



New Outlook on Income

A framework for evaluating retirement income solutions in defined contribution plans

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KEY INSIGHTS

- The pursuit of retirement income solutions for defined contribution plans has been underway for the better part of the last decade, yet adoption remains low.
- We believe uptake of retirement income solutions often stalls because the retirement industry leads with product and deemphasizes fundamental needs and objectives.
- This paper offers insights and a conceptual evaluation framework to help plan sponsors assess retirement income solutions in a more strategic and informed way.



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“**B**y failing to prepare, you are preparing to fail.”
— Benjamin Franklin

Like anything else, preparation is key to progress. In fact, having a plan makes action achievable. Without a plan, Benjamin Franklin’s words ring true: Failure may be inevitable. This wisdom carries over to the long and winding road of bringing retirement income solutions to defined contribution (DC) plans and participants.

Here, too, we believe preparation is almost always required to make progress. This retirement income journey has been underway for the better part of a decade, yet adoption of retirement income solutions remains low.

However, this should not be a complete surprise. The shift in mindset required to evolve a DC plan from a savings vehicle to a more full-fledged retirement solution is not easy work. It typically requires plan decision-makers to adapt their thinking

and alter long-established processes. Adding difficulty, false assumptions about retirement objectives can get in the way of making real progress.

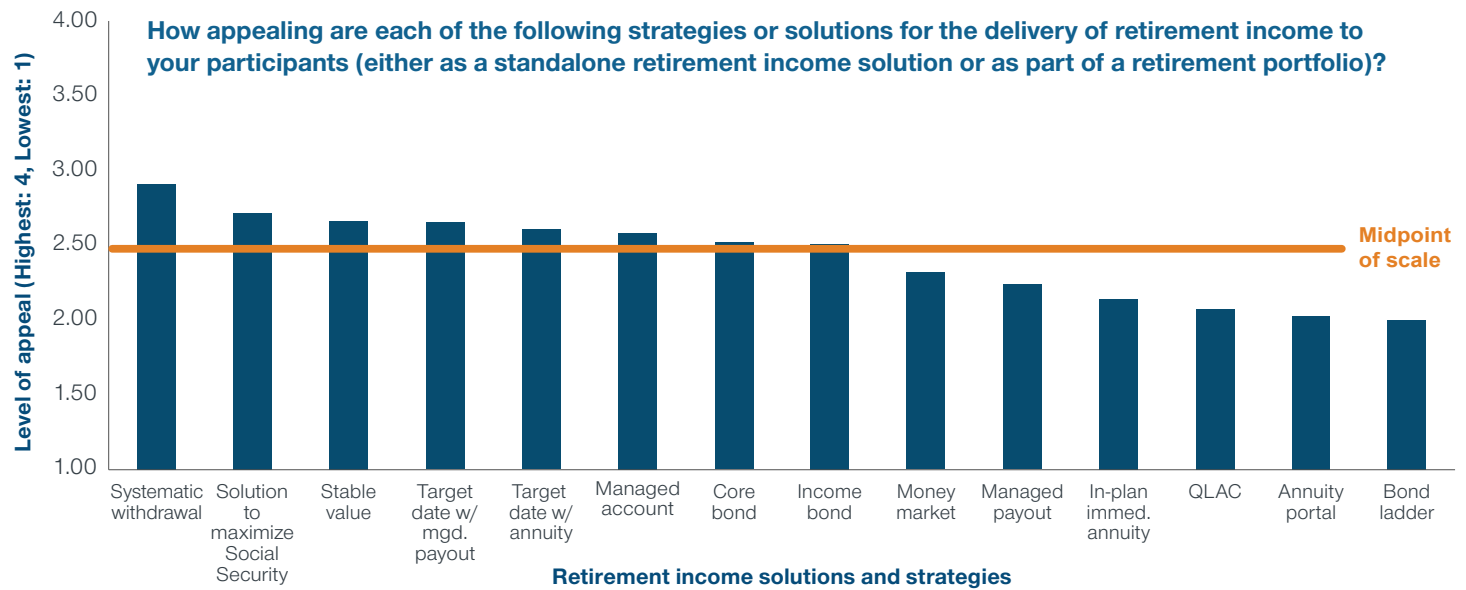
On the bright side, T. Rowe Price research with DC consultants confirms that retirement income is at the top of the list for discussion with their plan sponsor clients as we all recover from the “pandemic pause” of 2020. This suggests that retirement income conversations are again poised to take center stage.

