Pension Plan Fix-It Handbook

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DB Plan Provisions Are Influencing Way Sponsors Think About Retirement Income

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Defined contribution plan sponsors are starting to think like defined benefit plan sponsors when it comes to their retirement savings and income culture.

In its June report "Qualified Retirement Plan Barometer — A Study of Retirement Income Culture Among the Fortune 1000" (https://www.metlife.com/assets/cao/institutional-retirement/MetLife2014QualifiedRetirementPlanBarometerStudyFinal.pdf), MetLife examined retirement income culture in companies that offer only a DC plan and at those that offer both types of plans. Retirement income culture is defined by MetLife as "one which places a balanced emphasis on retirement savings and retirement income."

Not surprisingly, the study found that retirement income culture correlates with plan type. Typically, companies that offer only a DC plan focus on getting employees into the "pipeline" as early as possible for the purpose of accumulating savings for retirement. Companies that offer both a DC plan and a DB plan have a much stronger retirement income culture, reflective of the tradition of guaranteed lifetime payments bestowed by DB pensions.

DB plans already are more likely to communicate with participants in terms of retirement income, as many traditional DB plan benefit formulas focus on income at retirement, rather than accumulation during one's working years. DC plan sponsors are starting to include the importance of retirement income in their participant communications, according to the MetLife report, with 56 percent of respondents mentioning the effect of longevity on retirement savings and 52 percent discussing retirement income.

Organizations offering only DC plans are more likely than organizations with both DB and DC plans to begin investigating a lifetime income annuity option, the MetLife study said. DC-only plan sponsors without a lifetime income annuity are discussing the option with their recordkeepers, with 70 percent taking preparatory steps to offer this feature. However, only 44 percent of DC-only organizations stated that retirement income is an important focus, while 98 percent said that retirement savings is an important focus of their plans' overall objectives.

DC-only plan sponsors "are more than twice as likely to believe that workers reach retirement age with inadequate savings to generate sufficient retirement income." Federal regulators are also concerned with adequate retirement income for DC participants, as evidenced by new final rules on qualifying longevity annuity contract regulations announced July 1 (see box, p. 2).

What Is Sufficient Retirement Income?

Retirement income needs are often expressed as a percentage (for example, 65 percent to 85 percent) of one's pre-retirement income, or as a multiplier of pre-retirement income (for example, savings equal to eight to 11 times pre-retirement income).

A May study by Towers Watson titled "Why American Workers' Retirement Income Security Prospects Look so Bleak: A Review of Recent Assessments" questioned the assumptions used in a number of recent pronouncements about how much money people need in retirement. The report examined the methodology used in many studies of what constitutes adequate financial resources in retirement. It found that determining retirement income adequacy is difficult due to:

- investment risk;
- longevity risk;
- uncertainty about employment;

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Andersen (continued from p. 1)

- realities posed by adult children still at home; and
- large, unexpected health costs, including for a nursing home or similar facility later in life.

Some studies use a lifestyle approach, in which some work-related expenses will decrease in retirement but expenses associated with leisure activities and home maintenance expenses may increase. Another widely used approach is the "earnings replacement rate," which measures the percentage of gross pre-retirement income needed in retirement to enable the participant to maintain the same style of living (often defined as, 65 percent to 85 percent).

When evaluating studies about retirement income, it is important to note whether the study is evaluating current retirees or active workers yet to retire. Current retirees may have income from traditional DB plans that may not be available to future retirees. Other challenges, such as unknown economic conditions, family situations and the probability of working for multiple employers, make projecting future needs of current workers difficult, to say the least. Add the dramatic shift by employers away from DB plans, and the paradigm gets even more complicated.

Bottom line: Regardless of which study you choose as a basis for communicating retirement income adequacy to your participants, kick the tires and understand the assumptions.

Revisit Your Benefits Philosophy

When did your company last revisit its retirement plan offerings in terms of your corporate culture and overall benefits philosophy? If you have not revisited these lately, it might be time to shake the dust off the document!

Where do you begin? Start by looking at the plan document and changes that have been made since it was adopted. Assess the benefits landscape. It is not unusual

See *Andersen,* p. 3

IRS Finalizes Longevity Annuity Regulations With Tax Protection for Delayed Withdrawal

IRS has finalized regulations under which retirement plan participants can use part of their account balance to purchase a qualifying longevity annuity contract (see related story, p. 1) without being socked with tax penalties for not withdrawing funds early enough. Generally, QLACs withdrawals don't begin until age 85 or older; however, retirement plan rules require withdrawals to begin at age 70 ½ — and any delay has resulted in a penalty. Concerned that this conflict discouraged plan participants from using QLACs, IRS has established rules designed to "provide for greater security by giving American families more flexibility to plan for retirement and protect themselves from outliving their savings," according to the agency. "This change will make it easier for retirees to consider using lifetime income options: Instead of having to devote all of their account balance to annuities, retirees who wish to follow a combination strategy that uses a portion of their savings to purchase guaranteed income for life while retaining other savings in more liquid or flexible investments will be able to do so," according to an IRS press release on July 1. The agency notes that its regulations will affect 401(k) plans, 403(b) plans, eligible deferred compensation 457(b) plans and individual retirement accounts; trustees and custodians of these plans and IRAs; and insurance companies that issue QLACs. The regulations became effective when published in the July 2, 2014, *Federal Register*, and will apply to QLACs purchased on or after that date. Here is summary of the final rule's provisions:

- Sets maximum age to begin distributions: A QLAC must provide that distributions begin no later than an annuity starting date specified in the contract. That date must be no later than the first day of the month following the employee's turning age 85.
- Increases the maximum permitted investment: Retirement plans or IRAs may permit plan participants to use up to 25 percent of their account balance or (if less) $125,000 (up from $100,000 in the proposed regulations) to buy a QLAC and waive compliance with required minimum distribution requirements.
- Allows "return of premium" death benefit: A QLAC in a plan or IRA can provide that, if purchasing retirees die before (or after) the age when the annuity begins, the premiums they paid but have not yet received as annuity payments will be returned to their accounts, so in turn their initial investment can go to their heirs.
- Provides flexibility in issuing QLACs: The proposed rules had noted that a contract is not a QLAC unless it states that it is intended to be one when issued. The final rules provide that such a statement can be included in an insurance certificate, rider or endorsement relating to a contract. ❖

Andersen (continued from p. 2)

for companies to conduct compensation surveys to determine if jobs are priced right and to confirm that the organization is where it wants to be, relative to competitors.

Have you done that lately for your retirement program? The retirement plan landscape is ever-changing. Are you where you want to be, compared with your competitors and your overall compensation/benefits philosophy?

In addition, review committee meeting minutes to determine if there were any particular plan provisions that warranted discussion.

If so, what were the issues and how were they resolved? How have things worked since the change? Did the change meet the need?

Many employers have been changing their health plans in response to the Affordable Care Act. Health plans are an important component of an employee benefit philosophy. A change in one component can affect other components. Are your various employee benefits components in sync?

Has your workforce changed? Do you know what benefits they value most? Are they familiar with the provisions of your savings and retirement plans? If you haven't surveyed your employee population, or if it's been a while since the last survey, perhaps now is the time to get answers.

Take this "summer lull" to get back to basics and see if you are still on course. Think about developing communication strategies that emphasize the value of your retirement programs. If you haven't done so already, adopt a retirement income culture to help your employees prepare for financial adequacy in retirement. ❖

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