Welcome to InFRE's January, 2017 Issue of Retirement Insight and Trends

retirement-insight.com/welcome-to-infres-january-2017-issue-of-retirement-insight-and-trends/

Retirement InSight and Trends is the quarterly newsletter for the International Foundation for Retirement Education's Certified Retirement Counselors® (CRC®s) to help retirement professionals with the practical application of new retirement readiness, counseling, planning and income management concepts for the mid-market. Find out more about the CRC® and InFRE here.

One *free* CRC®, CFP®, ASPPA, and the American College's Professional Recertification Program (CLU ®, ChFC®, CASL) CE credit (click here to pay $15.00 reporting fee for CFP CE, included for Professional Development Memberships) can be earned upon completion of the corresponding 10-question Continuing Education Exam (see the "Continuing Education Exam" link at right and choose the newsletter issue desired, or click here). An email will be sent to you and InFRE upon successful completion (score of 70% or more) of the CE exam. You are responsible for reporting your CE hours for ASPPA recertification and the American College's Professional Recertification Program (CLU®, ChFC®, CASL).

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January, 2017 InFRE Update: CRC® Certification Can be One Answer to the DOL Fiduciary Rule

retirement-insight.com/january-2017-infre-updatecrc-certification-can-be-one-answer-to-the-dol-fiduciary-rule/

By Kevin Seibert, CRC®, CFP®, CEBS, Managing Director, InFRE

As the Bob Dylan song goes, "The Times They are a-Changin". Regardless if the DOL fiduciary rule is delayed, modified or repealed in the coming weeks or months, most retirement companies are in the process of implementing plans to meet rule requirements. Although these plans may be tweaked if and when the Trump administration decides to do anything other than accept the rule as is, most companies will find it difficult to entirely undue changes that are "Blowin' in the Wind".

Implementing changes to business structures related to compensation and potential conflicts of interest are complex and extremely time consuming. Although these elements of the rule appear to be the primary focus for companies thus far, how to train advisors to act in the best interest of their clients under a duty of care standard also needs to be addressed. Unfortunately, there is no minimum competency standard guidance for training advisors to act in the best interest of their clients within the DOL rule.

I'd like to suggest, however, that training via a comprehensive and credible retirement designation program such as the Certified Retirement Counselor® (CRC®) program can be at least one of the answers to how the industry can help advisors meet the duty of care standard. Working with our academic partner Texas Tech University, the CRC® program was created in 1997 by InFRE to ensure that Certificants meet a minimum competency standard for fulfilling their responsibilities as retirement counseling professionals. Based on original research and analysis by a team of more than 100 retirement practitioners in both public and private sectors and a network of university-based faculty, the CRC® was designed to enable professionals to meet the increasingly-complex challenges facing today's retirees. The study materials were originally developed over a two-year period and are regularly updated to address trends in the retirement industry, regulatory changes and to meet the professional development needs of today's retirement professionals.

The CRC® curriculum distinguishes itself from other retirement designations in that it covers both retirement income and accumulation planning. In particular, the distribution planning content also helps retirement professionals apply a consultative process oriented approach when helping clients make informed retirement planning decisions. In the most recent update, a new course entitled Principles of Retirement Education and Counseling was added. This course places emphasis on what it means to be a retirement "counselor" versus just having technical knowledge of investments and regulations. Importantly and as it relates to the DOL rule, the CRC® Code of Ethics includes as one of its' principles, "Acting in the best interest of the client or retirement plan participant". Click here to find previews for each of the recently updated study guides.

The CRC® is accredited by the National Commission for Certifying Agencies (NCCA). Independent third-party "program" accreditation for a professional certification program provides impartial, third-party validation that the program has met recognized credentialing standards for development, implementation, and maintenance. Accreditation is also an indication to consumers that all who hold an accredited certification possess a consistent level of knowledge and competency pertaining to their profession.

As one of many ongoing accreditation requirements, InFRE regularly conducts a detailed retirement industry-wide practice analysis to ensure that the CRC® program stays relevant and assesses up-to-date knowledge and skills required to assist consumers with retirement planning decisions. Each practice analysis is conducted by a committee of practitioners representing all certification stakeholders and then validated by other subject matter experts in the profession. The resulting CRC® Test Specifications contain the procedural oriented domains of

practice and associated tasks and knowledge statements which are the blueprint for the CRC® examination. In the case of the CRC®, it took almost two years to become accredited. Out of the 170 designations listed on the FINRA website, only 7 are shown to be independently accredited.

To be sure, the CRC® program is not the only answer to helping retirement focused advisors meet the duty of care standard under the DOL rule. The curriculum, however, will go a long way toward providing Certificants with a holistic retirement planning understanding of how to put their clients' interests first. Once candidates pass the exam and meet other certification requirements, CRC® Certificants can also tangibly demonstrate that they have completed a highly credible foundational training program that measures their knowledge and understanding of important retirement planning concepts and that requires a commitment to ongoing professional development and adherence to a code of ethics.

For more information about the CRC® program contact Kevin Seibert at 847-382-9032 or kseibert@infre.org.

Women and Retirement

retirement-insight.com/women-and-retirement/

By Cindy Hounsell, JD, President of Wiser, Mary Beth Franklin, CFP®, and Betty Meredith, CFA, CFP®, CRC®, President of Int'l Retirement Resource Center

Editor's note:

Below is an adaptation of the live webinar delivered by Cindy Hounsell, Mary Beth Franklin, and Betty Meredith in 2016. Their comments have been edited for clarity and length.

*You can read the summary article below as part of the 4th Qtr 2016 Retirement InSight and Trends Newsletter. You may also choose to **take the full length course here**, worth 2.0 continuing education credit hours.*

Cindy Hounsell, Mary Beth Franklin, Shelley Giordano, Betty Meredith

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This article is part of InFRE's 2016 4th Qtr Issue of Retirement Insight and Trends.

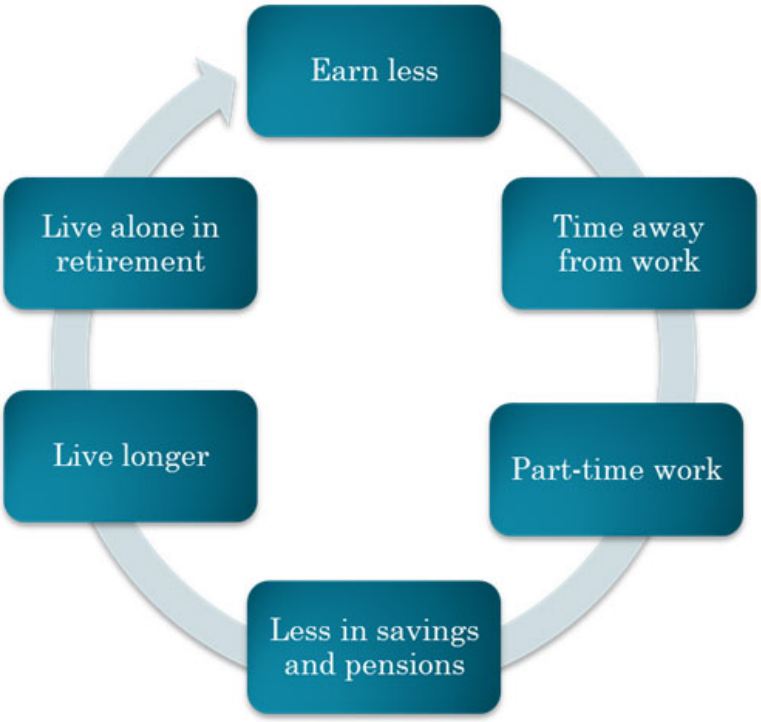
Cindy Hounsell, JD – Protecting Retirement Security from Retirement Shocks of Divorce, Widowhood & Caregiving

Most people are familiar with the issues that are unique to women. We're talking about some issues that may be less familiar.

Women earn less. It seems to be improving for millennial women, but that usually changes once the millennial women start having children. They start taking time away from work. The average number of years that women spend out of the workforce is 12 years. That can put a big dent in Social Security benefits or opportunity to save, unless you're planning to do that as a couple, which we would recommend to most women.

Women also are more likely to work part-time; twice as likely as men, usually for family reasons, taking care of the elders, children, whoever needs help. Women usually end up taking on most of that care. This results in less savings, less opportunities for pensions, defined contribution plans, other plans they might have had access to at the workplace.

Women live longer, anywhere from two to five years depending on which statistics. Because they end up living alone in retirement, by the time they're in their 80s, they end up living in poverty. That's the sad story.



How Divorce and Widowhood Affect Women in Retirement

Two devastating effects for women are often divorce and widowhood. Early divorce is something that women may never catch up from but at least there is more opportunity if divorced when younger than with grey divorce. Grey divorce is now a key issue for a lot of older people. The numbers for people divorcing post age 50 is double; 27% of grey divorced women are living in poverty.

If the divorce lawyer or mediator is not primed on learning about retirement issues, clients may lose out in many ways, such as survivor benefits, which are pretty important. Getting people primed on some of the things to be asked for or getting a divorce expert to consult is really important. Often, people just want to get through divorce and especially women often put their kids first. It's hard convincing them that maybe they shouldn't keep the house which they're not going to be able to afford in a couple of years, that they have to pay attention to the assets that will actually give them cash later on. Make sure you know the rules, because every state has a different rule on splitting spousal benefits.

Half of all women who are widowed over age 65 end up living ten years longer, 15 years more is not uncommon. It's something that needs to be prepared for. Women lose one Social Security benefit or 50% of the pension. Planners who help people look at the realities of the future are doing a great service. If you're relying on a retirement system, know the rules. There glitches that can keep people from getting benefits.

All of this should be an ongoing conversation so that there's full disclosure with the children, other family members, or the financial manager; other even than your financial planner, because many times people have benefits they don't even know they have. You hear the stories that people find out that the parent actually bought long-term care insurance but nobody knew.

With pensions, know the system that you're relying on. A lot of times there can be more than one company plan, since people change jobs all the time. An agency in Washington, the Pension Benefit Guarantee Corporation, has a list of company plans. Search their database and find if you were ever covered by a plan.

Make sure that clients are up-to-date on what they've earned throughout their lifetime, and whether either spouse is vested in a traditional plan or any matching contributions. A lot of times people leave a job and don't realize that they

needed to stay another year, so they weren't eligible for the matching contributions.