In this paper, we pick up where we left off in our *It’s Time to Get Serious About Retirement Income Solutions* paper¹ and bring focus to inputs that can inform the retirement income pursuit and outline an evaluation framework to help sponsors navigate the complex retirement income landscape. This work is designed to help sponsors identify retirement income solutions that merit further exploration and rule out less suitable approaches.

¹See *It’s Time to Get Serious About Retirement Income Solutions* at troweprice.com/DCIO.

Fig. 1: Lackluster Appeal

T. Rowe Price Retirement Income Plan Sponsor Survey, 2020.



Source: T. Rowe Price Retirement Income Plan Sponsor Survey, 2020. Includes responses from 211 DC plan sponsors and conducted with Pensions & Investments Content Solutions Group and Signet Research. Not all survey respondents completed all survey questions.

Replacing False Assumptions With Insight

Through our research with plan sponsors, participants, and DC investment consultants, we have identified anchor points that complicate the process of bringing effective retirement income solutions to participants. We can clear the way for progress by resetting some of these false assumptions with deeper insight.

Insight #1: Product-Led Discussions About Retirement Income Often Come Up Short

In recent research with DC investment consultants, we measured relatively slow progress in bringing retirement income solutions to DC plans. On average, only 21% of consultants' plan sponsor clients currently offer retirement income solutions. Further research with plan sponsors echoes this finding. Across a range of potential retirement income offerings, plan sponsors reported those solutions as only modestly appealing, as illustrated in Figure 1.

However, before we jump to the conclusion that providers of retirement income solutions have simply failed to find the necessary "silver bullet" and that more product innovation is needed, let's first reconsider the common product-led approach.

The retirement industry can be quick to begin conversations with a product and work backward to determine what problem the product can solve. While innovation is necessary to develop effective retirement income solutions, we believe "product" should rarely be the first step in a retirement income conversation between solution provider and plan sponsor.

Ultimately, it may be an issue of "the tail wagging the dog." Product-led decision-making leads plan sponsors and fiduciaries to try to fit participant needs onto what a solution can provide. However, we believe a better process should first identify the intended objectives of plans and their participants and only then determine which solutions best address those needs.

“...94% of DC consultants agreed that a suite of income solutions is preferred to a single retirement income offering.”

Insight #2: The Retirement Income Puzzle Doesn't Need to Be Solved All at Once

Many industry insiders have rallied behind the idea that providing a suite of solutions—what is often referred to as a “retirement tier”—is the most sensible path forward. On its surface, this is an elegant approach that provides retiring participants with building blocks to assemble portfolios suited to their unique circumstances and bypassing the false presumption that a single offering will be appropriate for all.

In our research, 94% of DC consultants agreed that a suite of income solutions is preferred to a single retirement income offering. However, while many consider it sensible, DC consultants also report that only 13% of their plan sponsor clients currently provide or are planning to provide a retirement tier.² Ultimately, the graceful simplicity of the tier approach may often succumb to the complexity of having to decide what a retirement tier should include and how it should be delivered.

However, by understanding that a suite of solutions doesn't need to be constructed all at once, we can simplify the process and begin to make progress. In fact, an iterative and intentionally staggered process—focused on short-term, intermediate-term, and long-term goals—enhances the flexibility of a tier-based approach. In fact, plans frequently already offer some of the building blocks that would make up an effective retirement tier. Phasing in additional solutions to fill gaps can power the construction of the retirement tier, step by step.

One symptom of the product-led disconnect is that new solutions often fail to find traction. Over the years, many retirement income solutions have been launched with expectations of high demand and use, only to be paused or decommissioned entirely due to low uptake. While these product launches are well intended, innovation in DC

is hard work and requires multiple layers of consideration. By starting with clear insight on needs and objectives rather than what a specific product is prepared to deliver, we can steer the evaluation process to better outcomes.

Insight #3: Annuities Don't Need to Have the Starring Role

Viewed at a high level, it can appear as if the primary objective of financing life in retirement is simply to not run out of money during one's lifetime. If addressing duration risk is the primary objective of a retirement income solution, then income annuities and the guaranteed lifetime income they typically provide seem to be the best and most obvious answer: a perfect tool for the job.

