



Outcomes  
That Matter

TIAA  
CREF

Lifetime income:

Prudent product selection and  
monitoring for strong outcomes



Financial Services

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# Agenda

- The view from Washington: Retirement security and lifetime income
- Lifetime income: How do we get there?
- Lifetime income options: Understanding annuitization and distribution
- Selecting and monitoring lifetime income products: Fiduciary concerns
- A plan sponsor perspective

The Obama administration believes lifetime income options facilitate retirement security

- Initiative to reduce barriers to annuitization of 401(k) plan assets
- DOL/IRS issue joint release with requests for information on Feb. 2, 2010
- RFI addresses education, disclosure, tax rules, selection of annuity providers, 404(c) and QDIAs

## The Retirement Security Project

- Released two white papers on DC plan annuitization
- Proposed use of annuities as default investment
- Utility of default annuities limited because of different needs to retirees and difficulty in reversal

### Two types of legislative proposals

- Encourage annuitization with tax breaks: *Lifetime Pension Annuity for You Act*, *Retirement Security for Life Act*
- Annual disclosure of what 401(k) plan balance would be worth as annuity: *Lifetime Income Disclosure Act*

Purpose is to investigate five focused topics

**Two areas of general policy-related interest:**

- Specific concerns raised by participants
- Alternative designs of lifetime income options

**Three areas of specific interest:**

- Fostering “education” to help participants make informed retirement income decisions
- Disclosure of account balances as monthly income streams
- Modifying fiduciary safe harbor for selection of issuer or product

## Proposed regulations and rulings on required minimum distributions

- PLR 200951039: No surprises as to age 70½ interpretations
- Proposed Reg. (Feb. 2012): Longevity annuity beginning at age 80 or 85 will not violate required minimum distribution rules. Annuity premium lesser of \$100,000 or 25% of account balance.
- Proposed Reg. (Feb. 2012): Split distribution options consisting of annuity and lump sum approved
- Rev. Rul. 2012-4: Participants can rollover 401(k) balance to same employer DB plan and convert to annuity from DB plan
- Rev. Rul. 2013-3: Deferred annuities in 401(k) plan will not trigger IRS death benefits for surviving spouse

- Anticipate future legislation or regulation
- Most likely: DC plans must disclose monthly or yearly lifetime income that account balance can provide through annuity purchase: Possible DOL regulation in 2013
- Also possible: DC plans must offer life annuities as benefit distribution option
- Be prepared to explain concept of longevity annuities



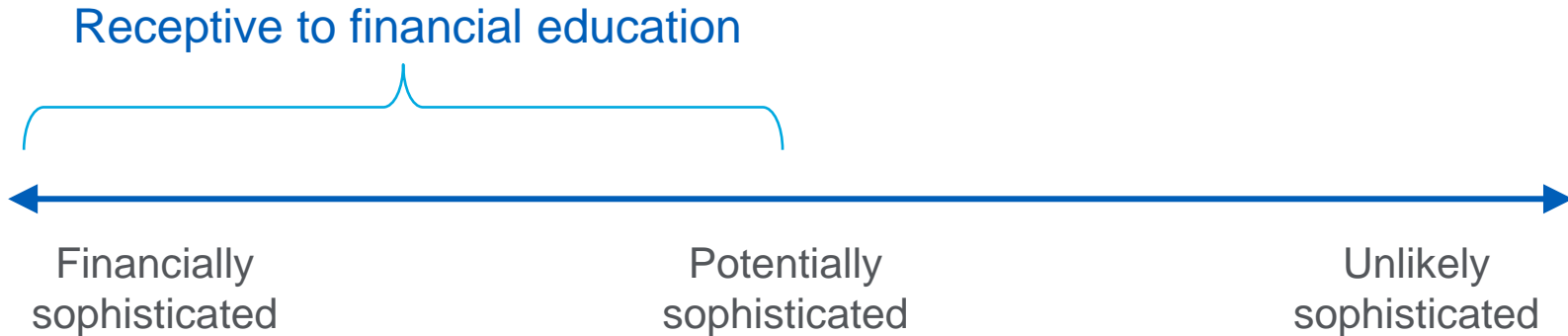
## Active area of research for over 50 years

- Should people annuitize retirement wealth?
  - People with no bequest motive should annuitize 100%
  - Under more general situations, people should annuitize a substantial proportion
- Are annuities priced to sell?
  - Annuity pricing is consistent with “money’s worth” valuations
  - Fees and expenses not large enough to explain lack of demand.
- Consistently low demand leads to the “Annuity Puzzle”

- Framing
  - “Consumption” versus an “investment” frame
  - “Retirement income” versus “wealth accumulation” system
- Loss aversion/Mental accounting
  - The “bird in the hand” fallacy
  - Writing a big check for a series of small checks
- Anchoring
  - Estate motives
  - Poor mortality and morbidity assumptions

