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Issue no. 11

What plan sponsors need to know about lifetime income

An article from next, issue no. 11. To read the publication, visit us online at *nuveen.com/next-11*.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

INVESTMENT CORNER

What plan sponsors need to know

about lifetime income

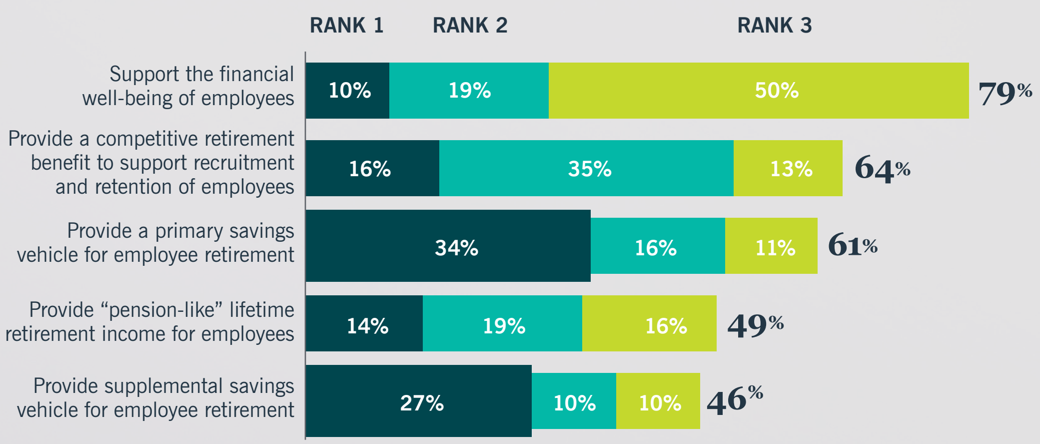
The conversation around guaranteed lifetime income has been steadily growing since the SECURE Act of 2019 changed safe harbor provisions to protect in-plan annuities. Participants have long wanted lifetime income built within their retirement plans, to mirror the benefits of now essentially extinct defined benefit plans.

When Nuveen conducted our third annual Equilibrium survey we spoke to 189 institutional investors who were actively involved in their DC plans, across the U.S., Canada and the U.K.

When asked about the overarching objective of a retirement plan, the respondents prioritized the traditional role of a DC plan, namely providing a savings vehicle for plan participants. However, the most selected answer across rankings was the broadest and most aspirational; to support the financial well-being of employees.

Figure 1: DC plan priorities

Select and rank which of the following objectives are a priority for your DC plan?



Supporting the financial well-being of employees was most commonly selected, but providing a primary or secondary savings vehicle for retirement is a high priority.

189 respondents involved in investment decision making around their DC plan. 2023 Nuveen Equilibrium global institutional investor survey.

Why guaranteed lifetime income

Research shows though that for plan participants, a guaranteed lifetime income in retirement is a significantly larger concern and could be used to motivate recruitment, retention and allow employees to retire on time. Seventy percent of participants surveyed by TIAA expressed a preference for a company that offers a guaranteed lifetime income solution in retirement. Even higher numbers expressed a preference for income stability over just principal protection, with 78% of respondents to an EBRI survey asking for income. These numbers are not necessarily indicative of a disconnect between participants and plan sponsors, but they could be a growing sign that participants want the next evolution in their retirement plan.

They are not simply looking for a tax-advantaged savings vehicle that opens up at retirement. Participants understand that guaranteed income has a significant role in securing their retirement and they are, rightly, looking to their employer to help them in that process.

When asked about their views specifically on guaranteed income, a majority of plan sponsors see that a guaranteed income solution can improve the risk/return profile for participants, and they see a growing need to explore the available options for lifetime income given the current market environment.

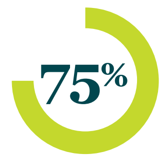
The other telling portion of the dataset is just how large the 'neutral' portion of respondents is. The education around the role and benefits of a lifetime income solution within a retirement plan is still at a relatively nascent stage. Those who have an opinion on the matter are largely in favor, with only around 10% of respondents disagreeing with the potential role and benefits of lifetime income solutions. It is the role of asset managers as well as advisors and consultants to help educate plan committees on the role that guaranteed lifetime income solutions can provide. The solution isn't right for every plan sponsor, but it appears that on balance, once a sponsor has a firm opinion of lifetime income, they view it positively.