However, we previously highlighted the lackluster appeal of retirement income solutions in the eyes of plan sponsors, and in that list, annuity-based solutions were well represented at the back of the pack. If annuity-based solutions fail to inspire, it's not due to lack of legislative support. In December 2019, the SECURE Act included several provisions that could encourage plan sponsors to adopt lifetime retirement income features. Yet, in November 2020—nearly a year after the passage of the SECURE Act—61% of plan sponsors reported that the act failed to motivate them to consider retirement income solutions. Granted, 2020 was an exceptional year during which many plan sponsors reoriented their strategic initiatives to address pandemic-related matters, but legislative and regulatory developments often open doors to innovation, so the resulting disinterest is puzzling. Or is it?

Guaranteed income solutions directly address the risk of outliving retirement savings, but addressing duration risk is only one of many objectives participants may want to achieve. In T. Rowe Price-sponsored focus groups made up of near-retirement participants, we encountered strong sentiments against annuitization. Ultimately, to the extent that income guarantees

²T. Rowe Price, 2020 Defined Contribution Consultant Study. Conducted in partnership with Schaus Group. Survey population includes 20 defined contribution consulting firms responding to a total of 41 questions from 1/7/2020–2/13/2020 and 4/8/2020–4/21/2020.

“Well over half of plan sponsors recognize the need to help their participants as they move into retirement.”

threaten to interfere with satisfying other needs—like continued growth of retirement assets, ability to adjust income level, or control of investment allocation—participants often choose to avoid income guarantees altogether.

Nonetheless, we should not let this dissuade us from working toward supporting income in retirement. At T. Rowe Price, we firmly believe that guaranteed income solutions can play an important part in financing life in retirement, but a collection of retirement income solutions should be flexible enough to address a wider and more varied set of income needs and objectives. Often, non-guaranteed income solutions can be effective by simply helping to translate retirement savings to a regular stream of income.

Pushing Forward With Key Inputs

We believe that better fundamental understanding of what plan sponsors and participants are trying to achieve are key next steps in the pursuit of providing retirement income solutions.

Input #1: Understand What Motivates (and What Doesn't)

In recent research with plan sponsors, we focused on determining what

factors motivate plan sponsors to explore retirement income solutions. Our results are reported in Figure 2.

The strongest motivator is an altruistic one. Well over half of plan sponsors recognize the need to help their participants as they move into retirement. Interestingly, results for the next most frequently cited motivator, participant demand, were complicated by a demographic chicken-or-egg dilemma. We think it is a stretch to expect younger populations to predict what they will demand decades in the future. Further, even “older” plans may not be able to get a clear signal of participant interest; even older participants may not express demand if they don't realize what kind of assistance is possible. Undecided plan sponsors waiting for demand to bubble up from participants before considering a course of action may be waiting a long time.

A second cluster of motivators includes external factors—evolving product capabilities, new legislation and regulations, and keeping pace with competitors—which demonstrate the impact of outside influences on motivation.

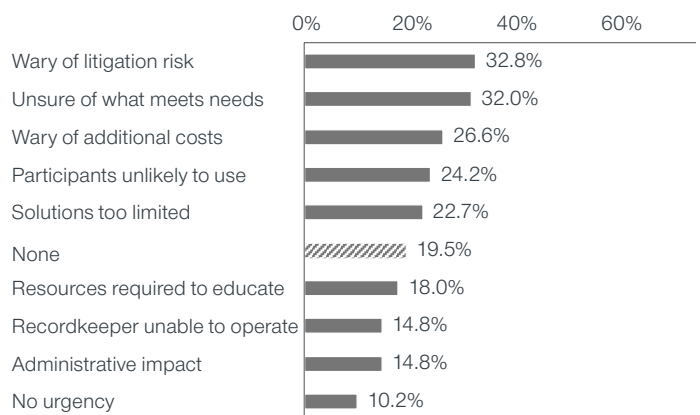
Lower on the list, three factors that may deserve more attention are cost management, business risk

Fig. 2: What Are We Solving for?

Which factors have **most influenced your interest** in exploring or offering retirement income solutions in your plan?

