

FEATURED INSIGHTS

Retirement needs heroes: Options for delivering retirement income

There's a significant need for retirement income, and delivering it may help improve people's lives.

There are multiple ways to provide retirement income. We've focused on two of them.

Everyone gets just one shot at retirement. Longevity insurance can help protect against bad outcomes.

Many people haven't heard of Frances Perkins, the first woman appointed to a presidential cabinet in U.S. history. Her name and contributions have faded in our collective memory with the passage of time. Without her, however, Social Security would most likely not exist in its current form, if at all.

The importance of Social Security:

~40% Percent of the average American's preretirement income replaced by Social Security¹

2/3 Fraction of retirees who say they would have "no idea" what to do without Social Security²

Frances was the architect of the Social Security program that passed in 1935. Her contributions have helped generations of Americans achieve retirement security. She was celebrated by contemporaries both as a visionary and pragmatist.

Yet, Social Security by itself often isn't enough to support a fulfilling retirement, and retirement income remains a challenge. To solve it, the world needs practical, forward thinkers like Frances. *Retirement needs heroes.*

Today's plan sponsors, consultants, and advisors working to make retirement income in defined contribution (DC) plans a reality will be admired by their peers. The plan participants whose lives are made better by their efforts, though, may never know their names. This doesn't make their work any less noble.

Calling all retirement heroes: This article is for you.

1. U.S. Social Security Administration; ssa.gov

2. 2019 Wells Fargo Retirement Study

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Opportunities and challenges

For over a decade, retirement income has been a major topic of conversation in the DC space. The need is significant. Roughly 98% of participants have told us they want guaranteed income.³ Nearly two-thirds of DC assets are held by individuals who are age 50 or older.⁴ In a significant shift, plan sponsors are now three times as likely to say they want employees to keep their assets in the plan after they retire, rather than transferring them out.⁵

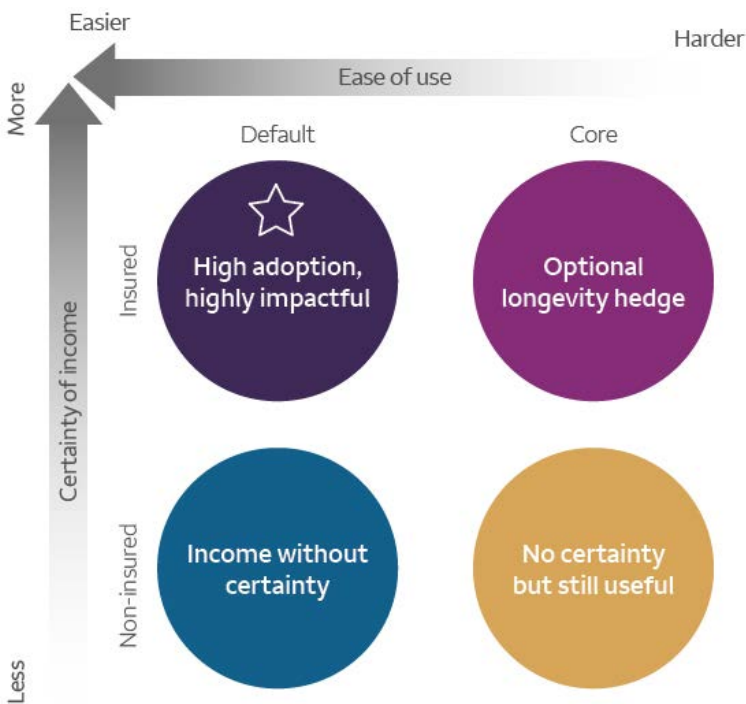
Yet, progress toward broadly available retirement income solutions has been slow. Plan sponsor and recordkeeper concerns about cost and complexity as well as fear of litigation have been significant hurdles.

Ways to deliver retirement income

We believe there are multiple ways to deliver retirement income. But for any retirement income solution to be successful, it must be simple, effective at addressing longevity risk, and adequately flexible for both plans and participants.

Figure 1 is useful in envisioning where and how retirement income can be delivered. The horizontal axis represents the ease with which a participant can use a retirement income solution, with the left side being relatively easier. The vertical axis represents the level of income certainty that can be delivered. The greatest certainty is at the top of the axis, and certainty decreases as you move downward.

Figure 1. Four ways to deliver retirement income



The bottom left (default, non-insured) essentially reflects today's target date funds. They tend to be effective tools for providing automatic diversification and de-risking. But while they're modeled to support income in retirement, they don't deliver an income guarantee. The bottom right represents multi-asset portfolios, designed to support income but without a guarantee. The top right represents optional income annuity platforms. Participants who understand how they work have benefited from these, but uptake tends to be low.

3. Wells Fargo/Gallup Investor and Retirement Optimism Index, fourth quarter 2017

4. Employee Benefits Research Institute

5. Callan 2020 DC Trends Survey

What is a QLAC?

A QLAC is a deferred fixed-income annuity that is exempt from required minimum distributions until age 85 and is limited by law to the lesser of 25% of an employee's qualified account balance or \$135,000 (although Congress is discussing proposals to remove this cap). QLACs can come with a variety of features, including early withdrawal options, return-of-premium guarantees, and cost-of-living adjustments.

