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Guaranteed Income Feature Can Play Key Role in Today's Retirement Plans

by Edward Eng

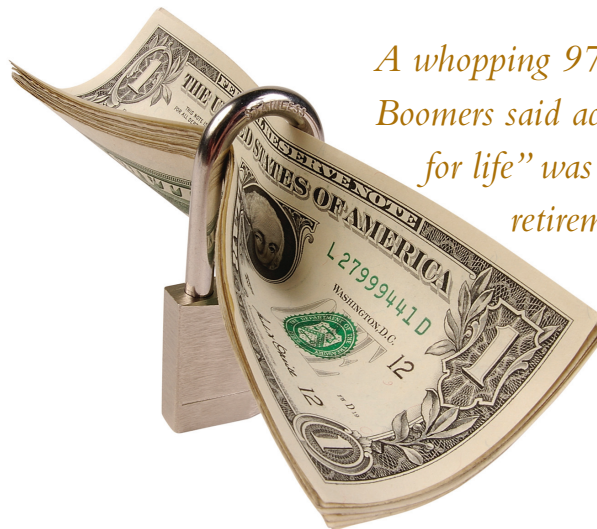
You don't need a crystal ball to know that Americans are concerned about retirement. Really concerned. As the country digs itself out of the biggest economic crater in nearly a century, millions of Baby Boomers are being forced to ask themselves some difficult questions: "Will I have enough to retire?" "Will my savings last through my retirement?" "What if something happens with the markets?"

These issues are challenging. The situation gets even more challenging when you consider that Americans' personal savings levels are at a long-time low, life expectancies are rising and health care costs continue to climb each year.

To help address their participants' concerns, an increasing number of employers are choosing to incorporate a guaranteed lifetime withdrawal benefit (GLWB) feature in their companies' retirement plans. A GLWB feature provides retirees with a source of guaranteed retirement income for the remainder of their lifetimes, affording them a measure of financial predictability and a degree of protection from volatile markets in retirement.

Turning Savings into Income that Lasts a Lifetime

While GLWBs are by no means a retirement planning panacea, it appears they may have a significant role to play in the 401(k) plans of



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today's participants. In a recent survey of pre-retiree investors, 85% said they placed a greater importance on guaranteed monthly income than earning above-average investment gains.¹ In another study, a whopping 97% of Baby Boomers said achieving "income for life" was their top retirement priority.² And nearly half of pre-retirees (46%) said they were "very concerned" about the prospect of outliving their retirement savings.³

Who said there were only two certainties in life?

A guaranteed lifetime income feature can provide participants with:

- A stream of income for life
- Protection from unpredictable markets
- Upside potential to take advantage of bull markets
- Access to their market value whenever they need it

1 "Fidelity Study Shows Economy Driving Demand for Guaranteed Income Products, Yet Annuity Knowledge Remains Low." Fidelity Investments. March 17, 2009.
2 America Speaks Out on Retirement: 2007 Investor Research Study. Plan Sponsor Magazine. June 2007.
3 McKinsey 2006 Consumer Retirement Survey.

Participants eager for guaranteed lifetime income options:

- 65% of participants feel that a guaranteed option would increase their satisfaction with their 401(k) plan
- 43% of participants want their company to be one of the first to offer such an option
- 71% of employers feel a guaranteed option would benefit their 401(k) plan

Statistics gathered from "Opportunities for Guaranteed Income Stream Options," a John Hancock-commissioned study by Mathew Greenwald and Associates, Inc. November 2007.

Indeed, given the uncertainty of the economic landscape, it seems that more participants may be warming to the idea (and the associated benefits) of a GLWB. The approach is also getting some serious consideration and support from a wide range of experts, including those at the top levels of government. In its recently-announced retirement plan initiatives, the Obama administration has called for greater use of guaranteed lifetime income features in 401(k) plans as a way to help Americans turn their hard-earned savings into lifetime income streams.

The Need is Real

When it comes to planning for a secure retirement, the Boomer generation is facing an uphill battle. On its own, the recent global recession would have been more than enough to knock some of the wind out of their financial sails. On top of this market uncertainty, however, is a growing stack of converging factors that appear to be conspiring against Boomers' financial futures.

Retirement is Lasting Longer

Thanks to medical advances and increased standards of living, Americans are enjoying longer life expectancies. In 1950, the average life expectancy of a person at retirement age was 79. For someone retiring in 2004, the average life expectancy was 84 years.⁴ What's more, there's a one-in-three chance that at least one of a couple of healthy 65-year-olds will live past age 95.⁵ That's the good news. The challenge is that for the first time in history, our retirement plans may need to last for 30 years or more. Today's participants need real options to help finance those additional years of life.