49%

of Americans say running out of money is their biggest retirement concern[3]

Participants say...

would choose to work for, or stay with, a company that offers access to guaranteed lifetime income in retirement[1]

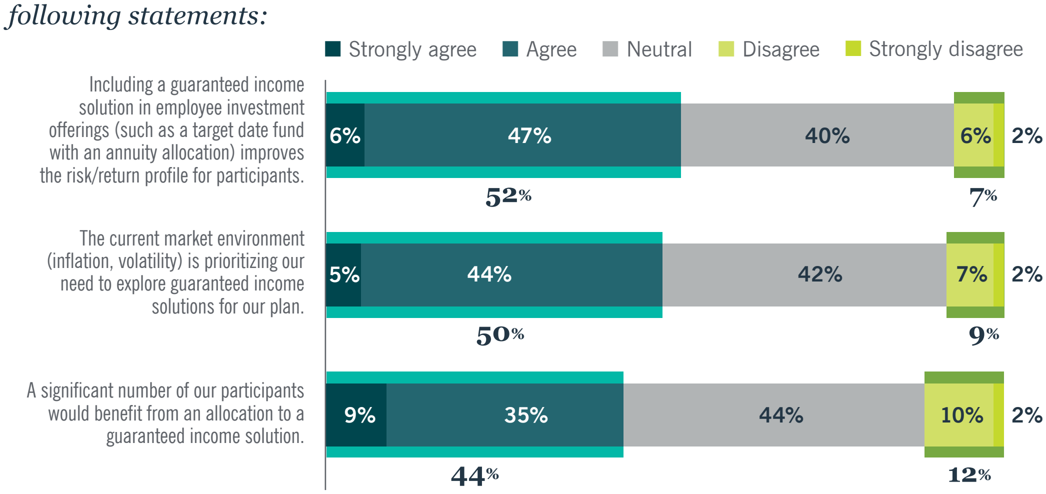


prefer income stability over principal preservation[2]

expressed interest in rolling some or all money from retirement plans to a guaranteed lifetime income product at the time of retirement[2]

Figure 2: Views on income solutions in DC plans

When considering your DC plan, please indicate your agreement or disagreement with the following statements:



Over half (52%) say that including guaranteed income solutions will improve the risk/return profile for participants, while about 4 in 10 have not made up their minds. Current market environment (inflation/ volatility) could influence consideration.

189 respondents involved in investment decision making around their DC plan. 2023 Nuveen Equilibrium global institutional investor survey.

The how of guaranteed lifetime income

When it comes to lifetime income solutions there are both guaranteed and non-guaranteed products. Systemic withdrawals are the most common withdrawal method employed in the current 401(k) environment, where the participant determines the amount and frequency of withdrawals from their retirement account, until the point the funds are depleted. This option contains few protections for the participant, but it is the most flexible and most liquid of the various payout options. There are also managed payout options, in which a managed account investment manager works to determine regularly scheduled payouts from the participant's assets, with the goal of ensuring that the assets last through retirement. However, there are no guarantees with this type of solution.

We think that an in-plan annuity is the best way to integrate a lifetime income solution into a retirement menu. This can be wrapped into a target date-like structure, where an allocation to an annuity is built into the overall glidepath of the retirement plan, culminating in an allocation around 40% to an annuity product at the time of retirement, although this percentage can certainly be higher or lower depending on specifics. It could also be structured as part of a range of QDIA-eligible structures.

The benefit of in-plan gives the option, but not obligation, to convert those assets into a lifetime income stream at the point of retirement. Simple is key though; annuities can be very complex, and we find it easiest for these solutions to be adopted by participants by embedding them into something that the participants are already familiar with — such as a target date or managed account offering.