Our approach to retirement income

Launched in 2020, our retirement income solution falls in the top left category in Figure 1. Simple for recordkeepers to implement, easy to understand, and designed to be low cost, it aims to deliver income certainty within the default investment option by combining a suite of Wells Fargo Target Date Collective Investment Trusts⁶ with an optional qualified longevity annuity contract (QLAC).⁷

Our conversations on this topic with plan sponsors, consultants, advisors, and recordkeepers have generated significant interest. Through these discussions, we've also learned that some plan sponsors have a strong desire to implement retirement income but aren't ready to make it part of their plan's default.

For these plans, we've been researching with our Multi-Asset Solutions team the concept of pairing a multi-asset portfolio with a QLAC as a core investment option available to participants on the plan menu. This arrangement would essentially combine the top right and the bottom right approaches in Figure 1.

Of course, there are tradeoffs:

Pros:

1. Optional longevity income insurance helps participants minimize the risk of running out of money.
2. It's a more holistic solution than either the top right bubble in Figure 1 (which doesn't consider the appropriate asset allocation for non-annuitized assets) or the bottom right bubble (which doesn't provide longevity insurance).

Cons:

1. We expect a retirement income solution in the core lineup to have lower uptake because it requires participants to opt in.
2. It's not as seamless as a default retirement income solution and may come with higher expense ratios for participants.

6. The Wells Fargo Target Retirement and Retirement Income Collective Investment Trusts (CITs) are Wells Fargo Bank, N.A., CITs that are subadvised by Wells Capital Management Inc., which is a Wells Fargo Asset Management entity.

7. QLACS are offered by non-affiliated third-party insurance carriers, and their guarantees are subject to the claims-paying ability of the insurance carrier.

We believe in not letting perfect stand in the way of good. Some plans, we think, will implement retirement income in the default. For others, the core option may make more sense.

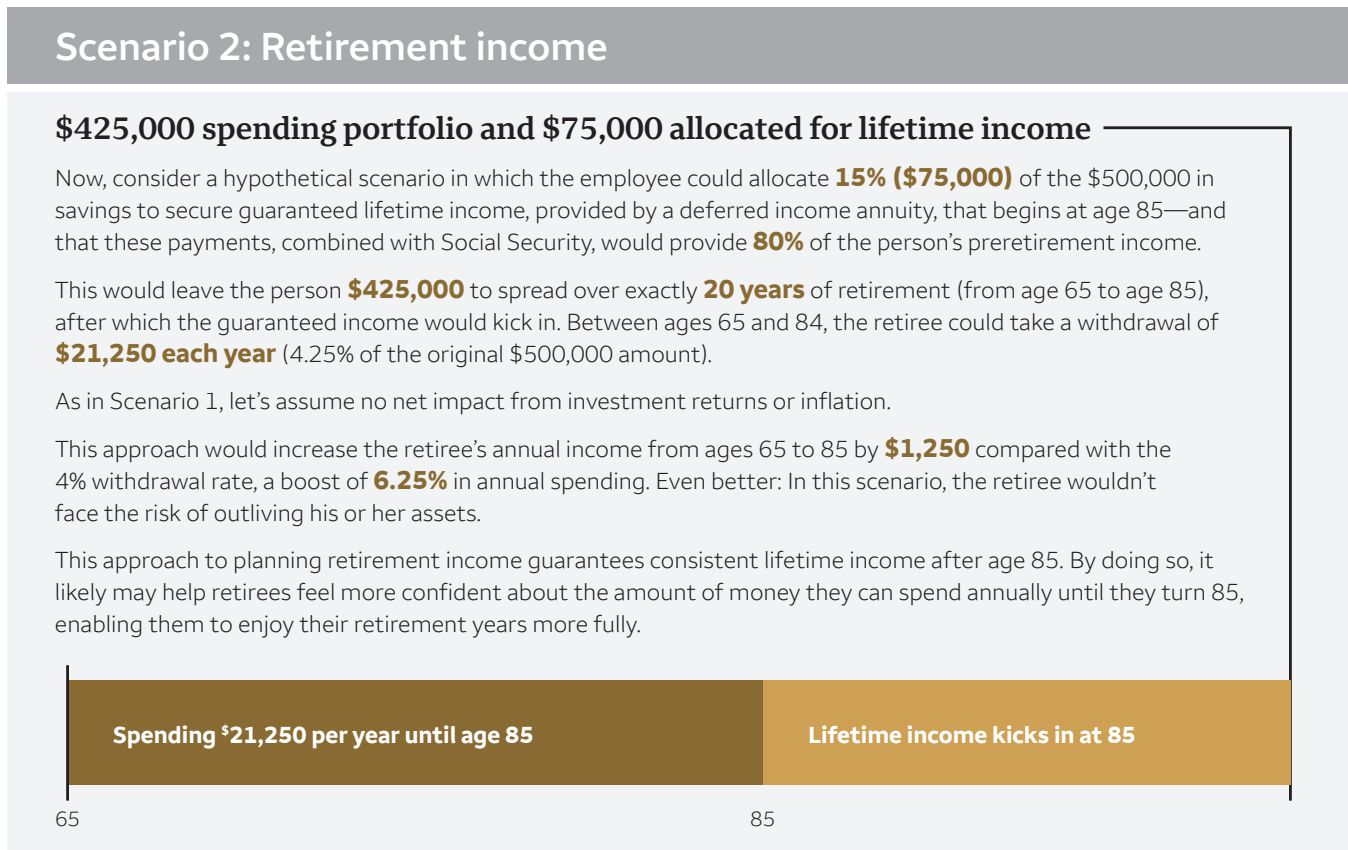
What's most important is that in both cases, there's potential value in combining a QLAC with a diversified portfolio. Specifically, we believe many participants stand to benefit from a modest (15%) allocation to a QLAC.