There are situations where the traditional plan is integrated with Social Security, which may mean the earnings are subtracted, resulting in a lot less than expected. That's true in the airline industry as well as retail. Unfortunately, most people only ask the question when they're getting closer to retirement, or leaving, "Oh, I wonder about that retirement plan, if I'm covered or if my spouse is covered?" Knowing the rules of the systems is key, depending on the state laws and how benefits are divided.

People tell me, "My ex-spouse is about to retire and I need to know what I should do to go get part of his retirement benefits." This needs to be part of the property agreement. If it isn't written into the agreement with a court order stating the right, you will not receive those benefits. Knowing where the benefits are coming from will make a huge difference in what somebody will be collecting for the rest of their life. It's good to have the benefits valued by an actuary or an accountant.

How Caregiving Affects Women's Retirement Security

Caregiving is a huge issue for many women, who frequently take on more of the caregiving responsibility. There are many caregivers who just take leaves of absence. Family Medical Leave, depending on where you're working, is obviously an opportunity, but still many get so overwhelmed they just end up leaving their job totally, one of those shocks that has a pretty devastating effect because it's not so easy to get back into the system once you leave.

All of this ends up having big financial consequences for caregivers. There are a number of bills in Washington trying to give new tax breaks to caregivers because of their out-of-pocket costs. Caregivers who take care of elderly parents are much more likely to end up living in poverty. When we talk to women, we say to them that they've got to share this experience with others in the family.

Caregiving has costs that are outside of the normal thinking: the cost of losing a job plus losing the opportunity to save and invest and compound returns, the ability to do other things such as finance home improvements that can increase the resale value of a home, the loss of promotional opportunities. We all know those stories.

Many assisted living residents believe that Medicare or somebody else is paying for their long term care, and it's most often the adult children that are paying for a good part of their assisted living care. There are filial responsibility laws such that some states are talking about going after adult children if they haven't stepped up to the plate and helped parents, so the state is having to pay for them. There are 28 states now that have these laws.

Develop a family strategy to get people involved early. Set up a personal care agreement on how to manage caregiver responsibilities within the family, and make it clear who's paying what so that one person is not bearing the burden of the whole care. Caring.com is a good resource for information needed to help avoid some of the money mistakes that caregivers make, and our own website which includes sample forms, www.wiserwomen.org.

Mary Beth Franklin – Why Proper Claiming of Social Security is Crucial to Women

Social Security benefits are incredibly important for your female clients. Of people 85 and older, two third of Social Security beneficiaries are women. Nearly half of all elderly unmarried women, and that includes those who are divorced and widows, rely on Social Security for 90% or more of their income, meaning about $1,200 a month as total income.

How Women can Collect Social Security Benefits

Women can collect Social Security benefits in several different ways:

- They may have benefits they have earned on their own work record.
- If they are married or an eligible divorced spouse, they may be able to collect as a spouse.
- If they are the caregiving parent of a child who is under 16, or permanently disabled and their spouse is collecting a benefit, they may be able to collect a spousal benefit regardless of their age if they're taking care of these minor or permanently disabled children.
- If they are a surviving spouse or an ex-spouse, they're entitled to survivor benefits.

Strategies for people to claim based on age and marital status:

- If you are entitled to Social Security benefits as a spouse or on your own record, you can claim benefits as early as age 62, but they are permanently reduced.
- If you are entitled to your own record and that of a spouse, and you claim before your full retirement age, Social Security must pay you your own benefits first, reduced for early claiming. If your spousal amount is higher, they will layer that extra amount on top, also reduced for early claiming.
- If you're entitled to benefits as a surviving spouse or surviving ex-spouse, you can claim benefits as early as age 62, reduced compared to claiming at your full retirement age.

Full retirement benefits are available at age 66, 100% of what you have earned on your own record or up to 50% of your spouse's benefit for people who were born from 1943 through 1954. If you're younger than that, your full retirement age is higher. It could be as high as 67 if you were born in 1960 or later.

If you claim Social Security benefits before your full retirement age, and you continue to work, your benefits may be reduced or completely eliminated by the earnings cap. There's a huge incentive to delay. For every year you postpone claiming Social Security benefits beyond your full retirement age up until age 70, you earn an extra 8% per year. It may make more sense for some people to tap their 401(k) or their IRA first as a way of allowing them to afford to delay collecting Social Security benefits until they're worth the maximum amount at age 70.

If you claim Social Security benefits before your full retirement age and have earnings from a job – in 2016, if you're under full retirement age and you earn more than $15,720 annually, you will lose $1 in benefits for every $2 earned over that limit. If you earn more than $47,000 you are going to forfeit all of your benefits. Once you reach your full retirement age, which is currently 66, any benefits that you have forfeited to the earnings test in prior years are effectively added back in. It's not a permanent penalty but if you claim before full retirement age and continue to work, not only will you temporarily lose benefits but you may blow the opportunity to use one of the remaining claiming strategies, and you must wait until the age of 66 to do that.

There is a higher earnings restriction in the year you turn 66. In the months leading up to your 66th birthday, you can actually earn up to $41,880 and you would only lose $1 in benefits for every $3 earned over that limit. Once you get to the age of 66, you can collect Social Security benefits even if you continue to work and not forfeit any Social Security benefits through earnings cap.

Women and Social Security Spousal Benefits

There were two major changes to Social Security claiming rules as a result of the Bipartisan Budget Act of 2015:

1. Eliminated the strategy known as "File and Suspend" allowed people once they've reached the age of 66 to file for their benefits and then immediately suspended them, which means they didn't receive pay. But this triggered a benefit for a spouse or possibly a minor dependent, or a permanently disabled adult child.

2. Ability to claim only spousal benefits when you turn 66, and allow your own benefits to keep growing up until age 70. That claiming strategy of filing for spousal benefits only will continue to be around for another eight years, but it is only available to people who were born on or before January 1, 1954.

Beginning April 30, 2016, people can still suspend their benefits at 66 but no one (spouse or child) can collect benefits during the suspension. Also, the lump sum payout option is no longer available. This is a loss for single people who were the ones who were most likely to say a couple of years later, “I have a medical condition. I may not live a long time; please pay me all my suspended benefits in a lump sum.”

I want to stress how valuable this remaining creative strategy of being able to file for spousal benefits only is to both currently married clients and eligible divorced clients. To be eligible as an ex-spouse to collect on a former spouse’s record, you must have been married at least ten years, divorced, and currently single. As a result of this new legislation, only people born on or before January 1, 1954, will be able to claim spousal benefits only when they turn 66.

Here’s an important planning point. Within currently married couples, only one spouse can claim spousal benefits. The other spouse either has to be collecting benefits, which triggers a benefit for the spouse, or have filed and suspended before the April 29 deadline.

What’s different for divorced couples is each ex-spouse can claim on the other spouse’s earnings record. They had to be born on or before January 1, 1954 in order to exercise this strategy of claiming spousal benefits only when they turn 66. This is a great opportunity to be able to collect only spousal benefits which are worth 50% of the worker’s amount while their own benefits continue to grow.

Social Security Benefits for Single, Divorced and Widowed Women

For single women, just like single men, in order to be eligible for Social Security benefits, you must work at least ten years in covered employment, meaning you’re paying FICA payroll taxes. But your actual benefit amount is based on your top 35 years of indexed earnings. It’s not necessarily sequential; it’s the top 35 years. If you worked fewer than 35 years, Social Security is going to consider those years zero years.

The important thing to note is that regardless of your age, even if you continue to work beyond your full retirement age, and you have earnings from a job, it is quite possible those earnings will be added into the calculation and result in a larger Social Security benefit in the future.

If your full retirement age is 66 and you claim at 62, your benefits will only be worth 75% of your full retirement age amount. If you claim benefits before full retirement age and continue to work, those benefits could be forfeited to the earnings cap.

The maximum benefits are available at age 70. They could be worth 32% more than full retirement age benefits. But there is a breakeven point. You’re probably going to have to wait until about 83 to make it worthwhile to have waited until age 70 to collect. Someone who has longevity in their family may want to delay. It’s an easier decision for married clients because they’re spreading that breakeven point over two lifetimes, and someone’s going to end up with the survivor benefit.

That is not the case for single women. Married women, if they wait until 66 and were born on or before January 1, 1954, have this incredibly valuable opportunity of being able to claim only spousal benefits at 66 and switching to their own at age 70. Even if someone collects retirement benefits early and those retirement benefits are permanently reduced, they are still entitled to survivor benefits if their spouse dies. And if they are at least full retirement age at the time they collect those survivor benefits, they will still be worth 100% of what their late spouse was collecting or entitled to at time of death.

In fact Social Security has more than 2,700 rules that govern benefits. One of the many exceptions is that if you're divorced at least two years, and if both ex-spouses are at least 62 years old, you can claim on your ex-spouse's record even if he or she has not yet begun collecting. That's known as being an independently entitled spouse to benefits.

Don't forget the kids. Many people do not realize that if a parent is claiming a Social Security benefit or disability benefit, and they have a minor dependent child defined as under age 18, or 19 if still in high school, or a permanently disabled child, that child is also entitled to a benefit worth 50% of the worker's benefit amount. However, the entire family is subject to something called the Family Maximum Limit, generally 150 to 180% of the worker's full retirement age amount. If the family breaches that limit, the dependent benefits will be reduced on a pro-rata basis but the worker's own benefit is not affected.

Survivor benefits are the most important thing for planning in married couples. The main goal is how to maximize the survivor benefit, by having the spouse with the higher Social Security benefits wait at least until age 70 to collect the maximum benefit.

Generally if you remarry, you lose the right to collect Social Security benefits on an ex. But if you wait until age 60 or later to remarry, you still lose the right to collect spousal benefits on a living ex, but you retain the right to collect survivor benefits on a deceased ex.

Anyone who collects any type of Social Security benefit has a right to change their minds within the first 12 months of claiming benefits. They can withdraw their application for claiming benefits, but there's a catch: They have to repay any of the benefits they have received. But the benefit is it wipes the slate clean. It's as if they had never collected they would be able to start benefits as if they had never claimed, at a higher rate.

If you miss that 12-month window, there's another opportunity, but you have to wait until the age of 66 to suspend benefits. You do not repay them. But you can start earning the extra 8% per year in delayed retirement credits. You can't collect anything during the suspension, and no one can collect on your record. But it's a great way of rectifying an early claiming decision.

Take-away Strategies

- **Singles:** Don't claim before FRA if still working; but it may not be worth delaying until 70.
- **Married couples**: Coordinate claiming strategies and maximize larger benefit in order to create largest survivor benefit. Spouse with smaller benefit may want to collect early to maximize household cash flow.
- **Divorced spouses**: Claim only spousal benefits at 66 if eligible and let own benefit grow until 70. May be eligible for larger survivor benefit if ex dies. Wait until 60 or later to remarry.
- **Survivors**: Claim either retirement or survivor benefits first and switch to the other later to maximize benefits. Retirement benefits earn DRCs; survivor benefits don't.