## Can financial education and advice help?

- Financial literacy programs can help some, but unlikely all, households



- Even if helpful, issues of cognitive decline at older ages

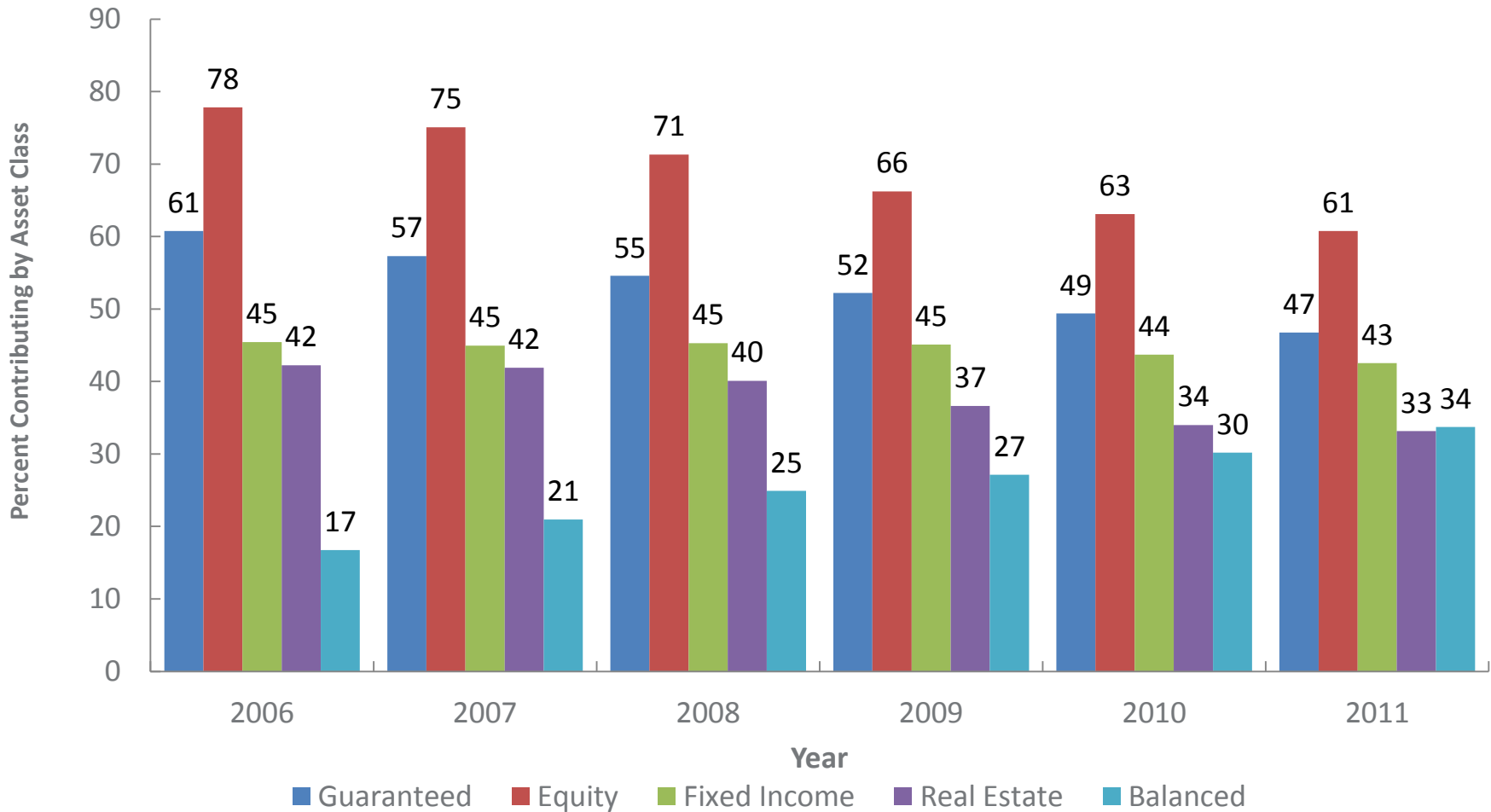
## What about plan design?

- Improvements in plan design have focused mainly on the accumulation phase
  - Auto-enroll provisions
  - Default contribution provisions
  - Auto-escalate contribution provisions
  - Default investment innovations (target-date funds)
- Research indicates strong “endorsement” effects
- Two questions
  - Can similar innovations improve retirement income distribution choices?
  - Are there current plan designs that seem to be working?

# What about plan design for retirement income?

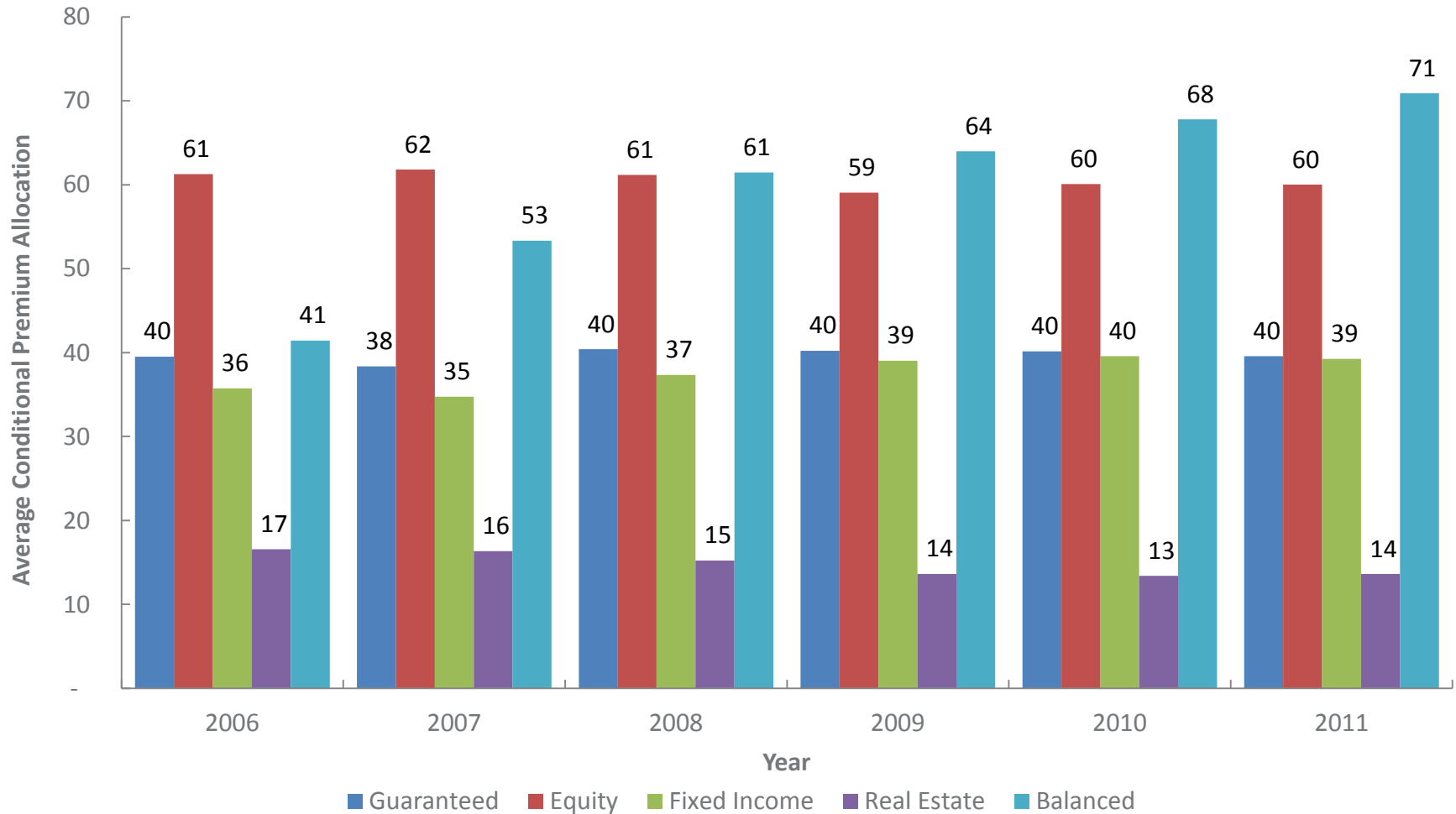
- Questions each retiree must ask
  - Do I annuitize?
  - How much do I annuitize?
  - When do I annuitize?
  - How do I annuitize?
- For most workers in 401(k) plans these questions are “at retirement” decisions
  - New annuitization rates around 5%
- For most participants in the TIAA-CREF system, the first two questions are “working life” decisions
  - New annuitization rates around 40%
- Evidence suggests that offering guaranteed income options during the accumulation phase increases annuitization in retirement