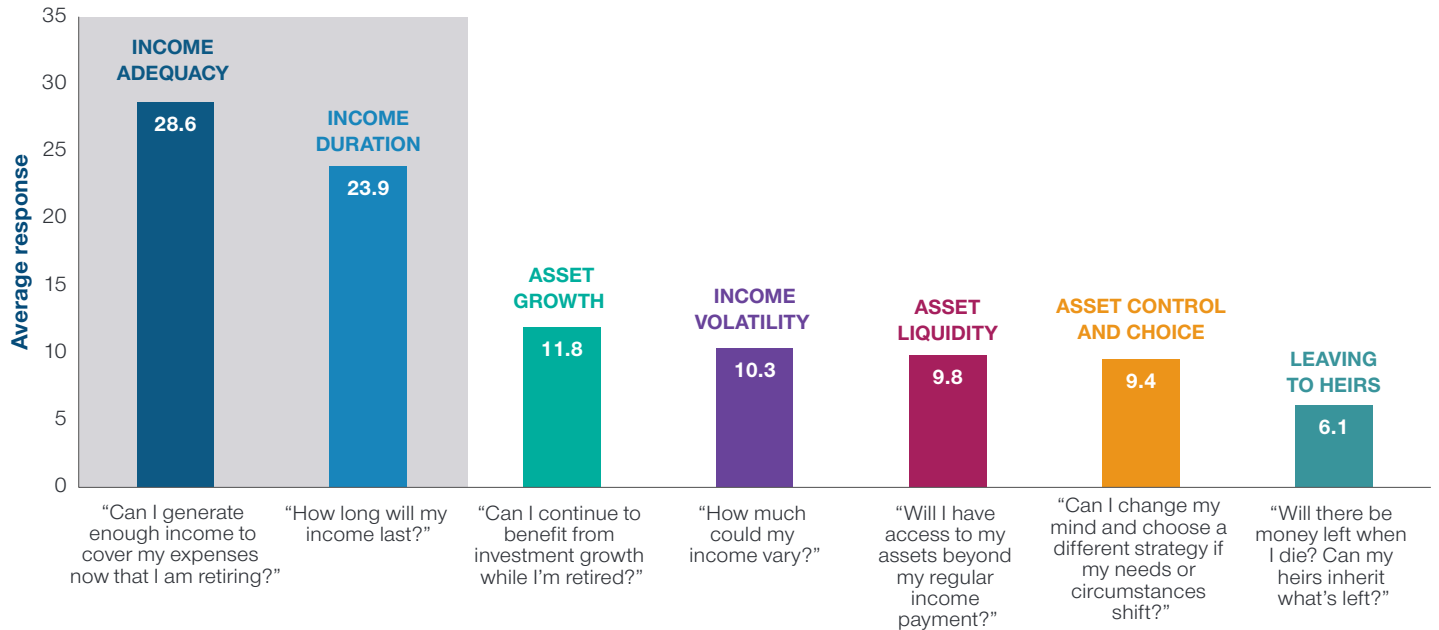


Which factors have **most discouraged** you from exploring or offering retirement income solutions in your plan?



Source: T. Rowe Price Retirement Income Plan Sponsor Survey, 2020.

Fig. 3: Plan Sponsor Estimate of Relative Importance



Source: T. Rowe Price Retirement Income Plan Sponsor Survey, 2020. Question: "Please assign 100 points in each column among the following seven options, representing your estimate of the relative importance of each income characteristic in your view as a plan sponsor."

from inaction, and preservation of advancement opportunity. We believe these factors will benefit from increasing focus as sponsors pivot toward workforce management, active retention of workforce talent, and the growing need to ensure individuals can retire on time.

Factors that most discourage plan sponsors include residual concern about litigation risk (even after passage of the SECURE Act), lack of clarity regarding participant needs, anticipation of low adoption, and a view that solutions may fall short of need.

Moving forward, we encourage plan fiduciaries to study this data and to establish their own priority list and better inform their consideration process.

