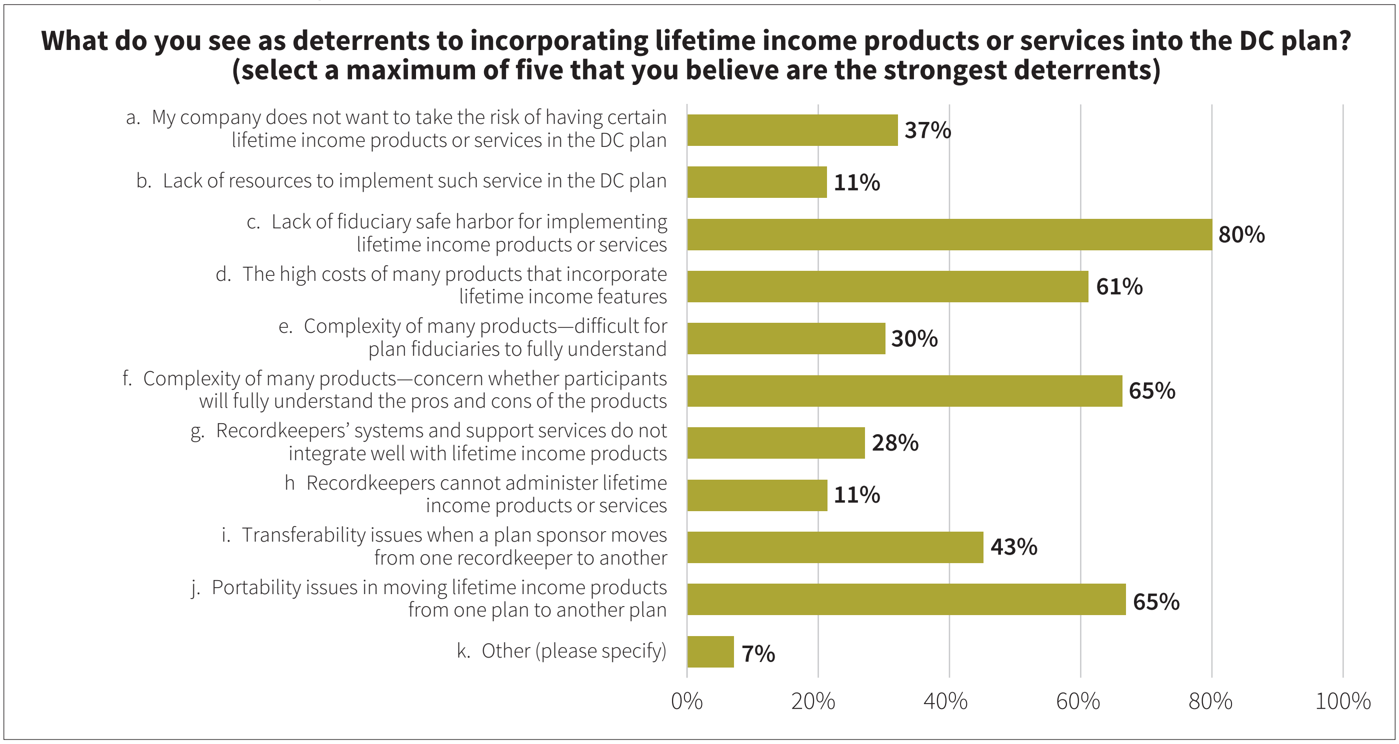
AR: What is your impression of how financial service products are evolving to encourage and provide options for the post-retirement period that provide for the regular payout of income? What are the key features of the products that seem to be gaining the most acceptance?

Figure 2
Lifetime Income Products Offered



Source: Testimony before the ERISA Advisory Council on Employee Welfare and Pension Benefit Plans, *Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA), Focus on Decumulation and Rollovers*, DCIIA, June 19, 2018.

Figure 3
Deterrents to Incorporating Lifetime Income Products or Services Into DC Plans



Source: Testimony before the ERISA Advisory Council on Employee Welfare and Pension Benefit Plans, *Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA), Focus on Decumulation and Rollovers*, DCIIA, June 19, 2018.

NL: For a long time, we have seen annuity-based products in the marketplace, and we have seen attempts to integrate lifetime income features, sometimes annuities, into target date funds so they could be included in the plan's Qualified Default Investment Alternative (QDIA). However, while these products have apparently led to some very engaging discussions, there has been limited take-up of these products.

What we have been seeing is the development of less-complex investment offerings that are being positioned as ideal for retirees. These typically have daily liquidity and pricing, institutional type fees (i.e., fees that are not too high) and are not that dissimilar to (in fact, they may be the same as) investment options already in the plan lineup. Based on an informal survey that Mercer conducted of a series of managers in 2017, we ended up classifying these products into four groups:

- Managed/target payout options: investment funds designed in some way to generate (payout) a certain pattern of income.
- Income-oriented asset class portfolios: typically, high-yielding equity or fixed-income funds.
- Multi-asset class funds: that will invest in different asset classes depending on market circumstances all with the purpose of trying to create stable income.
- Other: a catchall for any strategy that did not fit into the other three categories. For example, stable value funds, short duration bond funds, low-volatility equity strategies.