# Recent trends: The “Do I annuitize?” working life decision



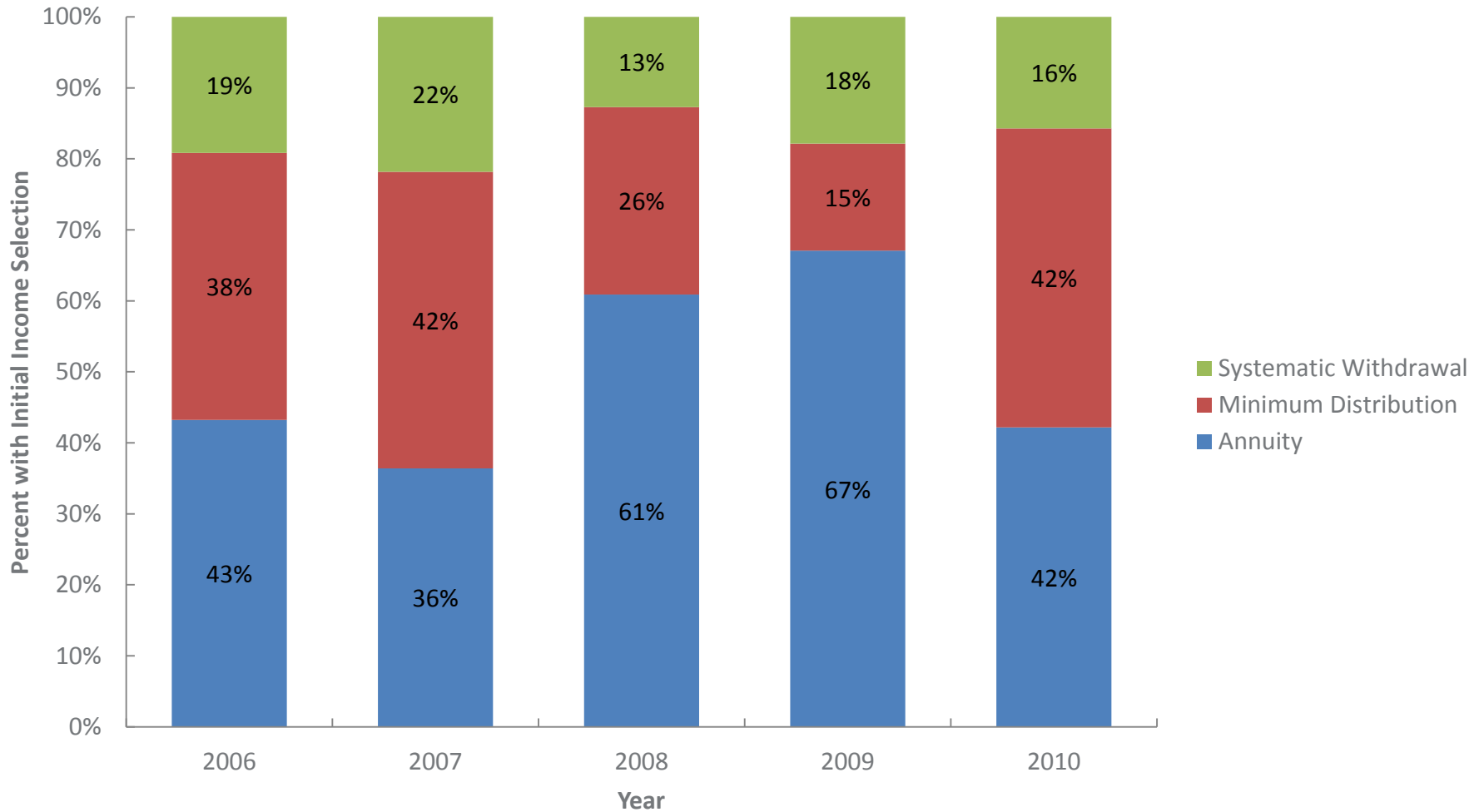
Source: Richardson, David (2013). “Trends in Premium and Asset Allocation Decisions by TIAA-CREF Participants: 2005 – 2011” TIAA-CREF Institute *Research Dialogue*, forthcoming.