If you have any questions, everything I just said here is available at investmentnews.com/MBFebook.

Betty Meredith, CFA, CRC®, CFP® – A Case Study: Options for Improving Women's Retirement Security

We can improve the retirement security of women.

We have a case study with Jane Davies, age 62. She was married 30 years and she's been divorced for eight years. She makes $40,000 a year in income, and she'd like to have $30,000 in retirement that will include her benefits of her ex-spouse's Social Security. She has $248,000 in assets and her current allocation is 60% bonds, 30% stocks and 10% cash so she's conservatively invested.

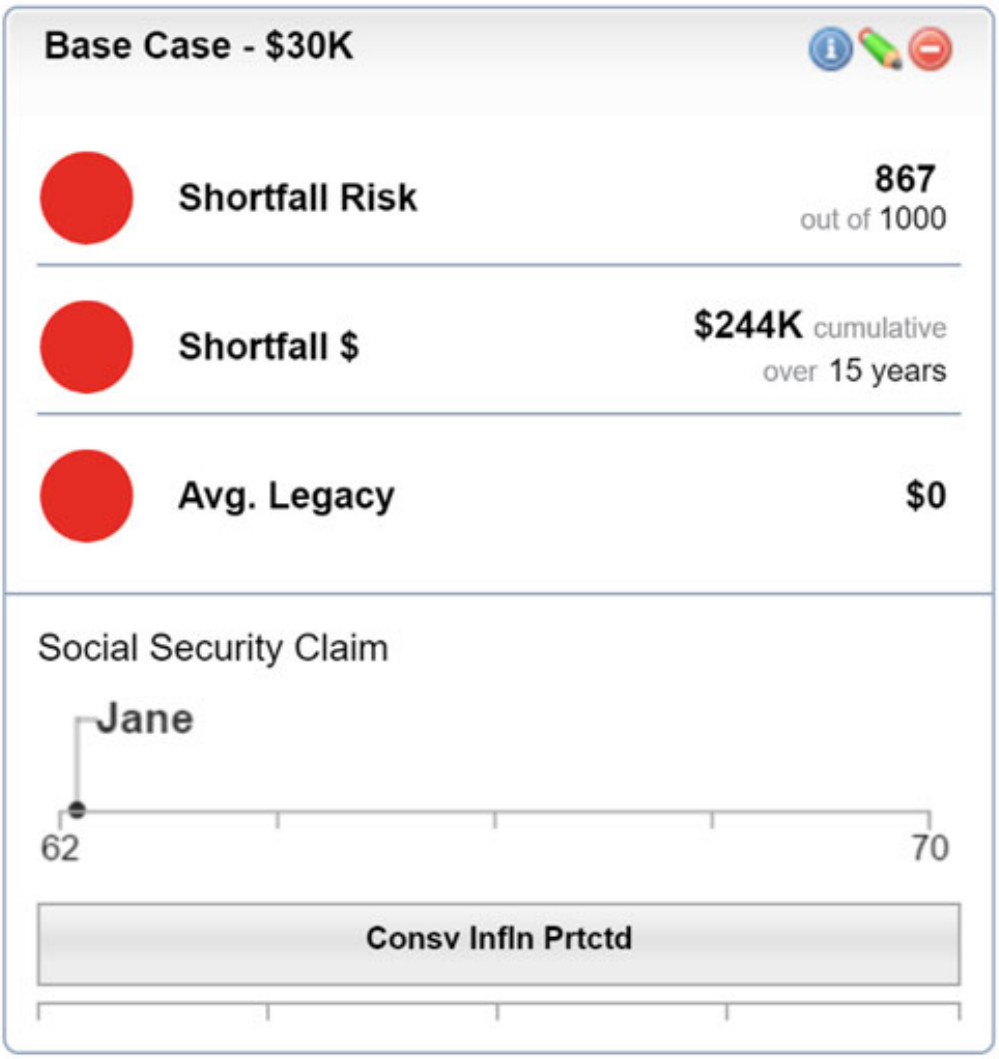
Her home is valued at $200,000, is paid off, no reverse mortgage. Her ex-husband earns around $130,000 so she'll collect his Social Security benefits, half of her divorced spouse benefit and then his survivor benefit when he passes. The assumption is that he passes at age 86. She is in good health and no children.

What are her risks? She could live a long time and possibly have healthcare issues down the road without long-term care. She doesn't have kids that she can rely on. She'll have issues with inflation over time increasing her expenses. And she's earning less right now so her own Social Security benefits and ability to save will be lower. She wants to retire at 62.

How would it help if she increased her portfolio risk from conservative to moderate? That tends to be the first line of attack, and might not be the best thing. We'll look at what if she delayed her Social Security to age 66, then moved it to a more moderate asset allocation with 40% of her portfolio – 20% in a fixed annuity, 20% in the immediate annuity. The higher lifetime income from the annuity because of the mortality credits, and the reduced sequence of returns risk could really help because she doesn't have to take as much risk with the rest of her portfolio.

Another option is if she works until age 70 and collects Social Security later; still collecting it at 66 but if she phases her income maybe where she has more income in the first phase and lower in the second. We will be able to reduce her risk tremendously if we do these things, using Discovery Software for this demonstration.

86% chance of ruin



Look at the upper right hand corner where we have the “percent chance of ruin”. If she were to retire at 62 and take the reduced Social Security benefit at 62, she has an 86% chance of ruin. She would need $244,000 more than she has in her portfolio to live on and she would have nothing left over for legacy. If the first thing she does is increase her portfolio risk from conservative to moderate, she can reduce her chance of risk from 86% to 69% again using 4.5% withdrawal, which is good, but still way too much risk for her to take. If then she delayed her Social Security to 66, she gets the biggest drop from 86% chance of ruin down to a 10%, allowing Social Security to build. She gets the delayed retirement credit and she’s not taking out of her portfolio any earlier as well.

The Income Discovery software used in these models has the ability to run an optimize scenario. If the client wants to retire at 62 the software can identify what would be the best solution, for example. In this case, it assumes that she would take her Social Security at 66, still work, and purchase a fixed index annuity and a SPIA with 40% of the assets being the single premium immediate annuity. Then she can go back and reduce the rest of her portfolio risk from moderate to more conservative asset allocation. In this case, she’s reducing her risk of ruin from where we started out at 86% down to a 6% with an income of $30,000 a year.

Finally, if she were to work until 70, collect the spousal benefit at 66, and purchase the two annuities, she could phase her income, taking $40,000 a year at the beginning when she’s traveling and wants to do things, and then

reducing it towards the end of life.

There's danger to having just one approach, assets under management, taking a percent of income out of the portfolio every year. If that's the approach used, the individual is forced to self-insure. They're taking on the longevity risk, the fact that their portfolio could run out, and that they could have sequence of returns risk with what's happening in the market. That's not the right solutions for the mid market.

Encourage your women clients, family, and friends to work as long as possible and delay Social Security if they're in good health. Traditional methods of generating income are less effective for the middle market because they have other assets. They get to retirement and there is this whole other asset with their home equity. Same thing with Social Security; by delaying they get a huge increase in the present value of assets that can help with their lifetime retirement income. A combination of options works best.

The order in which those options happen also makes a difference in how risk is reduced. The biggest thing is that adding more lifetime income addresses is the sequence of returns risk, which is a big bomb that can put people off course early in retirement. But watch because there are diminishing returns: The more you annuitize, the less overall because those assets are overall less returns except for Social Security, and also, you don't have the inflation protection from the annuity products unless you choose it as a rider.

Our point is to provide a way that gives clients permission to enjoy retirement and lifetime income, knowing that they don't have to be worried about what the markets are doing, having some money in the markets but also a good base of income to cover their fixed expenses.

About the authors of "Women and Retirement":

Women and Retirement – Cindy Hounsell, Mary Beth Franklin, Shelley Giordano, Betty Meredith

Cindy Hounsell, JD, is the President of WISER, the Women's Institute for a Secure Retirement, a nonprofit organization that seeks to improve the opportunities for women to secure retirement income and to educate the public about the inequities that disadvantage women in retirement. Ms. Hounsell provides technical assistance to several national organizations, as well as training to leaders and grassroots advocates around the country as part of her role as director of the National Education and Resource Center for Women and Retirement Planning, funded by the U.S. Administration on Aging.

Mary Beth Franklin, CFP®, Contributing Editor, InvestmentNews, is a nationally known and frequently quoted expert on Social Security claiming strategies. She has a long-time interest and expertise in retirement issues, Social Security, and taxes, with a background in the federal budget, international trade, and Capitol Hill as it affects personal finance. Mary Beth writes regularly about the latest research and thought leadership on retirement income planning. Her most recent book, "Maximizing Social Security Retirement Benefits – Everything you need to know to get the most out of complicated new claiming rules', has been updated to reflect changes in claiming strategies due to the Bipartisan Budget Act of 2015.

Betty Meredith, CFA, CFP®, CRC®, is a leading voice on retirement planning for the middle mass and mass affluent markets. She is the Director of Education & Research for the International Foundation for Retirement Education (InFRE), whose purpose is to increase the retirement readiness of the American worker through professional retirement certification and continuing education, and the Managing Member of the International Retirement

Resource Center.

The fourth speaker in the Women and Retirement webinar, Shelley Giordano, Chair of the Funding Longevity Task Force, also delivered a one-hour presentation in July, 2016. The article from her presentation is available here and the recorded webinar is available here.

Retirement Speakers Bureau

Optimal Retirement Income Solutions in Defined Contribution Plans

retirement-insight.com/optimal-retirement-income-solutions-in-defined-contribution-plans/

By Steve Vernon, F.S.A., Research Scholar, Stanford Center on Longevity

By Steve Vernon, FSA – Expert in Strategies that Integrate DC Plans, Social Security, QLACs

Editor's note:
Below is a summary of the live webinar delivered by Steve Vernon in 2016. His comments have been edited for clarity and length. The webinar draws from a four-part study sponsored by the Society of Actuaries' Committee on Post Retirement Needs and Risks and conducted by the Stanford Center on Longevity. The full report describing the four analysis phases and conclusions is available here.

You can read the summary article below as part of this 4th Quarter 2016 Retirement InSight and Trends newsletter. You may also choose to take the full length course here, worth 1.5 hour CFP®, CRC®, ASPPA, CLU®, ChFC®, RICP®, CASL and other CE credit.

