AllianceBernstein

DEFINED CONTRIBUTION RESEARCH

Leveling the Retirement Income Playing Field

A Comprehensive Framework for Evaluating Diverse Lifetime Income Solutions

June 2023

Christopher Nikolich
Head of Glide Path Strategies (US)
Multi-Asset Solutions

Howard Li
Senior Research Analyst
Multi-Asset Solutions

David Hutchins
Portfolio Manager
Multi-Asset Solutions

Executive Summary

Many defined contribution (DC) plan participants risk outliving their assets in retirement, despite the marked improvements in participation rates, savings rates and asset allocations since the passage of the Pension Protection Act (PPA) in 2006.

Because participants consistently want lifetime income security, DC plans have begun shifting their focus from growing wealth in the accumulation phase to ensuring income for life in their retirement years. The SECURE Act, passed in late 2019, and its successor, SECURE 2.0, passed in late 2022, have increased the momentum behind lifetime income solutions. However, wide-ranging features, such as fee structures, cash flows and investment exposures, make it challenging to assess and compare solutions.

To create a level playing field, we've developed a framework to help plan sponsors compare different methods for delivering sustainable income throughout retirement. It includes assessing the combination of income and remaining account balances throughout participants' lifetimes; quantifying the trade-offs between the total cost, value and risks of lifetime income solutions; and illustrating the best approach based on participants' diverse needs.

We've designed the framework to adhere to these core principles:

- Assess the **individual, not average, participant**, because potential market outcomes and life-spans for DC participants aren't smoothed over multiple people as they are in defined benefit (DB) plans, which could produce vastly different individual investment outcomes.
- Measure the **total costs** of lifetime income solutions, not just **explicit fees**, balancing these costs against the benefits each solution provides in order to accurately assess the impact on individual participants.
- Apply a **comprehensive** analysis encompassing income, account balances and major risks participants face—market risk, growth risk, inflation risk, and longevity and mortality risk. This approach enables a holistic comparison of solutions.

Applying our framework to several of the more common solutions for generating lifetime income in DC plans results in several key takeaways:

- Over one-third of participants may run out of money in retirement if they don't have explicit lifetime income insurance.[1] That's because many individuals overestimate the withdrawal rates they can sustain, risk failure by applying "rule of thumb" withdrawal rules, and are unlikely to build enough wealth to "self-insure."[2]
- Incorporating insurance into a participant's asset allocation may improve sustainable withdrawal rates by 70% or more,[3] based on our estimate of the median improvement in income rates versus self-insured sustainable-withdrawal rates. The most effective way to deliver insurance is as part of a qualified default investment alternative (QDIA), and doing so can improve workforce management for firms.
- The type of income insurance a plan chooses will impact participants' outcomes. Lifetime income insurance such as guaranteed lifetime withdrawal benefits (GLWBs) can generate more total value with less risk for most participants, and plans can use actively managed investment strategies as a way to offset fees. Participants also keep access to their assets.
- Using certain forms of insurance can result in significant "side effects" for participants, such as growth opportunity cost and mortality risk. It's critical that plan sponsors understand and avoid these unintended consequences.
- Longevity risk can be significantly reduced without an incremental cost, on average, versus a traditional target-date fund, because the presence of insurance enables higher exposure to growth assets within the fund's asset mix.

1 Based on a Monte Carlo simulation of 10,000 trials from ages 65 to 100 with AB's Capital Markets Engine as of 2Q:2022, using a weighted average withdrawal rate based on AB's 2023 *Inside the Minds of Plan Participants* survey results. As of May 31, 2023. Source: AB
2 As of 2022, to have a 99.5% or greater probability of not running out of money requires a withdrawal rate of only 2.3%.
3 Based on a Monte Carlo simulation of 10,000 trials from age 65 to 100, using the AB Capital Markets Engine 2Q:2022 forecast. The income rate improvement estimate is based on a 100% allocation to an income insurance contract and estimates will vary as market conditions change. Regardless of the changing market environment, incorporating income insurance may significantly improve the sustainable withdrawal rate. As of June 30, 2022. Source: AB

Guaranteed Lifetime Withdrawal Benefit (GLWB) is a type of annuity that sets a withdrawal amount that will last throughout a participant's retirement, even if the market falls or the account's assets run out. The insurers will continue the withdrawal payments, if needed. Guarantees are based on the financial strength and claims-paying ability of each insurance company.

DCI-376890-2023-04-26
DCI–8299–0523
AllianceBernstein.com