# Recent trends: The “How much to annuitize?” working life decision



Source: Richardson, David (2013). “Trends in Premium and Asset Allocation Decisions by TIAA-CREF Participants: 2005 – 2011” TIAA-CREF Institute *Research Dialogue*, forthcoming.

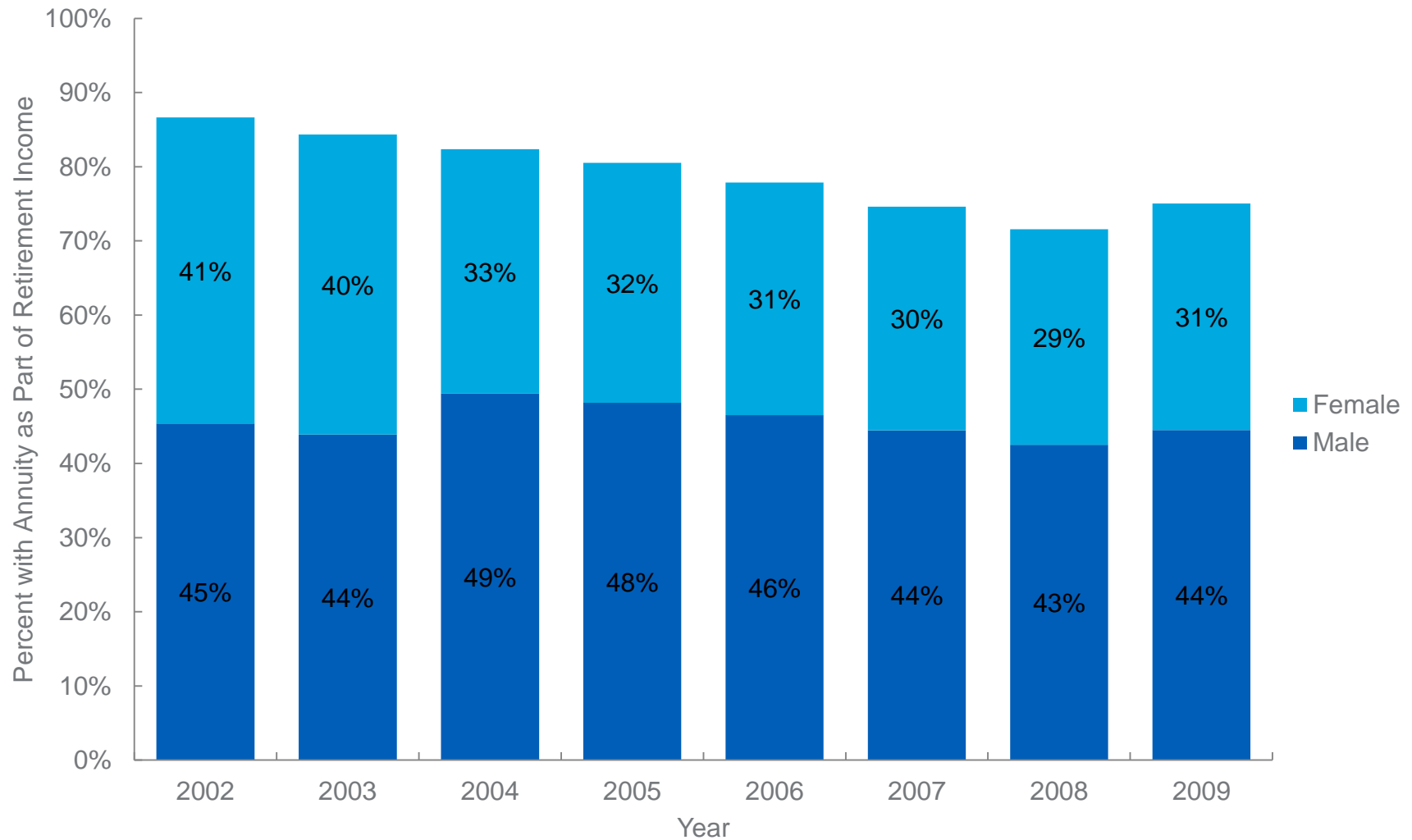
# Recent trends: The “When to annuitize?” retired life decision



Source: Brown, Jeffrey R., James M. Poterba, and David P. Richardson (2013), “Trends in the Retirement Income Decisions of TIAA-CREF Participants: 2002 - 2010.” TIAA-CREF Institute *Research Dialogue*, forthcoming