Please also see the next article in this issue of Retirement InSight and Trends from the Government Accountability Office (GAO) which addresses some of the plan design, fiduciary and other regulatory issues faced by plan sponsors in offering retirement income options for plan participants.

Bill Sharpe, who won a Nobel Prize and is now associated with Stanford University, was recently he was quoted as saying, "Retirement income is a really hard problem. It's the hardest problem I've ever looked at." If a Nobel Prize winner in economics, who helped invent modern portfolio theory, thinks that retirement income planning is a hard problem, how is the average consumer or the average plan participant going to handle this problem?

This article is part of InFRE's 2016 4th Qtr Issue of Retirement Insight and Trends.

Optimizing retirement income solutions in DC retirement plans are a focus of this project. The analyses that we have constructed will also be of great interest to advisors because we think that the analyses can also be used to construct retirement income portfolios both for people working in the employer-sponsored defined contribution world or planners that are helping individuals prepare retirement income portfolios using IRAs and 401K accounts.

In this study, we applied stochastic forecasting and efficient frontiers to illustrate how retirees and advisors can make informed retirement income allocation decisions. Stochastic forecast and efficient frontiers are what I call heavy-duty analytical techniques that, for decades, plan sponsors had used to manage their defined benefit plans. These same techniques can be used to help people construct retirement income portfolios for their retirement security.

Modern Portfolio Theory and Retirement Income Solutions

How do you take all the different solutions and construct retirement income solutions that might work for you and your clients? The solution is to apply modern portfolio theory to the payout phase. Modern portfolio theory talks about asset classes and their different characteristics, the asset allocation decision, accumulating assets, and

minimizing risks of investment losses. If we apply this thinking to the payout phase, now we'll be talking about retirement income classes. The decision we're focusing in on is the retirement income allocation decision. We'll be looking at the amount of retirement income that might be generated and a lot of the techniques might look at the risk of income losses.

The retirement income generators available today are:

- Shared solutions, i.e. annuities
- Investing solutions
- Solutions that can be embedded inside a DC plan
- Solutions that could be implemented outside a DC plan, say through IRAs.

You want to understand the different features and pros and cons of different retirement income generators because they are all different:

- Different in the amount of income that they generate, both at retirement and throughout retirement
- Their guarantees are different
- Accessibility of assets are different, and
- There is not a one size fits all solution.

So it's up to either plan sponsors or advisors for understanding the different characteristics of these different retirement income generators so that they can help their constituents.

In general, there are three types of retirement income generators and this applies whether it's inside a defined contribution plan or in an IRA or other retirement savings.

- The first one is to invest your savings. You keep the principal intact and you just spend the investment income.
- The second is a systematic withdrawal program where you're still investing your savings, but you're withdrawing principal cautiously to avoid outliving the principal, but we'll point that there's no guarantee if you live a long time or if you have poor returns, there's no guarantee that you might outlive your principal.
- The third RIG, or retirement income generator, is purchasing an annuity from an insurance company.

So we know that there are a lot of variations of each approach. The other thing we want to note is that the first two retirement income generators, whether you're investing and taking out just investment income or you're withdrawing principal cautiously, if you're within a deductible IRA or a defined contribution plan, eventually you're going to have the IRS required minimum distribution rules kick in at age 70½ and they might actually require you eventually to withdraw more money than your strategy might warrant under the first two retirement income generators.

Criteria for Plan Sponsors to Consider When Adding Income Solutions to Plans

So here a possible criteria that a plan sponsor might want to think about when evaluating different retirement income generators:

- What is the amount of retirement income that it's generated?
- Do you get a lifetime guarantee or not?
- Do you have protection of the income in the period leading up to retirement?
- Do you have protection of potential for increases after retirement for keeping up with inflation?

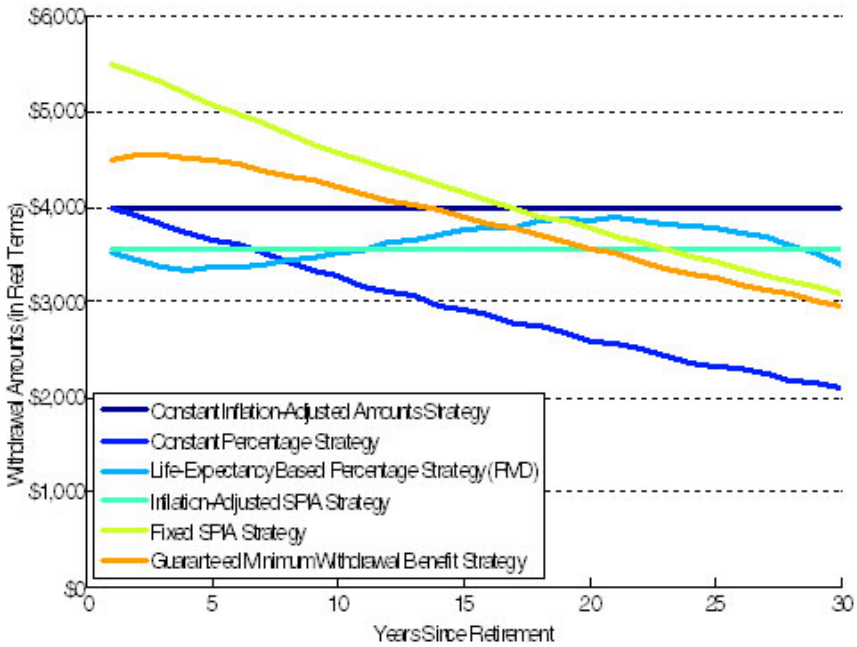
- Do you have protection post-retirement or if there's a stock market crash, will the income go down?
- Do you have access to funds?
- Do you have the potential for inheriting unused funds?
- Who's controlling the investments and the withdrawal? Is that the plan sponsor through the retirement income program or the participant's controlling the investments and the withdrawal amounts?

In this study we looked at six different retirement income generators.

1. Systematic withdrawal plan using a constant four percent rule, where withdrawing a constant four percent of initial assets and then adjusted for inflation after retirement
2. Four percent withdrawal of remaining assets
3. A systematic withdrawal program using the IRS' required minimum distribution
4. An inflation adjusted SPIA
5. A fixed SPIA
6. A GLWB or GMWB annuity.

Our assumptions regarding future investment returns, both for stocks and bonds and cash, reflected the current low interest environment, both in our expectations for future bond returns, but also for current annuity purchase rates.

This first graph shows for someone who has $100,000 in savings, what is the expected amount of income that they might receive over their life? So each line represents a retirement income generator.



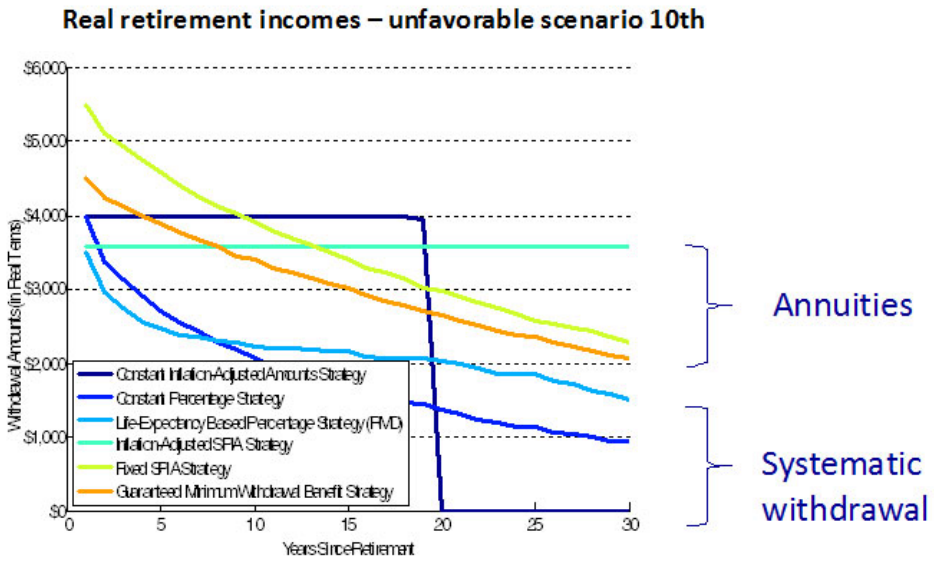
From Society of Actuaries' report: The Next Evolution in Defined

For a 65 year old married couple starting off with $100,000 in savings the income amounts are adjusted for inflation, so a flat line keeps pace with inflation. Each of these are viable retirement income generators, and they all have different patterns of retirement income. The fixed SPIA (lime green line) starts with the highest amount of retirement

income but, because it's fixed, it declines over time due to inflation in real amounts.

The flat line that you're seeing is a constant. There are two flat lines. One is the four percent rule, which is always withdrawing amounts that are adjusted for inflation, and then the turquoise flat line is the inflation adjusted SPIA. Then you'll see the other retirement income generators have just different patterns of how their income plays out over a 30 year period. One last point on this slide is this is what we call the expected scenario. So this is the 50th percentile of the stochastic forecast. So this is what we would expect, given our assumptions.

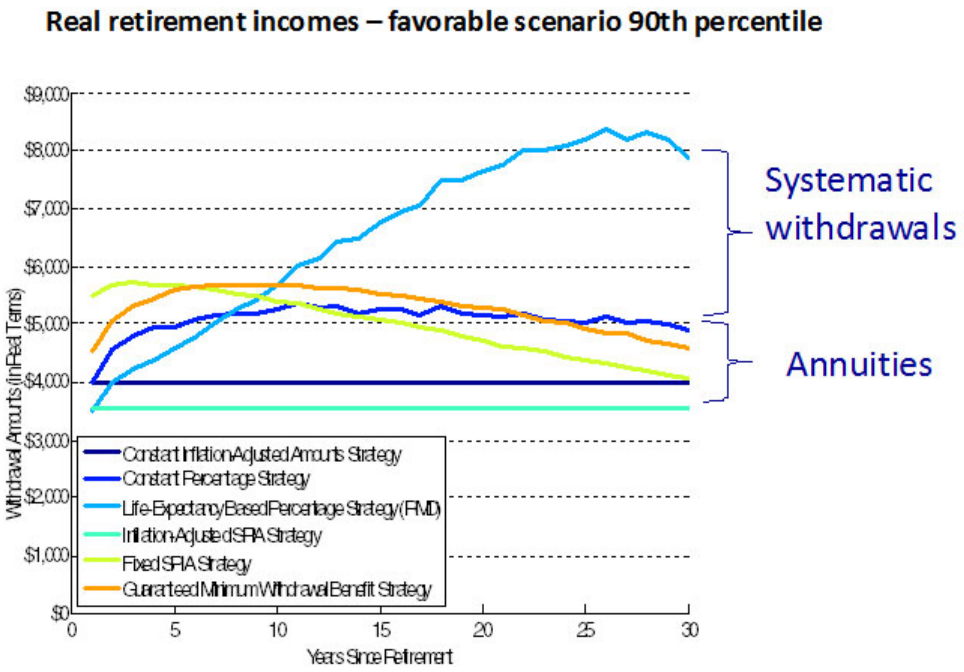
But now let's look at what happens to real retirement income under unfavorable scenarios. At the 10 th percentile of stochastic forecast annuities tend to do better than systematic withdrawal. Basically what we're doing is we're demonstrating with sophisticated analyses what we probably all know is that if the stock market does poorly, you really want to be in some kind of a product that is protecting yourself against stock market decline.