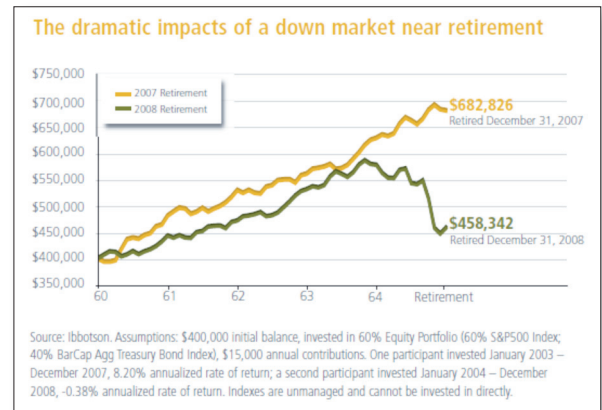
With a GLWB, you have the flexibility to self-manage your investments, but with a component of downside protection to keep your retirement plans on track if the markets should experience a downturn.

"When" You Retire Matters

As workers approach and enter retirement, they become more vulnerable to volatile equity markets since their investments don't have as much time to recover. Losing a portion of their retirement nest egg at that critical time can have a significant impact on their savings, as well as their future retirement income. This reality has already hit home for millions of Americans. In fact, 38% of people over the age of 62 said they have actually delayed their retirement due to the 2008 recession.

The accompanying illustration shows how a bear market that occurs close to retirement can drastically impact a participant's savings. In this instance, our two participants (let's call them Mary and Steve) each had a 401(k) balance of \$400,000 five years before their respective planned retirement dates. Mary retired in 2007, just prior to the recent recession, with a balance of \$682,826. Steve retired just 12 months later with a total balance of \$458,342—that's just two-thirds of Mary's balance at retirement. That's the difference a year can make.

The situation is by no means hopeless. But it does underscore the fact that all Boomers approaching the end of their working careers would be well-served to create a reliable income stream they can depend upon in retirement.



Generating a Retirement Income Stream

There are essentially three main alternatives available to any participant who is looking to create a dependable stream of retirement income:

The "Do-it-yourself" Approach

Imagine you're driving your car along a 25-mile suspension bridge that is 250 feet in the air. By the way, this bridge doesn't have any guardrails. On a sunny, windless day, making it across the bridge is a snap. But

4 National Vital Statistics Report, National Center for Health Statistics 2007.

5 Annuity 2000 Mortality Table, Society of Actuaries.

6 Most Middle-Aged Adults Are Rethinking Retirement Plans. Pew Research Center. May 28, 2009.

when the wind kicks up and the thunderstorms roll in, it can be a different story. You'll need to constantly monitor the weather and road conditions and adjust your speed and positioning accordingly to make it to the other side.

Welcome to the "do-it-yourself" approach. With this strategy, the participant manages his or her own portfolio of investments and takes regular withdrawals to fund his or her retirement. In order to provide steady income, this approach requires the owner to monitor market conditions on an ongoing basis and make appropriate adjustments to his or her investments. Perhaps the greatest challenge is to have a portfolio that is aggressive enough to ensure the money can last, but also conservative enough to provide protection from market downturns.

The "do-it-yourself" approach can be effective for the sophisticated investor who has a high tolerance for volatility. In many cases, it could also mean lower fees at the end of the day. But with no insurance component and the need to self-manage your withdrawal amount, it is definitely not for the faint of heart or novice investor.

A Traditional Annuity

Now, imagine you are driving your car through a long tunnel. There's no need to worry about adverse weather in the safety of the tunnel. But after awhile, you notice that there are no off-ramps. You're stuck going in one direction from point A to point B.

This analogy illustrates how the traditional income annuity works. An annuity is an insurance product that does provide a guaranteed series of payments. In other words, you will get from point A to point B. This security comes at a price, however, which means low flexibility (your money is locked in) and higher fees.

Guaranteed Lifetime Withdrawal Benefit (GLWB)

The GLWB offers the best of both worlds. To extend the automotive analogy, imagine you're driving across a bridge, but this time, there are strong, stable guardrails to help you stay on the road until you make it to the other side—no matter how bad the weather might get.

With a GLWB, you have the flexibility to self-manage your investments, but with a component of downside protection to keep your retirement plans on track if the markets should experience a downturn. The fees associated with GLWBs are moderate (somewhere between the annuity and do-it-yourself approaches). On top of that, you'll have access to minimum withdrawals without having to annuitize your investment.