Input #2: Recognize Different Retiree Needs

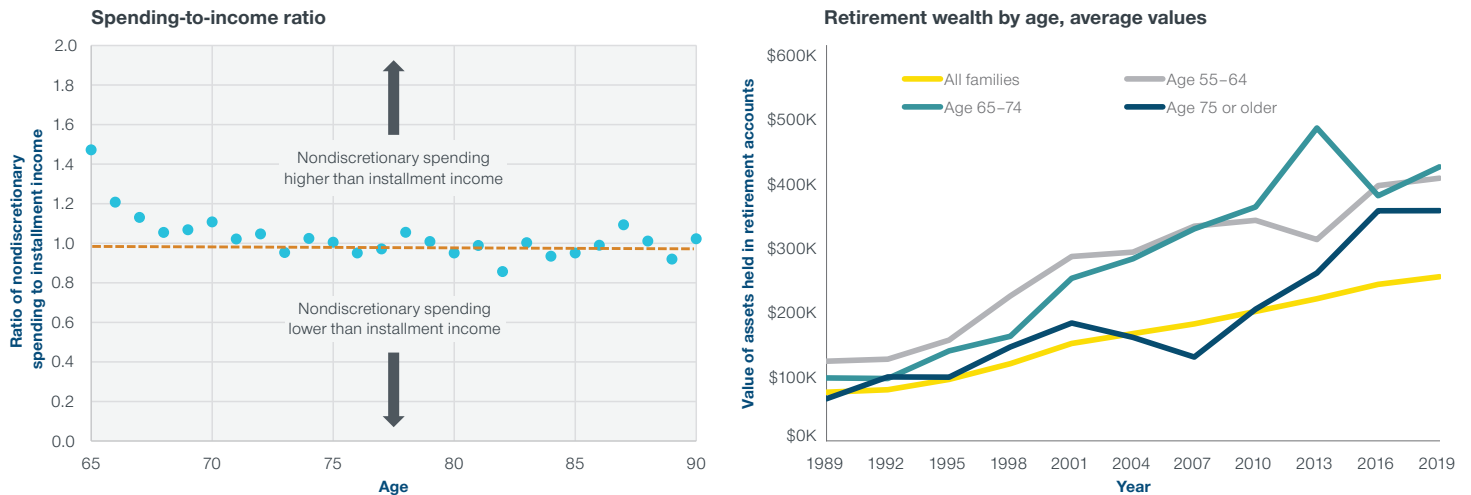
Participants will have varied retirement objectives and will require different strategies to solve for their individual needs—one of the main reasons that a suite of solutions, rather than a single income solution, is attractive to many plan sponsors and DC consultants. To get a more concrete

understanding of needs, we asked plan sponsors to rate the importance of different income characteristics.

Figure 3 reveals that the two highest-ranked income characteristics were *income adequacy* ("Will I have enough income?") and *income duration* ("Will it last long enough?"). It's important to note that *income adequacy* connects to multiple factors, including preserving a growth trajectory that can meet a participant's needs throughout retirement.

While the next five income characteristics scored lower in relative importance, they should not be dismissed. In fact, participants may demand these other income characteristics—asset growth, control of income volatility, asset liquidity, ability to pass assets to heirs, and continued control of assets—more than explicit income guarantees. Further, various retirement income solutions address some of these characteristics better than others. We encourage plan sponsors to consider their own hierarchy of income characteristics as an input to their retirement income evaluation process.

Fig. 4: Spending Often Driven by Income, Not Wealth



* T. Rowe Price estimates from Health and Retirement Study (2001–2015). Public use dataset. Produced and distributed by the University of Michigan with funding from the National Institute on Aging (grant number NIA U01AG009740). Ann Arbor, MI.
 ** Board of Governors of the Federal Reserve System. Survey of Consumer Finances. Values expressed in 2019 dollars. Retirement accounts include individual retirement accounts, Keogh accounts, and certain employer-sponsored accounts, such as 401(k), 403(b), and thrift savings accounts from current or past jobs; other current job plans from which loans or withdrawals can be made; and accounts from past jobs from which the family expects to receive the account balance in the future. On the Web at: <https://www.federalreserve.gov/econres/scf/dataviz/scf/chart/#series:RetirementAccounts;demographic:agecl;population:3,4,5,6;units:mean;range:1989,2019>.

Input #3: Understand Retirement Spending Patterns and Other Sources of Retirement Income

To better evaluate retirement income solutions, it is helpful to have a deeper understanding of spending in retirement. Taking the long view, it is also helpful to understand how retirement spending evolves as retirees age.