From Society of Actuaries' report: The Next Evolution in Defined Contribution Retirement Plan

The most dramatic result here with systematic withdrawals is this blue line. That's the four percent rule, where you're just withdrawing four percent of your beginning assets, adjusted for inflation, and you're ignoring what happens with your assets after retirement. If you just keep blindly withdrawing four percent, under a poor scenario, you'll run out of money according to our forecast. At around 20 years, the fixed four percent rule exhausts your assets. This was the unfavorable scenario.

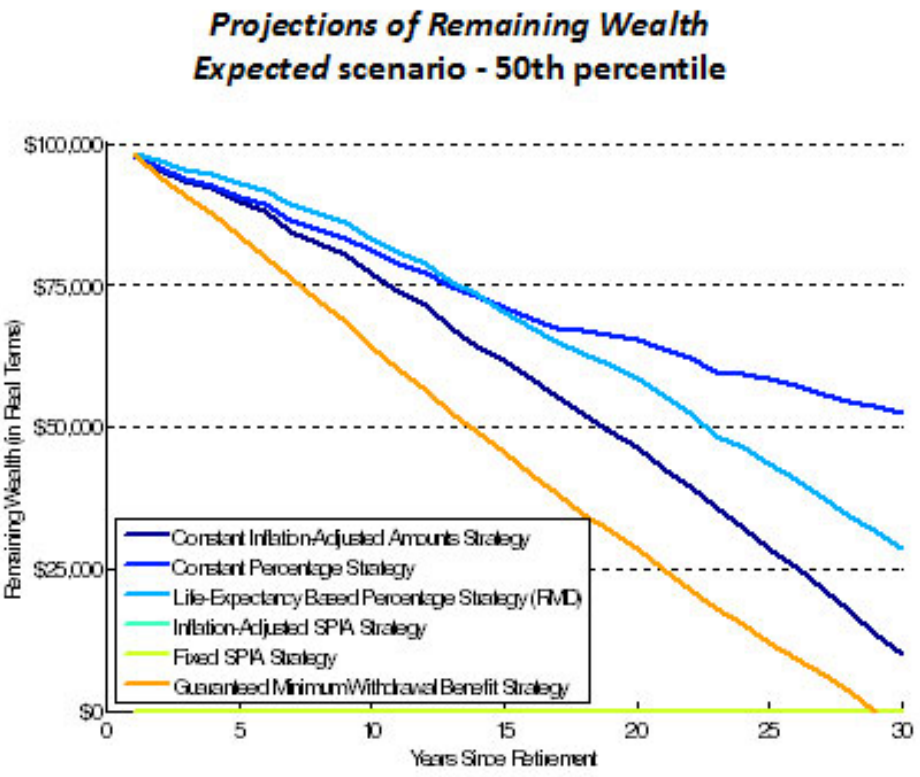
Under the favorable scenario, we looked at the 90th percentile and demonstrate that if the stock market does well, you want to be in a systematic withdrawal program and actually invested assets will produce more income than most annuity programs.



From Society of Actuaries' report: The Next Evolution in Defined Contribution Retirement Plan

In sum, if the stock market does well, you're better off investing your money rather than buying an annuity. The purpose of buying an annuity is to protect yourself against stock market decline and against long lives. These graphs just show the amount of income that you might get over a 30 year retirement.

Another analysis people might be interested in is remaining wealth. In this case, the retiree started off with $100,000 in savings. The flat line at the bottom is the SPIA, because once you submit your money to an insurance company and buy a SPIA, then you have no more accessible wealth.



From Society of Actuaries' report: The Next Evolution in Defined Contribution Retirement

The systematic withdrawal schemes and the GLWB annuity do have remaining wealth at different points in time. The GMWB annuity has the lowest amount of remaining wealth because there are fees being withdrawn from the assets to pay for the longevity protection. This is where GMWBs are a hybrid between a systematic withdrawal scheme that gives you complete flexibility and an annuity which gives you lifetime guarantee. GMWB gives you the best of both worlds, but then you're having the lower amount of accessible wealth throughout retirement, compared to the other systematic withdrawal schemes.

If you withdraw at a faster rate with the systematic withdrawal schemes you'll have a lower amount of accessible wealth over retirement. Conversely, if you withdraw at a very conservative rate, you'll have more wealth over your retirement.

So putting it all together, retirement income strategies that we think make sense is to combine systematic withdrawal plans with annuities. Cover your nondiscretionary, basic living expenses like the roof over your head, utilities, food, and medical insurance premiums, by sources that are guaranteed to last for the rest of your life and won't go down if the stock market crashes. Sources of that would be Social Security, pensions if you have one, and annuities.

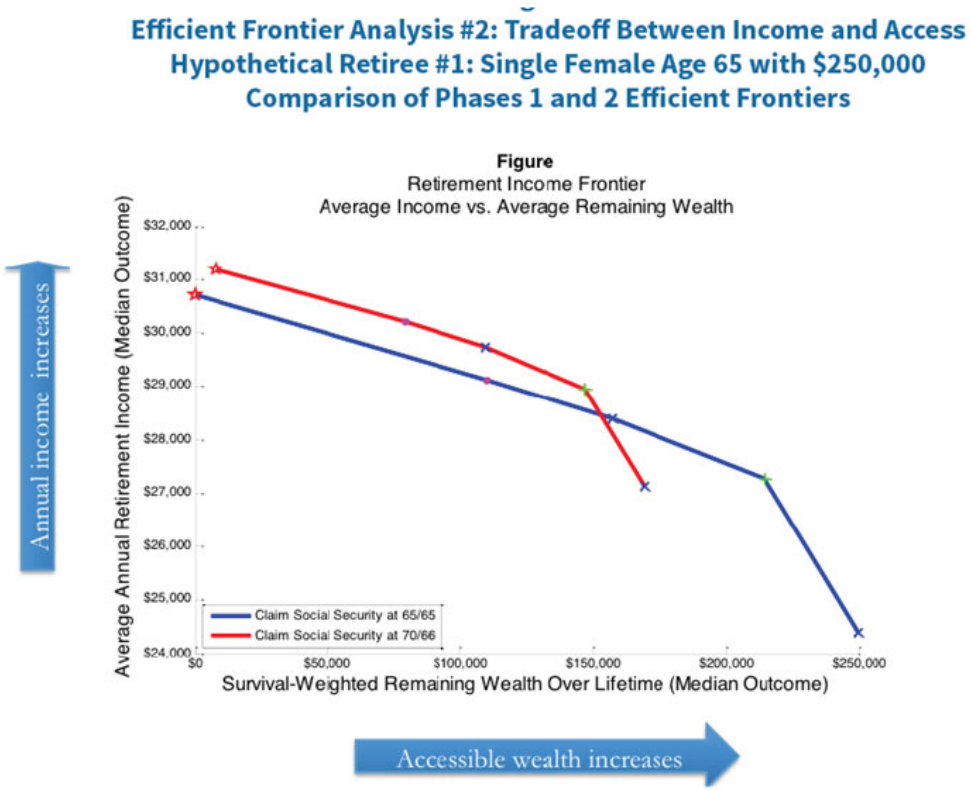
Then cover discretionary living expenses; travel, gifts, spoiling your grandchildren with a systematic withdrawal strategy. What our analyses shows is if you've covered your basic living expenses with the guaranteed sources, then you can justify either a higher withdrawal rate or a more aggressive asset allocation with the systematic withdrawal strategy. Basically what we're saying is that annuities, Social Security, and pensions become the "bond" part of your retirement income portfolio and then the systematic withdrawal retirement income generator is the equity or the stock part of your retirement income portfolio.

One last point we want to make at the bottom here is that the best systematic withdrawal solutions do adjust the retirement income to reflect emerging investment experience. That's really resulting from that graph we saw where under unfavorable scenarios, if you just keep blindly withdrawing the same amount of money under a fixed four percent withdrawal strategy, eventually you could run out of money. We think that the best solutions actually will adjust the retirement income to reflect, whether you're getting gains or losses, you'll apply some formula to your remaining assets each year.

Balancing Expected Retirement Income and Accessible Wealth

Efficient Frontier #2 of the study analyzed balancing two goals: expected retirement income, and the ability to access wealth throughout retirement. We think for a lot of retirees, they may actually be focusing in on this efficient frontier instead of the first one.

So with this particular efficient frontier, the measure of return on the vertical axis, the Y axis, is the average amount of retirement income over the retirement period. The horizontal axis, the X axis, is the average amount of accessible wealth throughout the retirement time, adjusted for inflation and adjusted for the probability of survival to each age.



What about taking a portion of your savings to enable delaying Social Security? We assume that you retired at 65, but that the primary wage earner would delay taking Social Security to age 70 and withdraw from their savings between age 65 and 70 to make up for the Social Security benefit that's being delayed. Then they would take their remaining savings and implement some kind of a retirement income solution with the remaining savings. We found that this strategy can increase expected total retirement incomes by amounts ranging from five percent to 12 percent, and the increase in the retirement savings was highest for solutions that had significant fixed income investments.

