Retirement Solutions, not Products

Mitigating risks in the drawdown phase of retirement

If you build it, will they *(really)* come? We have learned that there is a need for retirement income *solutions*, above simply retirement products, in the retirement income market today. This paper explores the importance of a holistic retirement income solution.

Retirement focus is moving from accumulation to de-cumulation

The focus within the defined contribution ecosystem continues to shift from the wealth accumulation (pre-retirement) timeframe to the wealth de-cumulation (post-retirement) timeframe. This is primarily due to recent participant demographic shifts, as well as overall maturity of the investment landscape.

To judge trends more adequately in today's DC space, we examine the perspectives of key stakeholders, including plan sponsors, consultant and advisors and, most importantly, plan participants.

From the participant perspective, research shows that 82% of respondents expect to draw down from their employer retirement plan as a source of retirement income.[1] Similarly, 83% of plan sponsors now seek to retain participant assets within the DC plan.[2]

Consultants and advisors who represent another key stakeholder group similarly are paving the way towards underwriting decumulation strategies. In fact, 63% of these respondents are currently evaluating new investments specifically designed to offer retired participants diverse options complementary to traditional retirement options. This comes as a result of 80% of the respondents believing current retirement plan options do not sufficiently address retiree needs.[3] As a bonus, these trends have also coincided with movement on the legislative front.

Legislative changes to the US defined contribution system over the past two decades have generally aimed to harness participant inertia to improve wealth accumulation outcomes. Simply put, participants' general lack of engagement did not necessarily position retirees for their best retirement outcomes. Thanks largely to the passage of the Pension Protection Act in 2006, and subsequent changes such as SECURE 1.0 in 2019 and the forthcoming SECURE 2.0 legislation, many participants have benefitted from the result of these legislative acts, including having automatically enrolled participants into a retirement plan. Additionally, plan design has also subsequently defaulted many participants into age-appropriate target date funds, which "automatically" addresses participants' risk tolerances as individuals near retirement. In other cases, participant contributions have automatically escalated over time, improving the total balance of their retirement wealth. Creating legislation to better utilize these design features has successfully addressed participants' general lack of engagement and, instead, has more resulted in organically better asset accumulation.

Holistic retirement solutions need to address the four fundamental risks participants are facing

Shortly after the founding of the US, one could expect to live to the ripe old age of 35.[4] People simply worked their entire lives. When Congress passed the Social Security Act in 1935, life expectancy had risen to a robust 61 years. Interestingly, the "retirement age" for full benefits was still set at 65 years, four years beyond life expectancy.

1 *Retirement Confidence Survey*, Employee Benefits Research Institute, 2022
2 Callan 2022 DC Trends Survey, Callan LLC
3 2022 PIMCO US Defined Contribution Consultant Survey
4 *Estimates of Regional and Global Life Expectancy 1800-2001. Population and Development Review. Volume 31, Issue 3 September 2005.*

Today, "retirement" in some form is widely expected and, for many, a persistent cause for concern. With current life expectancies, retirement can easily stretch into a person's 90s. Understanding how to financially plan for this unknown period has become a priority for American employees. Furthermore, understanding their concerns and the risks employees are facing helps us to develop holistic retirement solutions that fund a goal that may be decades away, and could span decades, in a rapidly changing and uncertain environment.

The four fundamental risks employees have when it comes to retirement income concerns are:

1. *Investment risk:* Allocation and diversification decisions – before and during retirement – can directly impact asset retention, growth potential and retirement income streams. Ensuring that the same level of investment care that happens during accumulation also happens throughout their retirement
2. *Longevity risk:* Longer life expectancies increase the risk of retirees outliving their assets. Employees are nervous about spending their wealth prematurely, leaving them with little to no wealth in the latest years of their lives.
3. *Liquidity risk:* We all know that life has a way of changing even the best-laid plans. Employees don't want to surrender all of their assets for indefinite monthly income. Certain investment vehicles, such as annuities and CDs, are less liquid and can restrict employees' access to, and feelings of control over, their assets.
4. *Utilization risk:* Investment solutions must allow retirees to manage the drawdown of their wealth and help them maintain a desired standard of living throughout retirement. These solutions need to be well-understood by participants before they actively engage in participation (and thereby the benefits).

