Why Retirement Income Matters to *You*

Retirement Income Consortium

If you're like most of us, financially you live month to month...mortgage or rent payments, credit card bills, car payments, insurance bills, groceries…on and on. When you retire, your paycheck stops but these expenses won't. Social Security will help but probably won't be enough. Your retirement plan or IRA savings (and any other savings or investments you have) needs to be a source of income to help cover those ongoing expenses.

But when you retire, you will face new risks in handling your savings. You need to understand those risks. You also need to understand steps you can take *now,* while you're still working and there's still time, to handle those risks.

To help you, we've provided 2 charts: the first explains the risks; the second lays out options that can help you deal with the risks.

RETIREE RISKS

The risks	What they mean
Longevity	**You're likely to live longer than you think.** Statistics show the average life expectancy after retiring at age 65 is about 20 years, a little longer for women and a little shorter for men. If you have a partner, one of you will likely live as much as 30 years. These are just averages…you may not live this long, or you could live longer. When you retire, you won't know which it will be. You need to plan on having income to cover expenses and other needs for more years than the numbers show.
Overspending / Underspending	**You'll have to be careful how you spend.** You can't take out too much of your savings, but you shouldn't take out too little either. • On the too much side, some people think they can take up to 10% of their retirement savings each year. When you look at the longevity numbers, you'll see this isn't a good idea. Most experts say to limit withdrawals to around 3-4% of your retirement savings a year, adjusted for inflation, but recent insights indicate this amount may be too much. • On the too little side, many folks are scared of running out of money, so they scrimp on their spending more than would be necessary if they had a sound plan for retirement income in place. The risk here is that they don't spend enough, and their lifestyle suffers. You need to understand what a safe withdrawal amount is or have your money invested in something that provides you with the appropriate level of retirement income. (These investments are discussed in the next chart.)
Sequence of returns	**This is a fancy term for fluctuations in investment market value.** In the context of retirement, it refers to the fact that investment losses may be permanent. While you're working and your money is invested in a retirement plan, it's possible to recover from a market downturn because you are putting in more money and it's invested over a fairly long period. The losses can be made up when the market cycles back up. But once you retire, it's hard to recover from investment losses, especially because you're taking out money to live on. Your pot of money – your retirement savings – is getting smaller for two reasons: investment losses and withdrawals. This means that how your money is invested is crucially important.
Inflation	**What about inflation?** Inflation refers to a general increase in prices and fall in the purchasing power of money. When there is inflation, it affects the amount you have to spend. Some of the investments discussed in the next chart can help with this, but this is one issue that isn't easily dealt with.
Cognitive impairment	**As we get older, our decision-making ability tends to decline**. It's not your fault; it's just that by your mid-80s, you're likely not to be able to make prudent decisions as well as you can in your mid-60s. You need to plan for this possibility.

RETIREMENT INCOME ALTERNATIVES

The following are four alternatives for dealing with your retirement savings in order to have income in retirement. The first, the non-income alternative, doesn't address any of the risks described in the prior chart. The next three categories are retirement income solutions designed to help address and/or minimize retiree risks. One or more of these alternatives may not be available in your plan. Additional solutions may come on the market in the future. In all of the following solutions other than the non-income alternative, your money is professionally managed for you.

NON-INCOME ALTERNATIVE [OR DO-IT-YOURSELF ALTERNATIVE]

How it works	What's good	What's not so good
When you retire, you may leave your money in your retirement account or take a lump sum distribution and roll it over to an IRA. In either case, you may take periodic withdrawals to pay your expenses, but you will need to make all decisions about the amount to withdraw, when to withdraw it and how the money is invested.	• You retain complete control over and access to the money in your account, so you can make withdrawals in any amount as desired or needed. • If the money is left in the plan, you will receive the benefit of your employer or its investment manager overseeing the investments in the plan, though not in your account. • If the money is rolled to an IRA, you have complete control over how the money is invested as well as withdrawals.	• You will not receive any help in dealing with the retiree risks described in the prior chart. • The plan may not permit periodic withdrawals and may require you to take a lump sum distribution, which means you are entirely on your own. • If the plan does permit periodic withdrawals, they may be subject to a fee for each withdrawal. • **Risks not addressed: All of the risks in the prior chart. You'll be on your own to deal with them.**