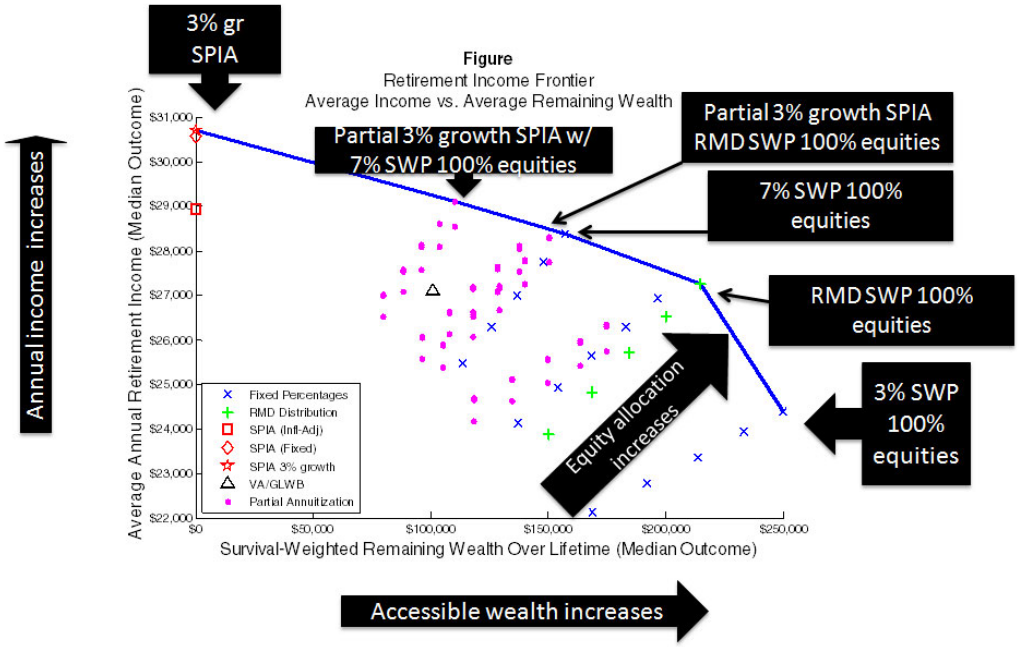
The increase in the benefit for delaying Social Security is more than an actuarial increase, so you can take advantage of that by delaying your Social Security benefit. You've got to invest almost 100 percent in stocks to have any hope of beating a delayed Social Security strategy. This is a significant concept that people should understand because if you're willing to commit some of your savings to guaranteed solutions, you should start with delaying Social Security.

The chart above shows compares the efficient frontiers. The red line is the efficient frontier if you'd use this delay strategy. The blue line was the efficient frontier that shows the tradeoff between amount of income and liquidity. We do note here though, over to the right, the red line crosses the blue line. What this is saying is that if you do use your savings to delay Social Security, you are depleting that portion of your savings at a fairly fast rate.

So if you're absolutely most focused on accessible wealth over your lifetime, that's one scenario where you may not want to use a delay strategy. If you're really, really focused on having the maximum amount of accessible wealth over your lifetime and you want to be down at that lower right hand corner, then you'll probably not want to use your savings in the early part of your retirement to delay Social Security.

Determining an Acceptable Tradeoff between Expected Income and Liquidity

The rationale for this particular analysis is that people might be hesitant to devote substantial resources to irrevocable annuities so they can have access to those savings, either throughout retirement or to leave a legacy for unused funds. So what's the acceptable tradeoff between expected amount of income and liquidity?



The vertical axis above is the average amount of retirement income from the solution. Each dot here represents a particular retirement income solution. The horizontal access is the average amount of remaining wealth over the lifetime of the retiree. So the efficient frontier here is the blue line that is, for any given point on the horizontal axis, the highest point on the vertical axis.

Now we can actually show different extremes. On the far left hand corner we see that the three percent growth SPIA produces the highest amount of income, but there is no accessible wealth. Nevertheless, it's the highest vertical point on that horizontal axis. If you go all the way to the right on the bottom, you'll see a three percent systematic withdrawal. We're taking three percent of assets each year and investing 100 percent in equities. That produces the highest amount of accessible wealth we would expect, but then it also produces a low amount of average retirement income.

If you go along the blue line, you'll see other points that are either on the efficient frontier or close to it. For example, just above the three percent systematic withdrawal plan is a required minimum distribution systematic withdrawal plan approach (green pluses) with 100 percent in equities. This approach provides more income compared to a three percent systematic withdrawal plan, but there's a little bit less accessible wealth because you're drawing down your assets at a faster rate.

The upper right most green cross is 100 percent in equities; from there the allocation to stocks decreases. The next green cross is 75 percent in equities; the next green cross is 50 percent in equities; then 25 percent; and then zero in equities. As you increase the allocation of the stocks, you get closer to the efficient frontier. What this says is if you're doing a systematic withdrawal plan, this particular analysis recommends that you invest 100 percent in equities. We acknowledge that people won't be comfortable with possibly, but this is what the analysis is showing.

At the second to the left most point, we see a three percent growth SPIA with a seven percent systematic withdrawal plan that can provide a three percent income bump every year. Thirty percent of the savings are devoted to the SPIA and 70% of savings were devoted to a seven percent systematic withdrawal scheme to create a retirement income solution on the efficient frontier. What we're saying is you've got a diversified portfolio. You've got the bond part of your retirement income portfolio consisting of a SPIA and Social Security. A seven percent SWP becomes the stock part of your portfolio, the retirement income portfolio, and if you invest that particular portion of your retirement savings in 100 percent equities, you'll get the highest point on the efficient frontier.

Just because a particular solution is on the efficient frontier, that doesn't mean it's necessarily the best solution for a

plan participant because there can be behavioral issues that can influence people wanting to take some solutions that may not lie on an efficient frontier, particularly if people are really worried about the risk of losing money, they may feel uncomfortable with a solution that has a fair amount of equity exposure even though our analyses demonstrate that that might be considered optimal.

Optimal solutions might combine investing retirement income generators with insured generators like annuities, and they'll also integrate with Social Security claiming strategies.

About Steve Vernon, FSA:

Steve Vernon, FSA, is the President of Rest-of-Life Communications, and a a research fellow at the Stanford Center on Longevity, Financial Security Division. He is active with research, writing, and speaking on the most challenging issues facing retirees today, including finance, health, and lifestyle.

With an effective mix of humor, stories, video clips, pictures, music, and cold hard actuarial analysis, Steve provides hope for working Americans with pervasive fear and anxiety about retirement. He is one of the most sought-after retirement experts in the country due to his surprising and inspiring insights.

401(K) PLANS: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants

retirement-insight.com/401k-plans-dol-could-take-steps-to-improve-retirement-income-options-for-plan-participants/

The following is an excerpt from the ***August 2016, GAO Report to Congressional Requesters, "401(K) PLANS: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants"****.*

Why GAO Did This Study

This article is part of InFRE's 2016 4th Qtr Issue of Retirement Insight and Trends.

As 401(k) plan participants reach retirement they face the challenge of making their savings last for an unknown lifespan, and many 401(k) plan sponsors do not offer options to help participants with this complex task. GAO was asked to review any related challenges and potential changes to help plan sponsors and participants. This report examines, among other things, barriers that deter plan sponsors from offering such options, and the defaults that exist for participants who do not choose a lifetime income option. GAO administered a non-generalizable questionnaire to record keepers, conducted a non-generalizable survey of 54 plan sponsors, and interviewed a range of stakeholders.[i]

What GAO Found

Workers relying in large part on their 401(k) plan in retirement may not always have a feasible way to make their savings last throughout retirement. Responses to GAO's non-generalizable questionnaire from 11 401(k) plan record keepers— entities that manage participant account data and transactions for plans— showed that most plans covered by the questionnaire had not adopted products and services that could help participants turn their savings into a retirement income stream (referred to as lifetime income options in this report). Responses to the questionnaire represented more than 40 percent of all 401(k) assets and about a quarter of plans at the end of 2014. GAO found that of the plans covered by the questionnaire, about two-thirds did not offer a withdrawal option — payments from accounts, sometimes designed to last a lifetime—and about three-quarters did not offer an annuity— arrangements that can guarantee set payments for life.

Concerns about legal risks and record keeper constraints may deter many plan sponsors—typically employers that provide 401(k) plans and establish investment and distribution options—from offering lifetime income options. The Department of Labor (DOL) issues regulations and guidance for plan sponsors and is responsible for educating and assisting them to help ensure the retirement security of workers. For example, DOL has prescribed steps plan sponsors can take to satisfy their fiduciary duties (i.e. act prudently and in the best interest of participants) when selecting an annuity provider for a 401(k) plan. However, according to industry stakeholders GAO interviewed, those steps are not often used because they include assessing "sufficient" information to "appropriately" conclude that the annuity provider will be financially able to pay future claims without definitions for those terms. Without clearer criteria to select an annuity provider, fear of liability may deter plan sponsors from offering annuities.

Further, GAO found that a mix of lifetime income options to choose from is not usually available. DOL provides an incentive in the form of limited liability relief to plan sponsors who, among other things, provide participants at least three diversified investment options. However, no such incentive exists for plan sponsors offering a mix of lifetime income options. Without some degree of liability relief, plan sponsors may be reluctant to offer a diverse mix of lifetime income options to their participants. Lastly, stakeholders told GAO that record keepers may make only their own annuities available to the plans they service. DOL provides guidance on selecting service providers, but it does not encourage plan sponsors to seek choices from their service providers, which may prevent plans from having

appropriate annuity options available to offer participants.

What GAO Recommends

GAO makes seven recommendations to DOL, including that it clarify the criteria to be used by plan sponsors to select an annuity provider, consider providing limited liability relief for offering an appropriate mix of lifetime income options, issue guidance to encourage plan sponsors to select a record keeper that offers annuities from other providers, and consider providing RMD-based default lifetime income to retirees.

1. Clarifying the safe harbor from liability for selecting an annuity provider by providing sufficiently detailed criteria to better enable plan sponsors to comply with the safe harbor requirements related to assessing a provider's long-term solvency.

Industry associations and other stakeholders told us that concerns about legal liability are the primary barrier deterring plan sponsors from offering annuities to participants. Of the 54 plan sponsors responding to our survey, 39 did not offer an annuity, and 26 of them said their decision was influenced by the resources required to obtain liability relief.In 2008, DOL promulgated a "safe harbor" rule that sets out procedures 401(k) plan sponsors can follow to satisfy their fiduciary duties when selecting an annuity provider. To obtain fiduciary relief under the safe harbor rule, for example, plan sponsors must perform an analytical search for annuity providers and consider the provider's ability to pay claims in the future, in addition to the costs and benefits of the annuity. According to the rule, plan sponsors and other fiduciaries following the safe harbor when selecting an annuity provider fulfill their fiduciary duty and should, therefore, not be subject to corporate or personal liability for that selection.

