Designing DC Plans to Support Participants through Retirement

DC plans can effectively provide participants with income during retirement through plan design, participant engagement, and education.
Key Takeaways:

- With baby boomers retiring in record numbers, many plan sponsors are working to determine if their defined contribution (DC) plans are adequately structured to provide retired employees with an income stream.
- Plan design features, education, and advisory services that focus on the needs of retirees can improve the ability of DC plans to provide income throughout retirement.
- These plan design features may include a broad range of withdrawal options, investment options focused on generating retirement income, and the ability for participants to consolidate retirement assets.
- Support for retirees may include retirement planning tools, educational services, and advisory services designed to help participants develop a comprehensive and personalized retirement income plan.

Historically, plan sponsors have focused on preparing participants for retirement by maximizing participation and savings, and improving asset allocation in their DC plans. Recently, many have started designing their DC plans with a goal to provide a specific level of income replacement at retirement. For participants in the accumulation phase, several plan design features have demonstrably improved retirement readiness, including auto-enrollment, auto-escalation, and the use of target-date funds or asset allocation funds as qualified default investment alternatives (QDIAs). Furthermore, plan sponsors and service providers have worked together to provide educational services aimed at helping workers save, invest, and plan for retirement, and to improve overall financial wellness.

Similarly, plan sponsors can also design their plan to effectively meet the needs of participants who are drawing down their accumulated savings during retirement. These plan design features may include a broad range of withdrawal options, investment options specifically designed for participants receiving income from the plan, and provisions that allow for the consolidation of eligible assets within the DC plan.

With the baby boomer generation aging, a large proportion of the population is now approaching or living in retirement. In addition, the decreasing number of people covered by defined benefit plans (as shown in Figure 1) means that more retirees may require their DC savings to be the primary source of income in retirement (i.e., the money they use to pay expenses throughout retirement).

Figure 1: Private-sector workers participating in employer-based retirement plans, by plan type

![Figure 1: Private-sector workers participating in employer-based retirement plans, by plan type](image)

In a recent Fidelity survey, 56 percent of plan sponsors indicated they would prefer for retirees to have the flexibility to keep some or all of their account balances in their DC plan throughout their retirement years, while only 9 percent preferred retirees take all their assets out (Figure 2). For plan sponsors who prefer retirees have the option to draw retirement income from the DC plan, effective plan design paired with education can help participants create an income strategy that can meet their needs.

In addition, a majority of plan sponsors agreed that offering retired participants access to systematic and unscheduled withdrawal options is important (Figure 3).

Fidelity Investments, Plan Design Survey, May 2017. The study was fielded using a Fidelity online plan sponsor panel.
While most pre-retirees have a vision of what they want their retirement to be, many don’t have a plan in place to make it a reality. To help build a plan and meet the varying needs of participants as they live in retirement, plan sponsors may consider offering automatic ongoing withdrawals, also known as systematic withdrawal payments (SWPs). These options include:

<table>
<thead>
<tr>
<th>SWP Type</th>
<th>Explanation</th>
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<tbody>
<tr>
<td>Fixed amount withdrawal</td>
<td>A specific dollar amount determined by the retiree is distributed on an agreed-upon schedule.</td>
</tr>
<tr>
<td>Withdrawal based on life expectancy</td>
<td>An increasing percentage based on age, using IRS life expectancy tables, is used to calculate distribution amounts.</td>
</tr>
<tr>
<td>Fixed percent withdrawal</td>
<td>A specific percentage of the retiree’s account balance is distributed on an agreed-upon schedule.</td>
</tr>
<tr>
<td>Fixed time period withdrawal</td>
<td>The account balance is distributed over a specified time period. Distribution amounts increase over time to achieve a full distribution by the end of the stated period.</td>
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By offering a broad range of withdrawal options, plan sponsors can give participants more flexibility to create a retirement income strategy that is based on their individual needs. Participants may also value the option to change or cancel systematic withdrawals during retirement, as their retirement income needs or expenses change.

Additionally, ad hoc partial withdrawals may allow retirees to meet unplanned needs by providing access to their retirement savings without requiring a full distribution of their account. Access to ad hoc partial withdrawals can be an attractive feature for many retirees, particularly in the early stages of retirement when income needs and expenses may be more variable.

Furthermore, plan sponsors that offer participants the ability to make either pretax or after-tax (including Roth) contributions to their plan may want to consider offering retirees the choice to receive withdrawals from either pretax or after-tax amounts based on their preference. This option may provide retired participants with tax-planning flexibility. For example, participants working part-time in retirement may wish to meet additional income needs by first taking withdrawals from their Roth contributions, to limit their taxable income.
A broad spectrum of investment options

Plan sponsors may also want to consider evaluating investment options designed to meet the needs of participants throughout retirement. While some participants may choose to manage their own investments in retirement, Fidelity analysis has shown that nearly half of DC plan participants prefer “do-it-for-me” investment options where their investments are managed by professionals. These options can include target-date funds, retirement income funds or managed accounts.¹

**Target-date funds (TDFs)** can be effective options for “do-it-for-me” investors, even in retirement. However, many TDFs have an equity “glide path” designed to bring savers “to” retirement rather than remaining invested “through” retirement.² Plan sponsors that want to support participants throughout retirement may consider offering a “through” TDF to account for the investment needs of retirees.