In-plan annuities wrapped into a fund structure offers the most seamless integration for plan participants as little will change from the perspective of the plan participant. The genesis of target date funds was to allocate risk according to age and time to retirement, and this metric, while simple, still reflects the needs of a significant portion of plan participants. Wrapping the annuity allocation into a structure that is broadly familiar to participants, whether target date or another type of structure such as a managed account, eases the transition from viewing a 401(k) balance as a savings vehicle to a lifetime income vehicle with a set

Myth vs. *Reality*

Annuities are restrictive, with little to no flexibility.

Annuities offer a range of options and can be used to diversify a retirement income plan.

It's all or nothing with annuities: they require using total savings.

Employees can annuitize a portion of their savings and leave the rest until they are ready to withdraw them.

Employees lose estate value

Employees have multiple options with annuities, including joint payout options to provide for an estate benefit.

decumulation plan. Making this transition as seamless as possible for the plan participant is the best way to encourage uptake of the annuity at the point of retirement and get participants the lifetime income they need.

Education for participants remains a significant area for plan sponsors. Recent TIAA data shows that upward of 80% of new employees use the default option in their retirement plan, while longer-tenured employees tend to more actively manage their investments. Both types of investors need to be educated as to the value of an annuity option within their retirement plan menu, either so they understand what the default option is and why the plan designers selected it, or so they understand that leaving the assets within that option is the better choice, rather than actively managing it away.

There are also some technical considerations of different types of annuities, as they can be relatively complicated products with different contract types. Without getting too into the details, as different annuity types will suit different plans and participants, the principal types are:

- An immediate fixed annuity, such as a single premium immediate annuity (SPIA). These annuities are taken at the point of retirement, when a participant signs the annuity contract and hands over a portion of their assets in return for lifetime income.
- A qualified longevity annuity contract, or QLAC. These are similar annuities, in that they are often fixed annuities, that take a portion of assets and surrender them in return for guaranteed income. The major difference is that there is a delay between the surrendering of assets, say at retirement, and the start of payouts, often 10 or 20 years later. This can significantly increase the payouts received but it can increase mortality risk if the annuitant dies before their payouts begin. The assets also have to come from a qualified account or IRA.
- Deferred annuities are used when a participant deposits into an annuity contract over time or at some point prior to retirement. These have two distinct phases, the accumulation phase, when the participant is paying into the annuity, and the payout phase, when they are taking the lifetime income. Some deferred annuities have lockup periods or withdrawal limits, while others have more flexibility and are liquid deferred annuities. We prefer retirement plan options that retain liquidity for participants and ensure as much flexibility as possible.

Figure 3: Lifetime income solutions offer varied benefits

	EMPHASIZE LIQUIDITY		EMPHASIZE LONGEVITY RISK PROTECTION		
Attribute	**Systematic withdrawals**	**Managed payouts**	**Guaranteed lifetime withdrawal benefit**	**Fixed annuity**	**Qualified longevity annuity contract**
Description	Participant determines amount and frequency of withdrawals from their retirement account until it is empty	Managed account investment manager determines the regularly scheduled payouts, adjusted for market fluctuations, with the goal of helping to ensure funds last through retirement	Contributions are invested into an insurance separate account and paid out to the retiree as steady withdrawals in retirement, regardless of market fluctuations	Predetermined interest rate is earned during the participants' working years. Participant can exchange the fixed annuity for a guaranteed monthly income amount throughout retirement.	Portion of retirement assets is used to purchase guaranteed lifetime income that does not start to payout until a later age: typically 85 or older
Principal protection	No	No	No	Yes	N/A
Payment guaranteed for life	No	No	Yes	Yes	Yes, but payments do not start until later in retirement
Income protected from market downturns	No	No	Yes	Yes	Yes
Ability to withdraw before payments have begun	Yes	Yes	Yes, but may impact guaranteed payment amount	Yes	No
Ability to withdraw after income has begun	Yes	Yes	Yes, but may impact guaranteed payment amount	No	No

Data sources: EBRI, Cerulli and TIAA/Nuveen. This comparison represents only a sample of features typically included in the product types when used in the institutional retirement plan market and does not attempt to articulate all options that may be available. Insurance product guarantees are backed by the claims-paying ability of the issuer.