Given the new economic realities and challenges the Boomer generation will face in years to come, allocating a portion of their portfolios to a GLWB feature today could provide the confidence and security that comes with a predictable income stream.

Benefits of Guaranteed Lifetime Income Features

In short, GLWBs provide participants with predictable growth, a stream of income they can rely on and protection from market events. The following is an overview of some of the specific benefits commonly associated with these types of plan features:

Income for Life

For many participants, income for life is by far the most attractive aspect of the GLWB—the fact that they will have access to a guaranteed withdrawal amount, no matter how long they live. And since the feature is not an annuity, the participant's heirs will be entitled to any remaining market value after the participant's death. This protects participants against the prospect of outliving their savings.

Protection from Unpredictable Markets

Even if a participant retires at the worst possible time (Remember our friend Steve?), the stream of guaranteed retirement income will not be affected. His or her deposits are protected.

Upside Potential

Many GLWBs have options that allow the benefit base to grow or "step up" to current market levels. These options provide a valuable opportunity for participants to participate in bull markets and to turn growth into guaranteed income they can count on.

Access to Market Value

Another aspect worth noting is that, unlike an annuity, with a GLWB, the participant's market value isn't locked in. This means that the participant can access his or her funds at any time (e.g., in the event of an emergency or other unexpected situation).

By helping to address some of the primary concerns of today's American workers, a GLWB can go a long way toward helping participants plan for a more predictable retirement.

Some Common Misperceptions

When evaluating the merits of adding a GLWB option to a specific company's plan, it's important to make assessments based on the facts. With that

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in mind, here are a few of the more common misperceptions about GLWBs:

It's an Income Annuity

Actually, it's not. While both annuities and GLWBs provide recurring payments for the lifetime of the investor, there are a few key differences. With a GLWB:

- The funds are never locked in. The participant can access the money at any time.
- The participant generally has a choice of investment options.
- After the participant's death, the heirs receive the full remaining value in the guaranteed lifetime income account.
- The participant controls the withdrawal amount (up to annual maximum) rather than taking a fixed income stream from a traditional annuity.

It's Not Appropriate for a 401(k) Plan

In fact, GLWBs can be an ideal complement to a 401(k) plan. To borrow a football analogy, guaranteed lifetime income features provide protection in what's known as the "retirement red zone"—the five or ten years prior to retirement, when an investor is most at risk of the effects of a market downturn.

It's too Complicated to Administer

Some analysts have bemoaned the fact that GLWBs are too difficult for employers to understand and too onerous to implement. In reality, the newest features are virtually "plug and play." Providers have the tools to help TPAs and employers implement these features quickly, seamlessly and with ease of ongoing maintenance.

Confusion about Percentages

With a GLWB, the participant can take a 5% withdrawal of the initial principal amount every year. This percentage shouldn't be confused with a 5% guaranteed investment income from a vehicle like a GIC.

Things to Consider when Selecting a Provider

It's clear that GLWBs can play an important role in many companies' 401(k) plans—and over the course of a participant's retirement. Having said that, it makes sense to invest the time up front to evaluate potential providers thoroughly and determine whether their respective features meet the short-term and long-term needs of your company and its employees. A comprehensive checklist should evaluate providers on a list of criteria, including the following:

- What is the guaranteed minimum withdrawal rate with the feature?
- Is there a spousal option available?
- Is there an option for taking income early?
- Is there a choice of underlying investments?
- What are the associated fees?
- Is there any lock-in period required? And if so, how long is it?
- Are there any age restrictions (e.g., a minimum age for taking money, etc.)?

It is also prudent to carefully consider the financial track record and stability of your potential providers. Since these companies will be required to back up these lifetime guarantees, you will want to ensure that you're doing business with trusted, established players who will be in a position to make good on these future financial obligations to your participants.

Conclusion

American workers are concerned about their prospects for achieving a financially-secure retirement. And with good reason. When it comes to planning for a comfortable retirement, the Boomer generation is faced with a truly unique set of circumstances and challenges. Today's retirees are living longer. There's growing uncertainty about the future of Social Security, health care costs continue to spiral upward and market volatility has become the norm.

The GLWB provides a valuable tool participants can use to add an element of certainty to their 401(k) plans. It's a way to help participants regain some sense of control over their financial destinies and to help create a dependable source of retirement income that will last throughout their entire retirement.

That's certainly a pretty good start. 🏠



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