INSURED INCOME SOLUTIONS

Solution	How it works	What's good	What's not so good
Out of plan solution	You buy an annuity (issued by an insurance company) outside of your plan with some or all of your retirement savings in a lump sum payment. The cost and annuity payments are based on the market at the time of purchase.	• Typically provides fixed guaranteed income for a specified period or for life. • **Risks addressed: Longevity, withdrawal rate, investment risk, and cognitive impairment.**	• May be more expensive than other options. • Typically, no access to money invested in the annuity in case of need. • You have to find and make the decisions about what insurance company and retirement income solution is right for you. • **Risk not addressed: inflation.[1]**
In plan solution	You buy an annuity in installments as you contribute money to your plan, if the option is available in the plan. As market prices fluctuate, the price of the annuity changes, so your average cost over time may be less than the lump sum at retirement.	• Provides fixed guaranteed income for a specified period or for life. • Can be less expensive than the prior option because it is available in the plan (vs. the out of plan solution) and is paid for in installments while employed. • Plan fiduciaries perform the due diligence to make prudent decisions about insurance companies and income solutions to make available in the plan. • **Risks addressed: Longevity, withdrawal rate, investment risk, and cognitive impairment.[1]**	• May be more expensive than other options described below. • Typically, no access to money invested in the annuity in case of need. • **Risk not addressed: inflation.[1]**

INVESTMENT-BASED INCOME SOLUTIONS (NON-GUARANTEED)

Solution	How it works	What's good	What's not so good
Designated Payout vehicle	This is an investment vehicle – for example, a mutual fund -- that provides a systematic withdrawal program to provide regular income. You can invest over time or at retirement in a lump sum.	• Provides fixed payout so long as invested money lasts. • Likely less expensive than an annuity. • You'll have access to money invested in the product in case of need. • **Risks addressed: withdrawal rate and cognitive impairment.**	• Income is not guaranteed as it is in an annuity and is still subject to market risks. • Payments may vary as markets fluctuate (unlike in an annuity), and if larger withdrawals are taken from the account. • **Risks not addressed: longevity (unless markets do well), investment risk and inflation.**
Managed account	You engage an expert to manage your money. They make investment decisions and can set up a payout schedule based on discussion with you about your needs. Generally, your savings will be diversified over a number of investments. [2]	• Can provide fixed payout. • Typically less expensive than an annuity. • You'll have access to money in case of need. • **Risks addressed: withdrawal rate and cognitive impairment.**	• Income is not guaranteed as it is in an annuity and is still subject to market risks. • Payments may vary as markets fluctuate (unlike in an annuity) and if larger withdrawals are taken from the account. • Likely more expensive than designated payout vehicle. • **Risks not addressed: longevity (unless markets do well), investment risk and inflation.**[2]

INSURED HYBRID INCOME SOLUTIONS

Solution	How it works	What's good	What's not so good
Guaranteed lifetime withdrawal benefit contract	Similar to an annuity but you have access to the money in your account after you retire. If the money in your account runs out, the insurance company continues guaranteed payments at the same rate you were taking distributions previously. Can be purchased at retirement but is often purchased in installments while employed.	• Provides fixed guaranteed income for life, so long as you comply with terms of the contract regarding periodic withdrawals. • You'll have access to money in case of need. • Payout cannot go down due to market fluctuation. • Eliminates any negative impact to payout due to down markets because provider continues payments even if your account runs out. • **Risks addressed: longevity, withdrawal rate, investment risk, and cognitive impairment.**	• The guarantee of retirement income after the account is exhausted adds expense during accumulation. • Generally more expensive than investment-based options. • Requires you to abide by terms of the contract for withdrawals until the guaranteed payments start. • **Risks not addressed: withdrawal rate (if you do not comply with the contractual withdrawal restriction) and inflation.** [1]

[1] Some products offer the ability to obtain inflation protection for an additional cost.
[2] If your plan offers an annuity and the expert managing your account elects to invest some of your money in the annuity, you may have some of the benefits of the in plan solution discussed earlier.