**Retirement income funds** are a type of target-date fund that assumes a specific rate of withdrawal within the fund’s investment management strategy. These funds may also include an automatic or optional systematic withdrawal to provide income to retired participants. Plan sponsors that want to provide retiring participants the option to draw down their retirement savings over time may find retirement income funds a helpful addition to their plan.

**Managed accounts** offer investment strategies for “do-it-for-me” participants. These strategies are proposed based on a participant’s personal circumstances, such as their risk tolerance and assets held outside of the retirement plan. To meet the complex planning needs of retired participants, plan sponsors may want to consider managed account services that help participants confidently transition to, and live in, retirement through a personalized investment approach.

Additionally, for some retiring participants, guaranteed income options³ may be suitable. For example, participants who have a gap between their essential retirement expenses and their predictable sources of retirement income, such as Social Security and pensions, may be able to fill this gap by purchasing an annuity with a portion of their retirement savings. For these participants, access to out-of-plan guaranteed income solutions through an insurance marketplace may provide flexibility in the amount, type, and timing of income payments to meet their unique retirement income needs.

Consolidation to simplify retirement income planning

When a plan has attractive and flexible investment and distribution options for retirees, participants may want to simplify retirement income planning by consolidating eligible accounts. Allowing incoming rollovers from other DC plan accounts or IRAs may be a helpful plan feature to enable a consolidated view of their savings, which can make planning and investing easier throughout retirement.
Participant education and advice to help navigate a successful retirement path

A comprehensive education and advice strategy that meets the needs of participants approaching or living in retirement would include resources, tools and education to help them develop a retirement income plan. To be most effective, the education would not only address DC plan assets but also assets and sources of income outside of the DC plan, as well as those of a spouse or planning partner.

Because participants approaching retirement face a number of significant decisions, plan sponsors may consider offering the following services:

- Social Security claiming tools
- Health care planning assistance, including education on insurance options, long-term care options, and Medicare eligibility
- Retirement budgeting tools, to help account for essential and discretionary expenses relative to sources of income
- Full advisory service that includes broader financial and retirement planning help, plus discretionary investment management

After assessing Social Security, health care costs, and a retirement budget, a participant can then develop an informed retirement income plan. Offering tools and education can help participants bring together various income streams, then decide on a plan that utilizes an appropriate withdrawal option available from their plan. After their retirement income plan has been put in place, participants may also benefit from programs encouraging them to revisit and adjust the plan periodically, or as their needs change.

However, some participants may require more help beyond tools and education. Fidelity research shows that while investing is complex and employees want more help managing their money, they also need help with planning their financial future and staying on track. However, many don’t know where to begin or whom to turn to. In fact, 81% of people aren’t confident about their financial situation.

- 8 in 10 employees lack a comprehensive financial plan
- 61% say there is too much information to keep track of on their own
- 80% say they would like reminders at key milestones

Furthermore, every person’s financial situation is unique, and so their approach to financial planning and investment management should reflect that.

Plan sponsors may also consider a comprehensive advisory solution that offers broader financial help that includes discretionary investment management over their portfolio, and developing and implementing a holistic retirement and financial plan across their various goals and priorities. These services may include an advisory fee, access to ongoing help from a team of professionals, and proactive quarterly and annual checkups to help pre-retirees track their plan, goals and eventual income and withdrawal strategy.
Addressing the options to roll over, stay in plan or cash out

To help participants make an informed retirement income decision, plan sponsors can work with their provider to utilize an unbiased methodology for comparing options available to retiring participants. A personalized evaluation should include an assessment of withdrawal options, investment options, and planning resources that are available in plan relative to other options, matching them to the participant’s needs and preferences. Other factors that may also be relevant for retiring participants include treatment of company stock, protection from creditors, and the potential to delay RMDs. Comprehensive distribution assistance should include an assessment of these factors.

Conclusion: Moving into the next stage

The DC system has grown and changed tremendously over the past few decades, and in that time, plan sponsors have recognized that automatic solutions, appropriate investment options, and effective educational services can greatly increase the number of participants who are successfully saving for retirement. Now, plan sponsors have the opportunity to ensure their DC plans can also effectively help participants prepare for the next stage—living comfortably in retirement.

Plan sponsors that are committed to enabling their retired participants to utilize their DC plan for income throughout retirement can start with the following approaches:

1. Review the plan withdrawal options, to determine if they provide retirees with the flexibility they may need or want.
2. Evaluate the plan investment options with retirees in mind, with particular attention to the needs of “do-it-for-me” participants.
3. Consider allowing participants to consolidate eligible assets by rolling them into the plan.
4. Provide education and advice with a focus on helping participants develop and maintain an effective retirement income plan.
In Fidelity Investments® recordkept data of corporate DC plan participants, 49% had all of their DC plan assets in a lifecycle (e.g., target-date) fund or were enrolled in a managed account in the plan. Excludes nonqualified plans, tax-exempt plans and tax-exempt pooled plans, DB cash balance plans, plans with no participants, and FMR Co. (Fidelity) plans. As of March 31, 2017.

Generally, “to” glide paths reach their most conservative asset allocation mix at the target retirement date, often by reducing the equity allocation aggressively as the retirement date nears. Conversely, “through” strategies tend to have higher equity exposure during the savings years, at the target retirement date, and for several years into retirement.

Guarantees are subject to the claims-paying ability of the issuing insurance company.

Fidelity Investments Planning and Advice Online survey. The survey was fielded in November 2017 using an external consumer panel of 2,250 DC participants employed full-time. Research was completed by ConsumerMetrics Inc. (CMI), an independent third-party research firm.

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