T. Rowe Price has explored this topic using a large national dataset from the University of Michigan’s Health and Retirement Study funded by the National Institute on Aging.

One of our top-level findings is often intuitively understood but frequently ignored when evaluating retirement income solutions—retirement spending declines as individuals age as illustrated in Figure 4. At face value, this is uncontroversial, but it also undermines the appeal of a static and unchanging level of income from the first day of retirement to the last.

Further, Social Security is a significant contributor of retirement income for many and will function as a partial lifetime income floor. The extent to which Social Security benefits will support retirement spending will vary by participant, but this

ultimately emphasizes the value of providing different building blocks to tailor retirement income to individual needs and objectives.

Given these findings, should an in-plan retirement income solution always aim to support a high, fixed level of spending based on a percentage of final salary? In many cases, probably not. We believe it is an important step for plan sponsors to become familiar with the baseline study of spending patterns in retirement to help inform the retirement income pursuit for their plan.

Next Steps: A Framework for Progress

We believe a critical next step for progress with retirement income solutions is an evaluation framework. A framework can help plan sponsors build a bridge for retiring participants that aligns with plan objectives. In our experience, time spent preparing to evaluate retirement income solutions is often insufficient. If fiduciary committees can clarify what they want to achieve and orient themselves with a clear set of objectives, significant progress can be achieved.

While that seems very basic, getting there can prove tricky. Ideally, there

By completing this process, plan sponsors should be better able to focus time and attention on specific retirement income services and solutions that are fit for purpose.

would be a simple grid of solutions, ranked and ordered according to their ability to address needs. In reality, there are multiple, interrelated considerations that can prove intimidating. The challenge of evaluating retirement income solutions is a multidimensional problem.

To help, we have constructed a framework for plan sponsors to consider that includes a few baseline assumptions. First, if you are reading this paper, we assume you want to solve for a range of retiree needs and expect a suite of solutions to be a better fit than a single retirement income solution. We also assume you are in the growing population of plan sponsors who prefer to keep participants in plan at retirement.

Providing a Framework to Bridge the Gap

Figure 5 provides a simplified example of elements we believe can be helpful in determining solutions that merit further exploration. When used as an initial screening, this process can help plan fiduciaries determine which solution categories will receive closer examination. Without doing this work, the range of available solutions can be overwhelming for the average fiduciary committee to tackle. Figure 6 is an illustration of an example framework to show what a narrowed list could look like after the narrowing process is complete. This list would provide the blueprint specific to a plan for further exploration.

Fig. 5: Starting With Foundational Alignment

Investment Solution-Level Evaluation

Functional Utility of Solution

- Does the solution address or resolve one or more retirement income needs or concerns identified as important to your committee?

Compatibility With Committee Views and Objectives

- Is the solution compatible with your committee's fiduciary views?
- Is the solution consistent with preferred levels of operational and administrative complexity?
- Does the solution align with your committee's comfort level and/or openness to innovation?

Practical Factors Unique to Your Plan's Circumstances

- Does the solution fit with your recordkeeper's capabilities, or are you willing to engage with them to explore adding?
- Can the solution be implemented within the desired timeline?
- Will a target participant population be able to understand and use the solution?

Fig. 6: Example of a Completed Framework

		Functional Utility of Solution	Compatibility With Committee Views and Objectives	Practical Factors Unique to Your Plan's Circumstances	Explore Further?
Insight and Guidance	Tools, calculators, and education/information	✔ Notes: Wish to explore better resources/tools	✔	✔	✔ <input type="checkbox"/>
	Financial planners/advisors	✔	✔	✔	✔ <input type="checkbox"/>
Single Asset Class	Current or new investment options as part of a suite of retirement income solutions	✔ Notes: Will leverage SV and income bond, add inflation	✔	✔ Notes: Determine what help RK can provide in comms and education	✔ <input type="checkbox"/>
Multi-Asset	Managed payout strategies	✔	✘ Notes: Committee prefers TD with payout, fewer inv.	✔	<input type="checkbox"/> ✘
	Target date with managed payout (non-guaranteed income)	✔	✔	✔	✔ <input type="checkbox"/>
	Target date with guaranteed income	✔	✘ Notes: Committee prefers to avoid guarantees in QDIA	✔	<input type="checkbox"/> ✘
	Managed account (with income planning)	✔	✔	✔	✔ <input type="checkbox"/>
	Custom solutions (e.g., yield target, risk target)	✔	✘ Notes: Potential complexity could be an issue	✔	<input type="checkbox"/> ✘
Annuities	Annuity, single provider	✔	✘ Notes: Committee prefers multiple insurers	✔	<input type="checkbox"/> ✘
	Annuity, platform	✔	✔	✔	✔ <input type="checkbox"/>

By completing this process, plan sponsors should be better able to focus time and attention on specific retirement income services and solutions that are fit for purpose.