# Recent trends: The “When to annuitize?” retired life decision



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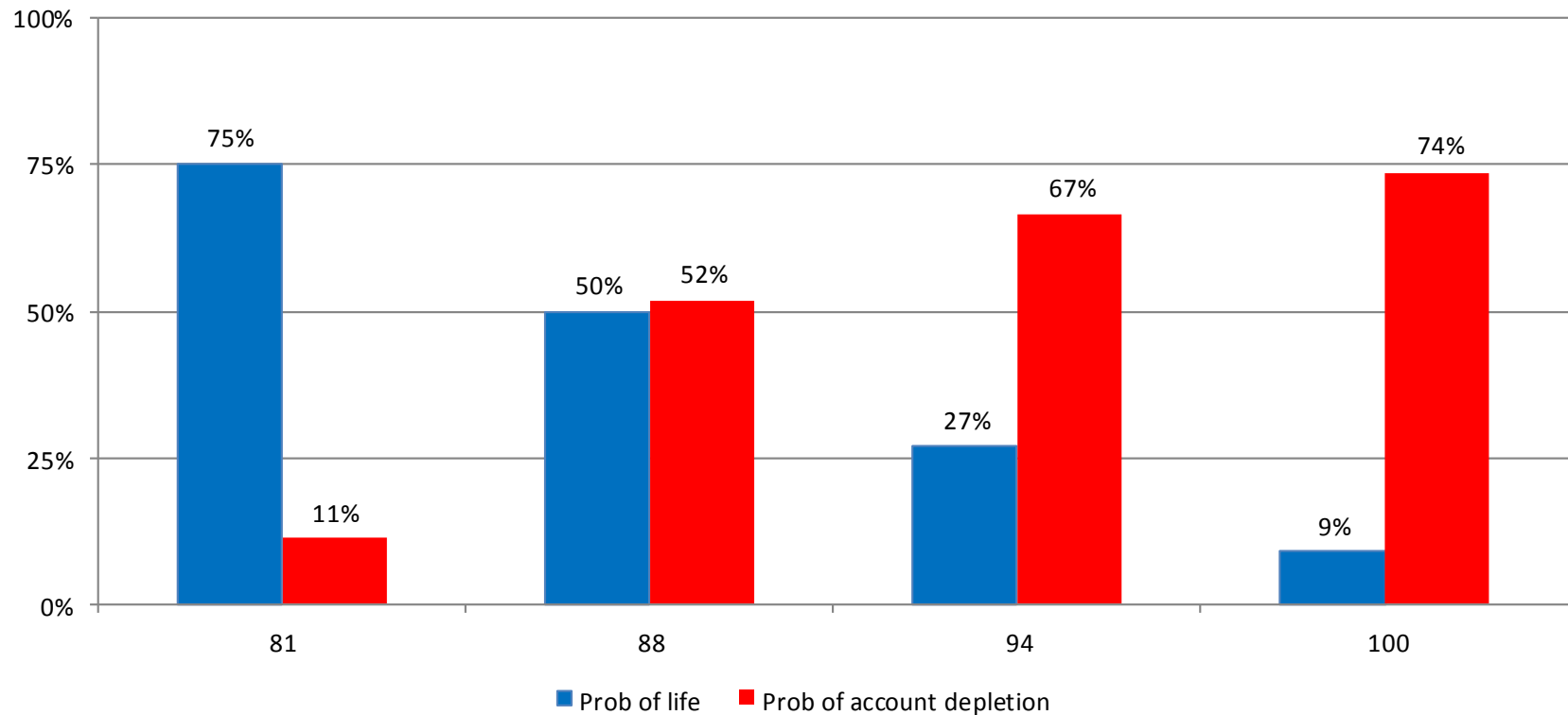
- Plan design matters a lot
- Defining the goal of the plan is critical
  - Wealth accumulation vs. retirement security
- Empirical evidence suggests
  - In-plan annuities help frame the plan objective of retirement security for participants
  - Annuities in the investment menu help participants make effective decisions over their working life on how to best structure retirement income
  - The mutual fund/immediate annuity strategy does not work well

# Lifetime income options: Understanding annuitization and distribution

Income option	Lifetime guarantee	Access to cash
Fixed and variable life annuities	Yes	No
Longevity insurance	Yes	No
Lifetime withdrawal guarantees (GLWB)	Yes*	Yes*
Fixed period annuities	No	Maybe
Systematic withdrawals	No	Yes
Managed/target income funds	No	Yes

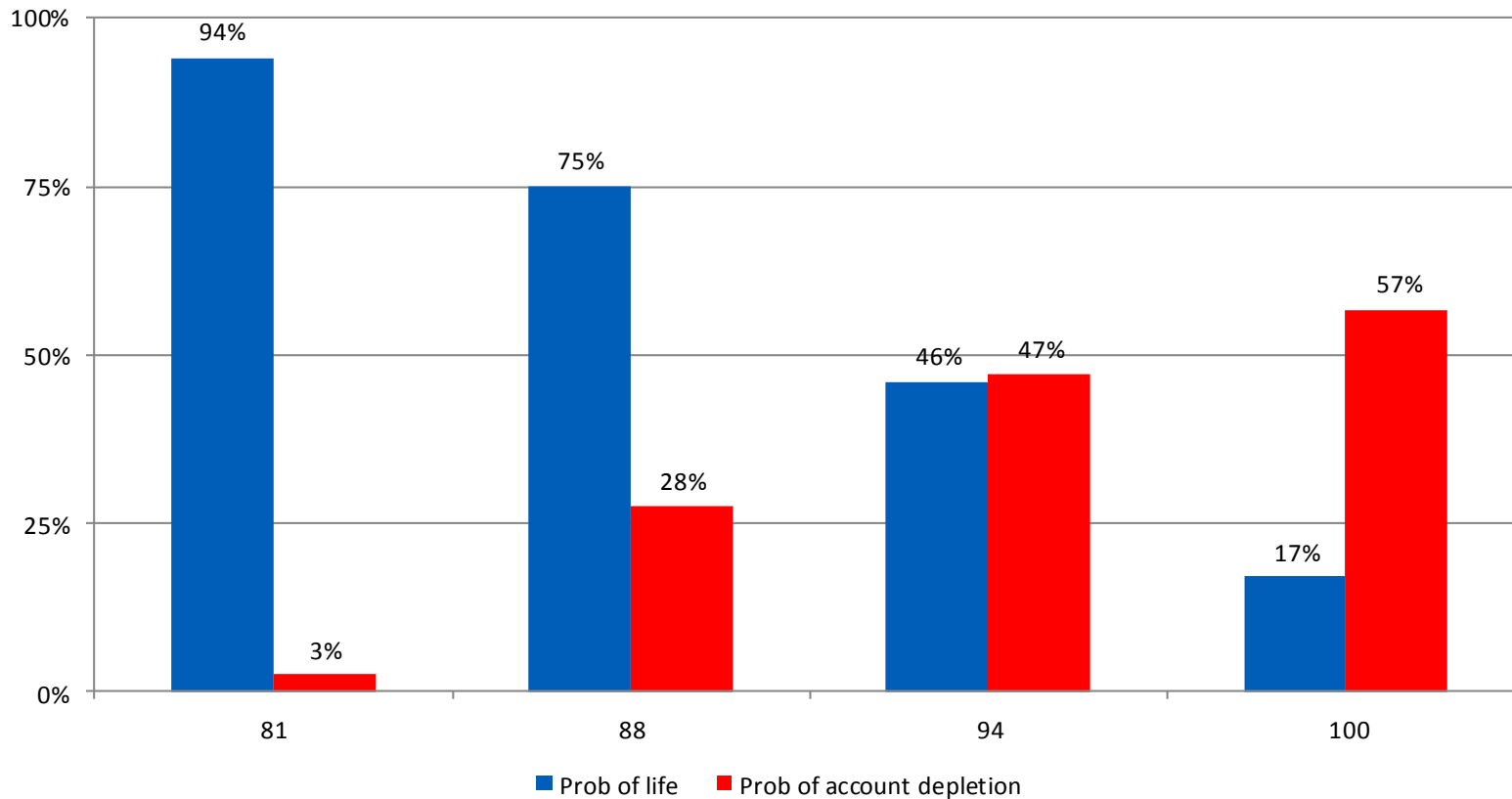
\* Typically a rider to an annuity contract; initial lifetime guaranteed withdrawal amount is lower than a life annuity benefit and any use of access to cash privileges will reduce future withdrawal guarantee further.