- The Guaranteed Lifetime Withdrawal Benefit, or GLWB. This type of annuity is different, as the assets remain the property of the participant, but the portfolio is redirected into a mix of stocks, bonds and other asset classes that then generate the income that is provided to the participant. The income is guaranteed by the insurance company if the level of income from the portfolio falls below that in the contract. This contract type includes explicit fees paid by the participant to the insurance company. This has the highest growth potential and ability to keep pace with inflation, while also offering flexibility for the participant.

There are also variables in the underlying contract within each of these types of annuity, such as minimum payment lengths, survivor benefits, variable or indexed annuities. Each change to the underlying annuity affects the premiums and payouts accordingly, and each type of solution needs to be carefully evaluated for its suitability. These are complicated insurance products that need to be understood before they can be implemented.

It also takes time to examine a plan menu and endeavor to evolve the options to include a guaranteed lifetime income solution.

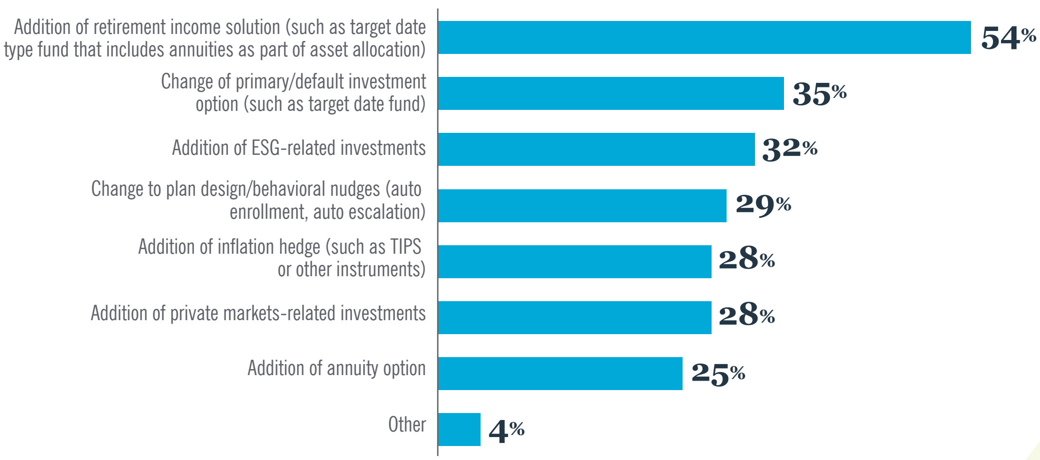
Our survey data shows that for those plans that are considering making changes to their lineups in the next two years, 54% are looking to add some form of lifetime income solution. This is significantly higher than any of the other options presented and highlights that plan sponsors are closely looking at retirement income as one of their highest priorities in the current environment.

We believe that a guaranteed lifetime income solution is something that plan sponsors should be carefully considering. The evaluation of different options and whether they are the right solution for participants to meet their needs in retirement rests on detailed and careful education and analysis. The cost of the solution is a major consideration, as is the underlying complexity. Not all solutions are easy to explain, and many have different characteristics that can change vital components of the annuity. The portability of the solution is also a significant consideration, as employees are increasingly more likely to change jobs, while the overall support afforded by the solutions provider to participants should be robust to educate and support them in their retirement journey.

> "They are not simply looking for a tax-advantaged savings vehicle that opens up at retirement. **Participants understand that guaranteed income has a significant role in securing their retirement.**

Figure 4: Planned changes

Which of the following changes did you make or do you plan to make? (n = 69)



Adding an income solution is the top choice for those plans that intend to make changes to their DC investment lineup over the next two years.

Overall (n = 69 respondents making changes to their DC investment menu in the coming 2 years). % Yes, multiple answers allowed.

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For more information, please visit us at nuveen.com

Endnotes

1 TIAA 2021 Lifetime Income Survey, May 2021.

2 EBRI Retirement Confidence Study, 2020.

3 AARP, May 2019.

Any guarantees are backed by the claims-paying ability of the issuing company.

Annuity contracts and certificates are issued by Teachers Insurance and Annuity Association of America (TIAA).

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