Plan Sponsor Survey Respondent on Legal Risk

"There is a not a single bit of upside to me as a plan sponsor in offering an option that participants don't want, particularly when it is a complex offering with lots of room for 20/20 hindsight by plaintiff's counsel, and one that tends to be more expensive. I care about our participants, but I have to balance that against my personal liability, as well as that of my employer."
Source: GAO Plan Sponsor Survey | GAO-16-433

Stakeholders we interviewed indicated that the safe harbor for selecting an annuity provider is not helpful and the primary challenges stem from the requirements that plan sponsors appropriately:

- Consider information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract.
- Conclude that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract. Plan sponsors must also periodically review the appropriateness of the conclusion over time as the provider continues to issue annuity contracts.

To facilitate the availability of annuity options in 401(k) plans, the 2005 ERISA Advisory Council Working Group on Retirement Distributions and Options recommended DOL change sponsor responsibilities for selecting an annuity provider. The Pension Protection Act of 2006 (PPA), required DOL to promulgate regulations clarifying the fiduciary standards applicable to the selection of an annuity contract as a form of distribution for a DC plan. In 2007, in the preamble to the proposed safe harbor rule, developed in response to the PPA requirement, DOL stated that plan sponsors had frequently cited their fiduciary liability as a reason for not offering an annuity spend down option. However, by DOL's own estimates, the safe harbor was unlikely to make plan sponsors substantially more willing to offer annuities because it estimated when it proposed the rule that the safe harbor would increase the share of participants offered an annuity by only 1 percentage point.

Assessing the future financial health of an insurer can be a difficult task for a plan sponsor, and many plan sponsors

responding to our survey indicated they would be more likely to offer an annuity if the benefits of the safe harbor were more readily attainable. Members of Congress in both parties introduced legislation that would have, among other things, amended ERISA to permit plan sponsors and fiduciaries to rely more heavily on state regulators when selecting an annuity provider. Additionally, the Director of the Federal Insurance Office told us plan sponsors should not be expected to look at an insurer's annual report to assess its financial liabilities or know more about an insurer than the research and metrics a rating agency or other entity might make publicly available. Officials we spoke with at the National Association of Insurance Commissioners (NAIC) also told us the safe harbor should have verifiable criteria. For example, the plan sponsors responding to our survey who did not offer annuities responded that any single criterion provided would make them more likely to offer them, as shown in table 4.

Table 4: Plan Sponsor Survey Responses to Annuity Provider Selection Criteria

Which of the following would make you more likely to offer annuities?	Yes	No
A list of insurance companies that plans could prudently select as an annuity provider	30	14
A specified minimum rating an insurer must receive from certain named credit rating agencies to be deemed a prudently selected annuity provider	24	19
Documentation from the annuity provider asserting that the criteria for legal protection for prudently selecting it have been met	28	17

Source: GAO Survey of Plan Sponsors | GAO-16-433

Note: There was a total of 54 responses to our plan sponsor survey, but the totals in the table do not add up to 54 because in addition to the "yes" and "no" responses, the survey also allowed respondents to choose "don't know" or "no response".

DOL is responsible for educating and assisting plan sponsors to help ensure the retirement security of workers and their families. However, the annuity selection safe harbor can only translate into increased retirement security if it is used, and it does not provide sufficiently detailed criteria that plan sponsors feel they can use to obtain the liability protection it offers. The safe harbor requires plan sponsors to consider "sufficient" information to "appropriately" reach a conclusion about the annuity provider's future solvency without defining the terms "sufficient" and "appropriate."

In 2010, a DOL official told us the agency was considering addressing industry concerns that plan sponsors have to second-guess state insurance regulators to assess insurers' financial viability, and in 2014, DOL published information indicating that it would be developing proposed amendments to the safe harbor to provide plan fiduciaries with more certainty that they have discharged their obligations when contracting to provide an annuity option. DOL officials told us one advantage of revising the annuity selection safe harbor would be that it could provide greater clarity for plan sponsors and thus lead to more annuity options for participants. NAIC officials mentioned a standard proposed by an association of insurers, which would include, among other criteria, that the insurer be licensed in at least 26 states. RFI responses from two participant advocates suggested that annuity providers should also be licensed in states with strong regulatory protections. A DOL official told us that because the ERISA standard of prudence requires plan fiduciaries to exercise some degree of judgement in making the annuity provider selection, it precludes development of a simple and easily verifiable checklist. However, clarifying how to comply with the annuity selection safe harbor to the greatest extent possible may help encourage plan sponsors to offer plan participants an annuity option.

2. Considering providing legal relief for plan fiduciaries offering an appropriate mix of annuity and withdrawal options, upon adequately informing participants about the options, before participants choose to direct their investments into them.

According to researchers we spoke to, participants should have multiple lifetime income options because no one

solution works for everyone. Treasury officials told us that participants can benefit by combining options to diversify their sources of lifetime income and help them manage multiple risks in retirement. For example, participants could use a portion of their savings to purchase an annuity and leave the balance invested in their plan for a withdrawal option.

A variety of products and services could be offered in the plan environment to provide participants with a mix of annuity and withdrawal options. For example, managed payout funds provide for automated withdrawals, and annuity providers offer a wide variety of guaranteed income options. Furthermore, plans can also offer participants access to an online annuity shopping platform, and with it, comparable information on multiple products from multiple providers.
However, there is no agency guidance available to help plan sponsors minimize their legal risks when offering participants a mix of annuity and withdrawal options within a plan. The current safe harbor for the selection of an annuity provider is available to plan sponsors only offering an annuity product from a single annuity provider. Based on our analysis, a plan sponsor could increase its risk of legal liability for each option it offers. For example, a plan sponsor that offers an in-plan annuity increases its risk by adding withdrawal options. Of the 12 plan sponsors responding to our survey who did not offer withdrawal options, 8 responded that the fiduciary responsibilities for managing participant assets in the draw-down phase influenced their decision.

The results of our record keeper questionnaire indicate that most plan sponsors are not offering a mix of lifetime income options. In contrast, plan sponsors are required to diversify the plan investments they offer. In addition, when 401(k) plans permit participants to exercise control over their investment choices and, among other things, offer participants a broad range of investment alternatives, plan sponsors or other fiduciaries are not liable for any losses that result solely from a participant's exercise of that control.

DOL has not provided an incentive for plan sponsors to provide participants a mix of lifetime income options and information about them. EBSA's mission is to assure the security of the retirement, health, and other workplace-related benefits of America's workers and their families, and without lifetime income options in workplace 401(k) plans, those benefits may not remain secure throughout retirement. Accordingly, DOL is engaged in an initiative with Treasury to encourage plan sponsors to offer prudent lifetime income options. Currently, each additional lifetime income option plan sponsors offer potentially exposes them to additional legal risk, unless that option is an annuity selected in a process pursuant to the safe harbor for annuity selection.

DOL has not established a process plan sponsors can use to prudently select an appropriately diverse mix of annuity and withdrawal options offered to participants. Consequently, DOL has not determined the types of products —such as those on an online annuity shopping platform—that might appropriately be included in such a mix. DOL officials told us the decision to offer any lifetime income option is still a fiduciary one, and that even if they provided such relief, plan sponsors would still have some fiduciary responsibility associated with providing participants lifetime income. However, if plan sponsors and others are protected from liability when participants exercise control choosing among lifetime income options in a way comparable to how they are protected when participants exercise control in choosing investments to accumulate retirement savings, sponsors may be more likely to offer a mix of lifetime income options from which participants can choose in their plan.

3. Use a record keeper that includes annuities from multiple providers on their record keeping platform.

One of DOL's roles is educating fiduciaries on how to carry out their responsibilities, which include selecting service providers. DOL's guidance in its *Meeting Your Fiduciary Responsibilities* publication recommends that, to ensure a meaningful selection, plan fiduciaries should survey a number of potential service providers before hiring one, but the guidance does not specifically include or discuss consideration or adoption of annuities or lifetime income options. The guidance specifies that diversifying plan investments—which can include annuities—and paying only

reasonable plan expenses for service providers and plan investments are among a sponsor's fiduciary responsibilities.

DOL also underscores the importance of plan fiduciaries' responsibility to compare potential providers' services to appropriately assess their reasonableness. However, DOL's guidance does not encourage plan fiduciaries to use a record keeper that supports products from competing providers. While factors like cost and business affiliation may prevent some record keepers from supporting a variety of products, DOL officials told us participants would benefit from their plans having the ability to access non-proprietary products along with proprietary products. We previously recommended that DOL provide guidance to plan sponsors that addresses, among other things, the importance of considering multiple providers when choosing a managed account provider, and the importance of requesting from record keepers a choice of more than one provider. By considering similar guidance encouraging plan sponsors to use a record keeper that supports competing annuity product providers on its platform, plan sponsors could be more likely to find options that serve their participants and adopt them.

4. Offer participants the option to partially annuitize their account balance by allowing them the ability to purchase the amount of guaranteed lifetime income most appropriate for them.

Industry stakeholders and Treasury officials indicated that many plans lack partial annuitization options, which means many participants who have access to an annuity option through their plan must either annuitize their entire account balance or none of it. Agency officials and industry stakeholders have said that allowing participants to partially annuitize their account balance helps participants to combine multiple lifetime income options and purchase only the amount of annuity that they need.

For an illustration of how multiple lifetime income options, including an annuity, can be combined together to generate retirement income, see our interactive models at www.gao.gov/products/gao-16-433.
Source: GAO | GAO-16-433

Partial annuitization also allows participants to purchase an amount of annuity that makes sense for their situation in consideration of not only their plan savings but also income sources outside the plan, such as from Social Security or the resources of a spouse. Research has also shown that when offered, partial annuitization increases both the percentage of people who annuitize and the average percentage of balances that are annuitized. An industry stakeholder noted the increase in the purchase of annuities through the Federal Thrift Savings Plan (TSP) after partial annuitization was introduced. When the TSP began in 1986, the annuity option was an "all or nothing" choice. In 2004, TSP amended the plan to include partial annuitization and saw an increased use of annuities. For example, although the take up of TSP annuities in general remains low, more participants annuitized after TSP introduced partial annuitization. According to the insurer that has been the exclusive annuity provider to the TSP since its inception, 784 annuities were purchased in 2003. From 2004 to 2008, after partial annuitization was implemented, the number of annuity purchases—including partial or full annuitization—increased to an average of 1,645 per year, a 110 percent increase in the number of participants annuitizing at least a portion of their account balances. In addition, the insurer noted that the average purchase amount of annuities increased 60 percent from $66,000 to $106,000.