## Withdrawal payment set equal to fixed annuity – Single age 65



Annuity payment used for withdrawal is based on a Single Life with 10 years guaranteed priced at current TIAA mortality and 4.5% interest. Withdrawal account is invested with a 40%/60% equity/bond allocation, using 1,000 runs of an SOA rate generator.

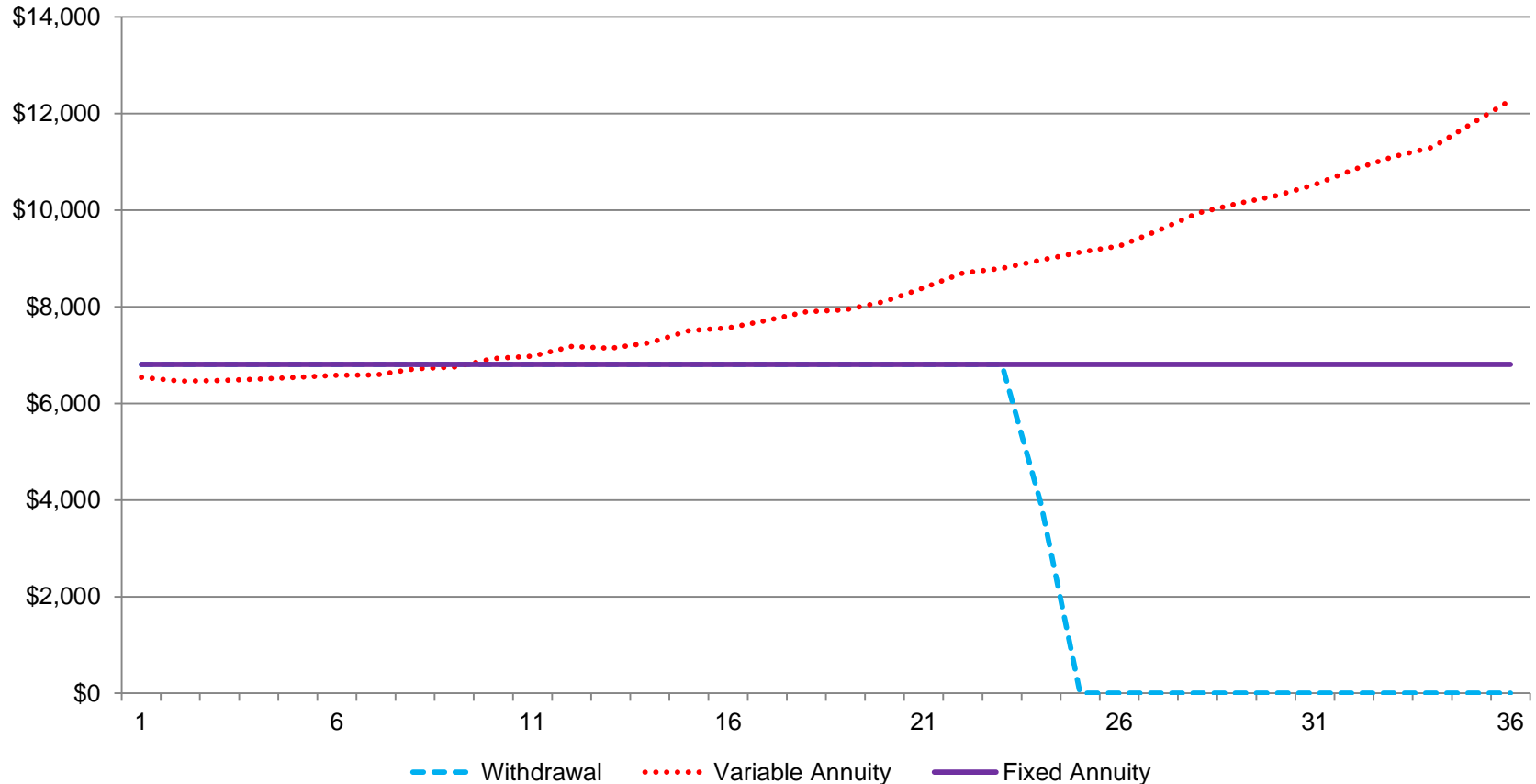
## Withdrawal payment set equal to fixed annuity – Joint ages 65



Annuity payment used for withdrawal is based on a Joint & 100% with 10 years guaranteed, priced at current TIAA mortality and 4.5% interest. Withdrawal account is invested with a 40%/60% equity/bond allocation, using 1,000 runs of an SOA rate generator.