Dividing the unknown of retirement timeline into distinct segments can ease the planning process

As people continue to live longer than any generation has seen, the idea of retirement presents new challenges when planning for the future. The greatest of these challenges is the unpredictability driven by 1) the general effects of aging and 2) how long their retirement will last. To help mitigate this unpredictability when planning for retirement, we take a "divide and conquer approach": we divide the retirement planning into two distinct phases—early retirement and later retirement. Although retirement age can vary depending on when retirement begins, for this purpose we will assume an age 65 at retirement. We propose that the early phase is finite, encompassing the first 20 years, which may be dominated by relative certainty and the likelihood of more precise planning (until age 85). Subsequently, the later phase comprises the post-20 years into retirement (after age 85), which can be expected to present more of the unknowns.

Communication is key to delivering the holistic retirement solution

Given the increasing ubiquity of auto-features, by the time a participant nears retirement, it has become entirely plausible that the participant has never actually made an active affirmative decision regarding their defined contribution plan. Furthermore, as we are seeing today, participant engagement markedly begins to ramp up as participants approach retirement age.[5] Recent research shows that older participants are more likely than younger participants to transact within their defined contribution plan.[6] Plan sponsors, recordkeepers and investment managers increasingly must provide the education and support these participants desperately need, particularly at the time in the work cycle they are wanting it. We know that utilization risk (the risk that solutions are misunderstood and therefore not utilized within a plan) is an underappreciated factor in participant inertia, preventing participants from best meeting their retirement goals.

Communications and education must deliver relevant, intuitive information to participants who are looking for answers. This often can best mitigate utilization risk. Specifically, participants on the cusp of retirement need the most information. The decisions regarding their defined contribution plans represent only part of a wider retirement decision mosaic, though. Simultaneously, participants also attempt to navigate Social Security (with its enthralling 32-page primer[7]) and Medicare (with an equally riveting 128-page 'brochure'[8]). In addition to this backdrop of information overload, circumstances within these age cohorts can differ widely. Unlike the savings years, when the goal of accumulation is generally universal, the decumulation years (post-retirement) feature increasingly diverse participants with heterogenous planning goals. The decumulation phase does not as easily feature an elegant one-size-fits all investment solution. Rather, various approaches naturally

5 Clark, Fiaschetti and Gerrans, "The Demand for Advice in Defined Contribution Pensions Plans: Age, Gender and Size-of-Bet Effect. August 2015. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2551819
6 Blanchett, David, "What Helped Participants Stay the Course in 2020" February 2022. https://cdn.pficdn.com/cms/pgim4/sites/default/files/PGIM-DC-Solutions-Stay-the-Course-0422.pdf
7 https://www.ssa.gov/pubs/EN-05-10024.pdf
8 https://www.medicare.gov/Pubs/pdf/10050-medicare-and-you.pdf

appeal to different sets of retiree profiles. For example, a guaranteed insurance-solution that appeals to one retiree may be completely inappropriate for another. For this reason, participants must receive targeted communications to be able to weigh the relative merits of the various solutions in order to confidently make decisions around retirement income.

Today's communication and engagement outreach present a mixed bag of effectiveness. According to EBRI's 2022 Retirement Confidence Survey, participants' views on current efforts pose reason for optimism yet also room for improvement. According to the survey:

- Over half of workers who are offered a workplace retirement savings plan use provided tools to determine/review how much to save or how to generate income at least every six months.
- Three in five workers who are currently contributing to a retirement savings plan say their employers offer information on their projected monthly income in retirement. Nine out of 10 of those who receive this information find it useful.
- But when asked "What would be the most valuable improvement to a retirement savings plan?", nearly one-third of the workers would like more information about how much income their savings will produce in retirement (which was the top response).

Based on these findings, workers nearer to retirement use the tools offered and find them useful.

However, it is equally clear that there remains more work to be done around helping educate participants about how much savings is required and how to produce relevant income from retirement savings plans.