Treasury noted one of its goals is to make it easier for plans to offer participants a combination of retirement income options that avoid an all-or-nothing choice. However, 401(k) plans are not required to offer partial annuitization and our interviews with industry stakeholders and agency officials indicate that plan sponsors are not incentivized to offer partial annuitization and may not be aware of the benefits to participants. Recent collaborations by Treasury and DOL have tried to encourage plans to allow participants the ability to combine multiple options to receive their retirement benefits. For example, the actions taken by Treasury approving the use of QLACs and by DOL facilitating the use of deferred annuity contracts embedded within a target date fund have made it easier for plans to offer partial annuitization options. However, partial annuitization is not encouraged broadly through general guidance

applicable to all 401(k) plans, such as DOL's *Meeting Your Fiduciary Responsibilities* publication. Agency officials have told us that many plans continue to frame annuity purchases as an "all-or-nothing" choice even though one Treasury official said that there is nothing prohibiting plans from offering partial annuitization. With DOL guidance encouraging plans to allow partial annuitization and enabling their participants to purchase the amount of annuity that they need, participants will be able to make annuity purchases that are most appropriate for their individual circumstances and support their lifetime income needs.

5. Consider whether a contract with a service provider ensures future service provider changes do not cause participants to lose the value of their lifetime income guarantees.

Another deterrent to plan sponsors offering annuities, according to representatives of annuity providers, is the possibility of plan participants having to lose lifetime income guarantees when the plan sponsor changes service providers. To serve the best interests of participants, plan sponsors may at times be required to change service providers, including annuity providers and record keepers. Plan sponsors have a legal obligation to establish and follow a formal review process at reasonable intervals to decide whether to continue to use a service provider or look for replacements. However, lifetime guarantees—insurance policies offering lifetime income—can be difficult to transfer.

When participants contribute over time to a guaranteed lifetime income product such as a deferred income annuity or a GMWB, they are purchasing both an investment product and a guarantee of lifetime income. Purchasing an annuity in small amounts over time can have certain advantages, such as managing interest rate risk. When the plan sponsor changes record keepers or annuity providers, the investment will transfer, but the lifetime income guarantee may not. Some products might charge a guarantee fee of 1 percent or more every year and, as such, there is the potential for participants to have committed substantial resources to the guarantee before losing it due to a service provider change.

Representatives of one service provider told us that in general it is difficult to transfer annuities among annuity providers because it is difficult for providers to absorb the risk of another provider's insurance products. For a product with a lifetime income guarantee to transfer from one record keeper to another, the new record keeper's platform must either have the capacity to support the annuity product, or use third party software to allow a link to product information on the platform. Representatives of one annuity provider told us that given the complexities in effectively managing such a situation and the confusion about whether those efforts would be successful, many plan sponsors may be reluctant to offer annuities.

According to examples provided by industry officials, options needed to protect participants already exist, whether by refunding, preserving, or transferring their lifetime income guarantees, and some annuity providers and record keepers have taken steps to preserve participant benefits when plans change record keepers or annuity providers. For example, an association of defined contribution plans' record keepers has developed common data standards for tracking annuity products, which are intended to simplify the transfer of annuity data among record keepers. In another example, one annuity provider representative offers participants a refund of fees if they lose their lifetime income guarantee, returning to them some value that could replace the lost lifetime income. Further, another annuity provider representative told us his company paid the lifetime income guaranteed by another annuity provider's product, effectively transferring the annuities from provider to provider. An additional approach to preserving such benefits would be to allow participants to roll over their 401(k) plan annuity into an IRA version of the annuity provider's product in the retail market if it would otherwise be lost. However, such distributions would move some 401(k) plan benefits while leaving others, increasing the likelihood of participants having to manage benefits in multiple places, which we previously reported can be challenging for participants.

DOL has not issued guidance encouraging plan sponsors to consider whether a service provider contract ensures future service provider changes do not cause participants to lose the value of lifetime income guarantees. While

options to prevent lifetime income guarantee loses may exist, it is not clear how widespread they are in practice. However, by following such guidance from DOL, plan sponsors could make such options more widespread by requesting them, and they may be more willing to allow participants to accumulate in plan annuities in the future, if they are confident that a service provider change will not amount to a benefit reduction for participants.

6. Include participant access to advice on the plan's lifetime income options from an expert in retirement income strategies.

Participants we surveyed in coordination with a research organization cited obtaining advice as a key step in selecting lifetime income options offered by a 401(k) plan. We asked participants to check all the steps they would take to assess what lifetime income options are right for them, and almost 50 percent of respondents reported they would seek advice. Our surveys also found that participants preferred to obtain financial advice through their plans as opposed to other sources. We asked participants to select from a list the types of individuals they would consult in selecting among a plan's lifetime income options. Fifty-nine percent of respondents selected a financial adviser provided by the plan. In comparison, fewer than 40 percent of respondents selected a tax professional or lawyer (39 percent) or a financial advisor outside of a plan (about 36 percent).

Despite broad recognition of the need for participants to consult an adviser on lifetime income options before they make any decisions, industry research indicates only a minority of plan sponsors make advisers available to plan participants. In a 2013 survey of more than 600 plan sponsors, less than one-third reported offering access to any kind of advice to participants.80 One industry stakeholder told us plan sponsors are reluctant to provide access to investment advice, in part because of concerns about the costs. One survey reported this is true even though participants can get advice on withdrawal options through their plan for less than half the cost they would pay on their own. Lawyers representing 401(k) plans told us they counsel their clients against providing access to advice because of legal liability.

DOL officials told us it was a good idea to encourage sponsors to offer participants access to investment advisers in-plan, though sponsors should diligently vet prospective advisers before they are allowed to make open presentations to participants. However, in DOL's publication *Meeting Your Fiduciary Responsibilities*, plan fiduciaries are not encouraged to provide access to an investment adviser knowledgeable about lifetime income strategies. Despite the absence of such guidance, some plan sponsors have already ensured that their participants have the chance to speak with an investment adviser about their plans' annuities and withdrawal options, enabling participants to talk to professionals before they leave their plan or make a decision that can jeopardize their retirement security. Without guidance about the importance of providing their participants access to an adviser at the point of retirement to discuss in-plan lifetime income options, plan sponsors may continue to not offer such a service.

7. Consider providing RMD-based default income–plan distributions as a default stream of lifetime income based on the RMD methodology–beginning, unless they opt-out, when retirement-age participants separate from employment, rather than after age 70 ½.

One option already in place that can provide a default for participants in 401(k) plans is the provision of required minimum distributions (RMD). A plan can be disqualified under the Internal Revenue Code if they do not follow the RMD provisions. Under these provisions, participants are required to begin receiving at least minimum payments starting after the participant retires and reaches the age of 70 ½. RMD calculations based on life expectancy provide lifetime income by design. Some plan sponsors are willing to administer RMDs as lifetime income by providing the minimum distribution to the participant in the plan rather than requiring participants to take a lump sum. As a result, participants who do not proactively commit to a lifetime income strategy may still get lifetime income through a plan that complies with RMD provisions by making distributions on the regulated minimum schedule. Default income based on RMD provisions can also begin when a participant retires and is in need of income, even though a

distribution is generally not required until after the participant turns 70 1/2. For example, the Thrift Savings Plan (TSP) for federal employees offers a series of monthly payments computed by the TSP based on IRS life expectancy tables.

Conclusion

DOL can take action to address fiduciary barriers that deter plan sponsors from offering lifetime income options to participants. First, most plan sponsors are unlikely to be equipped to judge the long-term viability of an insurer, yet they currently must do so under the existing safe harbor. Providing clearer criteria for making this determination likely would encourage more sponsors to seek fiduciary relief for offering annuities. Second, DOL offers fiduciary relief when savings are accumulated in an appropriate mix of investments, but it offers no such relief for plans offering a mix of lifetime income options. Extending this relief to plan sponsors could encourage more plans to make a mix of options available and, therefore, allow participants to create a better retirement strategy by selecting and combining annuity and withdrawal options.

DOL can also provide additional guidance, in its Meeting Your Fiduciary Responsibilities publication or elsewhere, for fiduciaries as they consider how their participants' account balance will translate into retirement income. DOL guidance can encourage plan sponsors to use a record keeper that includes annuities from other providers on its record keeping platform and increase the likelihood the plan sponsor will have access to annuities that the plan sponsor considers to be in the best interest of the plan participants. DOL guidance can encourage fiduciaries to offer participants the option to partially annuitize their account balance, allowing participants to purchase the amount of guaranteed lifetime income most appropriate for them.

DOL guidance can also help plan sponsors plan for future service provider changes when offering an annuity. The fear of causing participants to lose annuity guarantees due to a service provider switch may cause plan sponsors to stay in a less than ideal service provider relationship or not offer an annuity. Guidance can encourage plan fiduciaries to consider whether a lifetime income contract could cause participants to lose lifetime income guarantees under such a circumstance before entering into the contract.

DOL guidance can also encourage plan sponsors to provide an expert in retirement income strategies for participants to talk to about the plan's distribution options. Enabling participants to receive advice about in-plan lifetime income options given their individual circumstances will better ensure they make retirement income decisions that can be directly applied to their specific circumstances.

Lastly, DOL can encourage participants who have not chosen a lifetime income option at retirement toward income security with defaults. These participants may be less likely to take advantage of advice when offered. RMD-based default income can stretch out the account balances of these participants throughout retirement if sponsors and participants understand how they can be administered and used. Unless DOL encourages plan sponsors to consider providing RMD-based default income, many retirees who do not select a lifetime income option may continue to receive a single lump sum payout that may not be used for lifetime income.

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A copy of the full report can be found here .

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Endnote

[i] To better understand the adoption of lifetime income options in 401(k) plans, we administered a questionnaire to 11 401(k) plan record keepers that together accounted for approximately 42 percent of the 401(k) plan market as measured by plan assets, 46 percent as measured by participants, and 26 percent as measured by the number of plans, as of December 2014. To examine what barriers, if any, deter plan sponsors from offering lifetime income options, we conducted a non-generalizable online survey of plan sponsors through industry organizations such as PLANSPONSOR, the Plan Sponsor Council of America, the National Association of Plan Administrators and BenefitsLink. We reviewed relevant research; industry publications; and federal laws, regulations, and guidance on lifetime income options in 401(k) plans. We also interviewed industry stakeholders, researchers, and government officials—including officials from DOL's Employee Benefits Security Administration (EBSA) as well as from the Department of the Treasury's (Treasury) Office of Tax Policy, Federal Insurance Office, and Internal Revenue Service (IRS). We conducted this performance audit from July 2014 to August 2016 in accordance with generally accepted government auditing standards.

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