# Comparison of Different Payment Options: Single

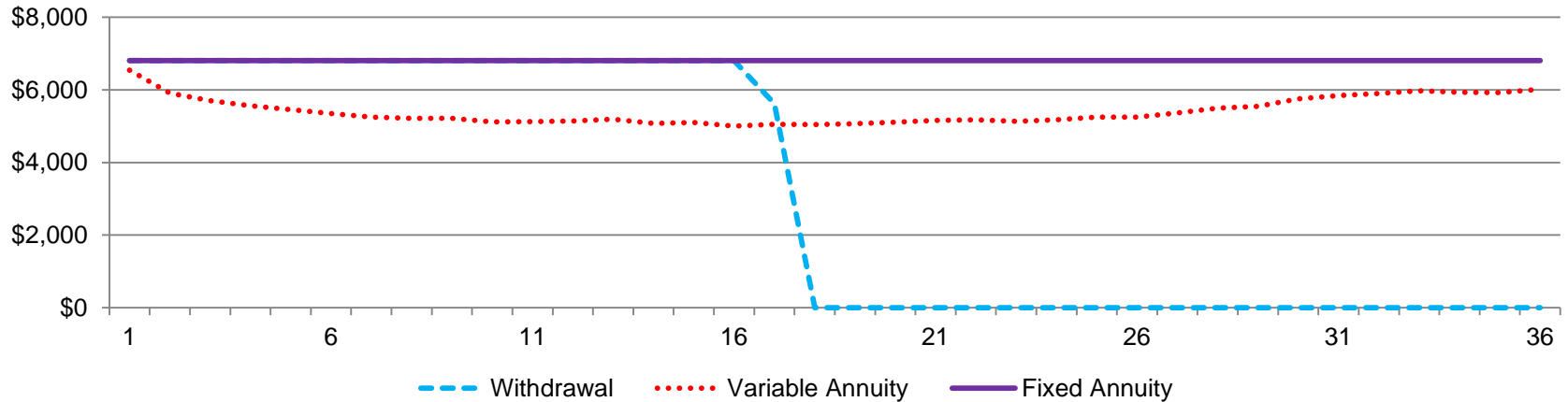
## 50th percentile



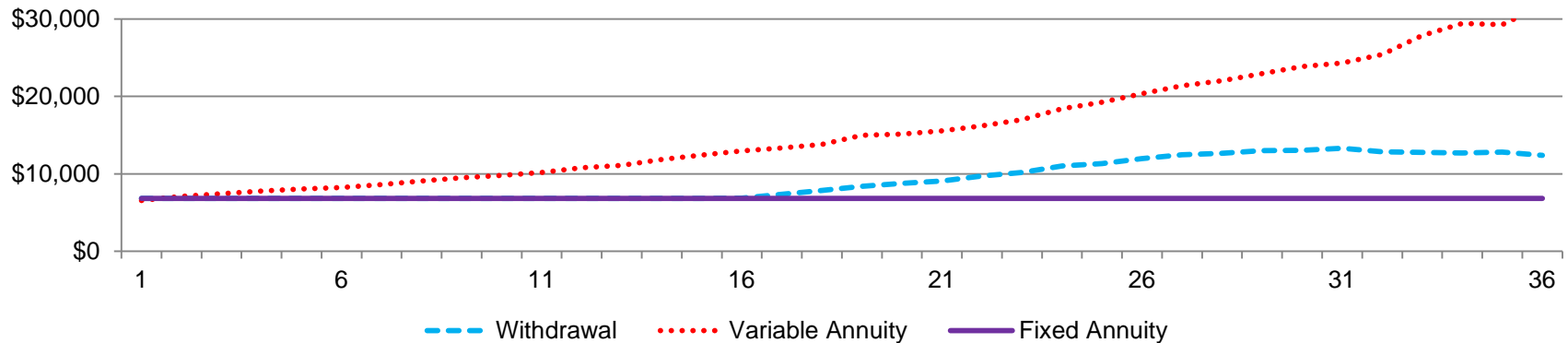
- SOA generator using a 40% equity/60% bond allocation (1000 runs) was used for Variable Annuity, Withdrawal and GLWB, Variable Annuity initial payment assumes a 4% AIR and current CREF mortality. TIAA fixed annuity based on 4.5% interest and current TIAA mortality. Annuity is at Age 65, Single life with 10 years guaranteed. Withdrawal set equal to TIAA fixed annuity and remains level unless RMD requires more. GLWB has a 5% initial payout and has an additional 100 bp fee. Retirement accumulation is \$100,000..