While the idea of retiree-focused investments originally resonated quite well, there were some challenges:

- Newer products had very limited track records and often were investing little more than seed capital.
- It was unclear who was going to explain these products to retirees and how they would fit with existing advice tools in place.

Our impression is that for the products that have been more successful, where success is defined as having added these funds to lineups, it has seemed to be cases with a combination of an existing track record and an existing trusted relationship with the plan sponsor—for example, where the plan sponsor is already using that asset manager.

In addition, we have seen increased interest in managed account solutions. These solutions are not new, but they have enhanced their ability to assist retirees with retirement planning aspects beyond pure investments. Today they will often provide additional advice on social security optimization, Medicare/Medicaid choices, asset location advice, items that can be shown to add real value. In addition, from an investment perspective, they provide a solution more tailored to individual circumstances, and there is general agreement that as one ages, there is increasing heterogeneity and a one-size-fits-all solution is less successful.

In the past when looking at the retirement challenge, there has been too much focus on creating a perfect solution.

AR: How much are they doing to communicate such options?

NL: In the case of managed accounts, the managed account provider will clearly promote their services and actively reach out to retirees and near-retirees.

But otherwise, communication can be a challenge, since the typical communication and recordkeeping infrastructure is not really designed to deal with decumulation; it has been designed for accumulation. For example, typical investment decision tools are not typically focused on drawdown strategies. This is beginning to change, and recordkeepers are evolving in this regard, but this does remain a challenge.

AR: What trends are emerging?

NL: The focus today is increasingly on the concept of the "retirement tier." A retirement tier is a more holistic concept and can comprise any product, solution, tool or service that simplifies or facilitates the decisions that need to be made by plan participants prior to, at and during retirement, taking into account their own household circumstances in order to ultimately generate income.

Essentially it is a way of looking at your plan where you agree to consider what can be done to assist those near, at or in retirement.

In practice, in creating a retirement tier, you do need to consider plan design, in particular whether or not you wish to allow partial withdrawals, since that influences what else you may want to do. In addition, you need to consider the role the recordkeeper can play and the optionality they provide—this is critical since the recordkeeper is a key point of contact, particularly for those in retirement.

But beyond that, there is a wide range of solutions that can be included, some examples being:

- Targeted communication
- Diversified (nonguaranteed) investments solutions
- Tools and advice
- Products with guarantees (e.g., annuities)
- Consolidation service

AR: Why do you think the retirement tier may be more successful than other approaches?

NL: I think our feeling is that in the past when looking at the retirement challenge, there has been too much focus on creating a perfect solution—the silver bullet or creating a very in-depth menu of options for retirees. In many cases, the thought of going through such an extensive exercise has been too much, given all

the other pressures facing employers, whether it be other plan issues or simply their job outside of the DC plan.

With the retirement tier, increasingly the focus is on encouraging plan sponsors to look for something that can be done that can assist retirees, and that's simple to do. We would rather see lots of plan sponsors taking one small step forward; over time, the retirement tier can be fleshed out: We don't need to make it an overwhelmingly complex and time-consuming undertaking.

AR: How do you see the future of the employer/plan sponsor role in providing income post-retirement?

NL: While there is no doubt that the support employers have provided to U.S. workers has been a key reason why many do have reasonable retirement resources, but there is an interesting question as to what type of system is best at supporting post-retirement initiatives. As mentioned earlier, not all employers believe they need to focus on retirees.

There are current proposals dealing with the introduction of Open Multiple Employer Plans (MEPs) and Association Retirement Plans. What is interesting with these initiatives is that the overseas experience has shown that similar open plans have quickly focused on lifetime income initiatives in a way for these plans to retain assets in retirement as a commercial imperative—an incentive employers do not have.

So, while I certainly hope we see more employers warming to the retirement tier concept, I am pretty sure that if we get Open MEPS or similar, retirees will be a focus for them.

AR: Are there any references you recommend on these topics?

NL: In the current environment, I would recommend that anyone involved with a DC plan to keep an eye on regulatory and legislative developments. There is a lot of retirement legislation being proposed at the moment, almost all of it including lifetime income features. In addition, retirement legislation seems to be bipartisan in nature, so the prospects for legislative change are much greater than in some other areas.

Finally, in my view, I find many people within the industry fall into the trap of thinking about retirement as a math or engineering problem. That's a mistake—retirement is an essentially human experience with a lot of behavioral biases behind the decisions we make that influence what we truly aspire to in retirement. I believe it is absolutely essential to do what we can to understand what retirees' needs and wants truly are—not just focus on what we think retirees' needs and wants should be. With this in mind, I highly value the work performed by the SOA Post-Retirement Needs and Risks Committee and find their work with surveys and focus groups absolutely essential to understand what retirees are truly interested in—and it's often not what you think. ■

Anna M. Rappaport, FSA, serves as chairperson of the Committee on Post-Retirement Needs and Risks (PRNR) and the Steering Committee for the Aging and Retirement Strategic Research Program. She can be contacted at *anna.rappaport@gmail.com*.