We know, based on this same survey, that 82% of workers expect workplace savings plans to be a source of retirement income. It remains incumbent on the option providers, namely, plan sponsors, recordkeepers, consultants/advisors and investment managers, to better deliver on this expectation. To effectively drive participant engagement and utilization, a robust communication platform is required, developed from a close partnership and commitment to better education between the investment manager, recordkeeper and plan sponsor.

The investment manager must play a crucial role when communicating evolving retirement income solutions. Retirement income products must be incorporated as just pieces of the overall solution. The 'solution' combines the underlying investment product but must also support the participant communication necessary to engage participant action. And in doing so, we know communication must be thorough, easy and attenable for end user, the participant.

Retirement Income Product + Participant Engagement Support = Retirement Income Solution

Investment managers today must do more than simply provide a fund fact sheet and assume it is enough education for the participant to take action. Plan sponsors adopting retirement income solutions are now demanding an additional degree of educational support not seen before from other retirement products. While in no way exhaustive, the below list highlights several requirements for robust participant support:

- **Multi-media:** Participants differ in their preferred communication methods and have moved beyond the paper-digital split. Consider that in some workplace settings, employees may never set foot in a physical office, while others may not even have access to a computer; some employees may spend their days in trucks, on hospital floors or in the field. Investment managers must be nimble and support not only paper and e-mail campaigns, but mobile and social media efforts to connect, communicate and educate participants where they yield the greatest chance of consumption.
- **Clear, relevant and concise**: As participants are increasingly busier and attention spans vary, the messages must remain clear, relevant and concise. Specifically with retirement income, participants generally want to easily know how much income they can reasonably expect to derive based on a particular savings plan, how they will eventually receive that income, and better understand long it will last. This relevant information should be clear and easy to access. The harder it is to find, the less likely the participant will be to engage. Perhaps most importantly, participants want to understand what they're being told—we must avoid the confusing jargon the financial services industry loves to use. The easier we make it for participants to access and consume relevant information, the more likely they will be to engage.
- **Filter the information to make it easy**: We have learned the importance of tiering the information sharing to ensure all questions are answered quickly and logically. Just as participants prefer varied methods of communication delivery, they, too, prefer varying levels of detail. Communication should support not only those that want high level answers but should also address those communication consumers that revel in the minutiae. The key to successfully providing effective detail is to make it easy to find and digest the information relevant.

Forged partnerships lead to better communication

The merit of the investment manager remains a central focus for those evaluating retirement income products; we need to be adequately describing the value the specific retirement product can potentially bring. However, the level of support provided to plan sponsors and participants about how to actually use these products is the art of delivering a holistic solution. A strong communication and education effort remains one of the best ways to reduce participant utilization risk and increase the participant engagement.[9] To best achieve this, investment managers must raise the bar in becoming true partners with plan sponsors and recordkeepers when it comes to establishing communication and educational support strategies.

We want to help

At LGIM America, we understand participants' concerns/risks, the importance of segmenting the retirement unknown, and the value of effective communication; we welcome this partnership. We have retirement solutions to help address these evolving n needs, including communication and educational support strategies. For more information about this thought paper or LGIM America's retirement capabilities, please contact Jimmy Veneruso at Inquiry.DefinedContribution@lgima.com.

About LGIM America

LGIM America (LGIMA) was founded in 2006 with the purpose of helping people achieve their long-term financial goals. We offer a range of strategies to help our institutional clients (corporations, healthcare agencies, non-profit, education, public plans and Taft-Hartley) manage their investment objectives, which can range from market-based alpha-oriented strategies to those that are designed to be more liability-centric, derivative overlays, or indexed solutions. Encouraging a diverse and inclusive environment coupled with a solutions-focused culture allows us to increase our breadth of knowledge and the likelihood of improved client outcomes and stronger financial performance. We have teams of experienced, innovative professionals committed to helping plan sponsors meet their pension promises, managing investment exposures efficiently to seek enhanced returns while mitigating risks, and working to generate returns while making a positive societal difference. For further information about LGIM America, find us at www.lgima.com.

9 LGIMA defines utilization risk as the risk that after a fiduciary's due diligence and effort to improve outcomes, participants will not use a plan option