These are only the first steps, and further evaluation of the solution sets you identify will require careful study. The continuation of this process will further narrow the list of potential solutions and get plan sponsors closer to selecting a suite of solutions.

We welcome further engagement and encourage you to reach out to your T. Rowe Price relationship manager to solicit support. Our team has developed foundational considerations to support the next phase of assessing each solution, one by one.

The following list provides a few areas to review:

- Evaluating your standard offer of tools, calculators, and measurements, as well as considering when to look beyond what your recordkeeper provides
- Assessing the impact of systematic withdrawals, partial distributions, and governing documents
- Bridging the gap to more strategic timing for Social Security benefits
- Addressing the need for advice (e.g., managed accounts, financial advisors)

- Reorienting or adding investment options suitable for a suite of retirement income offerings
- Considering income guarantees and how best to implement them (e.g., part of a multi-asset solution, stand-alone annuity, annuity platform)
- Investigating custom strategies (e.g., yield target, risk target)
- Considering which retirement income options may require more education for your participants

Take Participants on the Journey With You

Once you have identified a set of retirement income offerings that will be incorporated in your plan, it is imperative to build a strong communication, education, and engagement campaign. Figure 7 is a sample framework that outlines key considerations.

Establishing an engagement strategy aligned to the objectives set forth in this work will ensure participants are set up for success and can use the range of provided solutions to achieve better outcomes. This stage should be iterative and focused on actionable, timely, and relevant engagement strategies designed around the suite of solutions and target cohorts of your participant population.

Fig. 7: Careful Assessment of Participant Engagement

ALMOST ALWAYS:

Comparative value of DC plan

- Investment expense and institutional pricing
- Why fiduciary oversight matters
- The marginal value of infinite investment choice

Timely, relevant, and actionable outreach

- Begin early engagement with preretirees (5+ yrs. prior)
- Target the retirement solutions suite to preretirees

Broadly applicable retirement income topics

- Social Security planning and optimization
- Budgeting and long-term spending expectations
- Why spending down is not failure

PLAN-SPECIFIC:

Unique solutions only available within DC plan

- Stable value
- Custom strategies

Relevant topics for solutions selected for your plan

- Structuring basic income with liquid solutions
- Further customizing by adding other building blocks
- QLAC and targeted duration planning

We also encourage you to begin engagement early. Our research shows that many plan sponsors begin their communication when a participant reaches full retirement age. However, if we are to make progress and engage participants to use retirement income solutions and strategies appropriately, the engagement should begin in the preretirement phase and continue up to and through retirement.

Putting It All Together

We have built a foundation that resets preconceived notions that stand in the way of progress, provided insights that can help focus your understanding of retirement income needs, and outlined a framework to start your own evaluation process. As much help as this can provide, there is still more work to do, and we are eager to discuss these challenges at a deeper level.

For now, consider these five action steps as you progress in your retirement income pursuit.

- 1. Embrace a beyond-product mindset.** To better tackle the challenge of retirement income, don't start with product. Lead with identifying what you hope to solve first, and define your objectives.
- 2. Start with an evaluation framework.** Design a framework based on plan objectives, capabilities, aptitude for adoption and change, as well as participants' preferences and needs.
- 3. Consider a suite of offerings.** Don't overlook the range of available retirement income solutions. Likewise, don't underestimate what may already be on your platform. Some investment options may be repositioned as retirement income solutions, and some new investment options can be pursued.
- 4. Build a blueprint.** It doesn't have to be done all at once. Embrace a timeline and phase in solutions when you can.
- 5. Take participants on the journey with you.** Journey planning requires engagement and understanding. Build a philosophy and engagement platform that sets participants up to successfully use retirement solutions that you make available.



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