# Comparison of Different Payment Options: Single

## 10th percentile

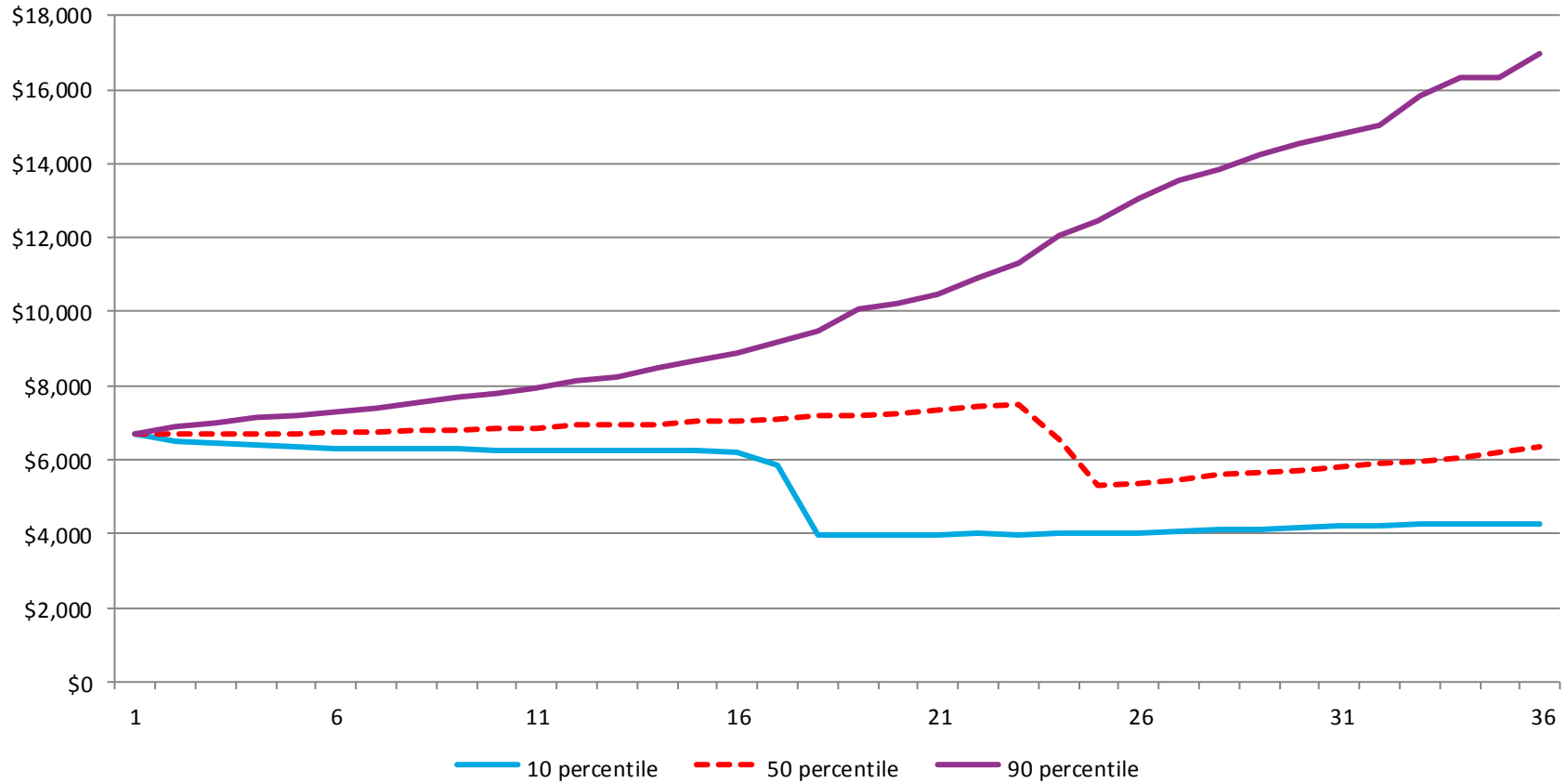


## 90th percentile



- SOA generator using a 40% equity/60% bond allocation (1000 runs) was used for Variable Annuity, Withdrawal and GLWB, Variable Annuity initial payment assumes a 4% AIR and current CREF mortality. TIAA fixed annuity based on 4.5% interest and current TIAA mortality. Annuity is at Age 65, Single life with 10 years guaranteed. Withdrawal set equal to TIAA fixed annuity and remains level unless RMD requires more. GLWB has a 5% initial payout and has an additional 100 bp fee. Retirement accumulation is \$100,000..

## Combination



One-third of \$100,000 retirement accumulation is used for each of a fixed annuity, a variable annuity and a withdrawal account. SOA generator for 40% equity, 60% bond used for Variable Annuity and Withdrawal, Variable Annuity assumes a 4% AIR and current CREF mortality. TIAA fixed annuity based on 4.5% interest and current TIAA mortality. Age 65 Single life with 10 years guaranteed. Annual withdrawal is set equal to fixed annuity payment unless RMD requires more.



## Selecting and monitoring lifetime income products: Fiduciary concerns



ERISA prudence requires engaging in a process of gathering and evaluating information about the annuity provider

Identifying the “safest possible annuity” is not among criteria for annuity selection

DOL has formulated a safe harbor for selecting annuities that entails five steps

- Objective, thorough and analytical search to select annuity provider
- Consideration of information to assess the insurer's ability to make all future payments under the annuity contract
- Consideration of the annuity's cost in relation to the services and benefits provided
- Determination that insurer is:
  - Financially able to make all future payments and
  - Cost is reasonable in relation to annuity's benefits
- If necessary, consultation with experts regarding the conclusion as to the insurer's ability to pay and annuity cost

## First step — Objective thorough & analytical search

- Requires process to gather information relating to the annuity and to evaluate its quality in relation to cost
  - Fiduciaries judged on process not results
  - Selection process should be documented

## Second step — Assessing insurer's payment ability.

- Factors to consider include:
  - Insurer's experience and expertise with the particular type of annuity
  - Capital, surplus and reserves of insurer
  - Insurer ratings
  - Structure and benefit guarantees of the annuity product
  - Protection through state guaranty associations

## Third step — Annuity cost

- Fiduciary must consider the annuity's cost (including fees and commissions) in relation to its benefits and administrative services
  - Longer mortality assumptions and lower interest rate factor applied to participant account result in lower annuity payments
  - Also consider liquidity and surrender charges
  - Fiduciary should not automatically pick cheapest annuity, but must evaluate additional features which could justify extra cost; financial strength of insurer may affect price

## Fourth step — Conclusions as to financial ability of insurer and annuity cost

- Informed and reasoned determination required
- If participant receiving annuity distribution, determination occurs at point of distribution and monitoring not required
- Ongoing obligation to monitor if insurer is selected to issue future annuities or begin annuity payments in future (e.g., where annuity is plan investment)

## Fifth step — Seeking expert advice

- Necessary only if fiduciary lacks education, experience or skills to obtain and evaluate information regarding annuity provider
  - Carefully review the expert's advice and recommendations (no rubber stamp)
  - Determine that expert advice is independent and impartial

# A plan sponsor perspective

## A call to action



Yale University

# Q&A

## Key action items

- Shift the focus from pure accumulation to include income planning and distribution
- Ensure your investment menu includes options that generate retirement income, including guaranteed income in addition to accumulation
- Understand this major trend and have a point of view on it and how it affects your plan
- Stay abreast of developments in Washington that can affect your plan and your participants



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