The benefit of using a QLAC is that it may reduce the chances of running out of money while at the same time potentially enable a higher rate of spending. Here's a very simple illustration of this concept using the "4% rule."

Figure 2. Here are two scenarios to illustrate how this approach would work.



This is hypothetical data and is for illustrative purposes only. Source: WFAM, December 2018



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Using stochastic drawdown analysis, we've considered a wide variety of potential scenarios for participants in retirement. In scenarios where asset returns are strong, there tends not to be a significant benefit to using a QLAC — in fact, doing so may somewhat reduce a retiree's bequest to beneficiaries.

In adverse scenarios, however, the benefit of reliable income coming from a deferred annuity can be critically important. We see income from a QLAC as providing a “mattress” on top of the hard “floor” of Social Security — income that lasts for as long as a participant lives.⁸

The fact is, every person gets just one shot at retirement — so it's important to try to avoid the possibility of experiencing a bad outcome. With this worry mitigated, retirees can feel more comfortable spending their savings more freely and truly enjoying the golden years they've saved for over their careers.

Concluding thoughts

We believe implementing retirement income within a DC plan is easier than some might expect, and it's a great opportunity to help improve participants' lives. We encourage you to also read our previous retirement income articles — [“Alive at 85,”](#) [“Finding a Middle Way,”](#) and [“What 20 Years Means”](#) — for more of our thoughts on this important topic. Those articles, like this one, focus primarily on our beliefs and philosophy.

For more detailed discussions about our retirement income research and solutions, please feel free to reach out to us directly. We're excited to engage in conversations with *retirement heroes* everywhere.

8. Subject to the claims-paying ability of the issuing insurance company

For more asset management insights

We are committed to working together with clients to help them and their employees achieve their goals—whether planning for retirement, finding investments that align with personal values, or building portfolios for the fluctuating markets of today and tomorrow. To discuss ways we can work together toward these objectives, please contact Nathaniel Miles, head of Retirement at Wells Fargo Asset Management, at nathaniel.s.miles@wellsfargo.com.

About the 2019 Wells Fargo Retirement Study

On behalf of Wells Fargo, The Harris Poll conducted 3,918 online interviews of 2,708 working Americans age 18–75 and 1,004 retired Americans, surveying attitudes and behaviors around planning, saving, and investing for retirement. The survey was conducted June 21–July 17, 2019. Working Americans are age 18–75 and working full time (or at least 20 hours if they are working part time) or are self-employed. Retired Americans self-identified as retired regardless of age. Both working and retired Americans are the primary or joint financial decision maker for their household. High-net-worth workers have at least \$1 million in household investable assets. Data were weighted as needed to represent the population of those meeting the qualification criteria. Figures for education, age, gender, race, ethnicity, region, household income, investable assets, marital status, employment, number of adults in the household, and propensity to be online were weighted where necessary to bring them in line with their actual proportions in the population.

This material is for general informational and educational purposes only and is NOT intended to provide investment advice or a recommendation of any kind—including a recommendation for any specific investment, strategy, or plan.

About the Wells Fargo/Gallup Investor and Retirement Optimism Index (fourth quarter 2017)

These findings are part of the Wells Fargo/Gallup Investor and Retirement Optimism Index, conducted November 1–5 by telephone. The index includes 1,015 investors, age 18 and older, randomly selected from across the U.S. with a margin of sampling error of +/- 4 percentage points. For this study, the American investor is defined as an adult in a household with total savings and investments of \$10,000 or more. About two in five U.S. households have at least \$10,000 in savings and investments. The sample size consists of 67% non-retirees and 33% retirees. Of total respondents, 41% reported annual incomes of less than \$90,000; 59% reported \$90,000 or more. The Wells Fargo/Gallup Investor and Retirement Index is an enhanced version of Gallup's Index of Investor Optimism, which provides the historical trend data. The median age of the non-retired investor is 47 and the retiree is 68.

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Only general features of hypothetical QLACs (annuities) are discussed herein. Annuities, including QLACs, are not offered by any Wells Fargo Asset Management (WFAM) entity. These products are offered by third-party companies, which are not affiliated with WFAM entities. Annuity guarantees are subject to the claims-paying ability of the issuing insurance companies. Investors should consult their tax advisor for advice and information concerning their particular situation. WFAM does not provide tax or legal advice.

Only general features of hypothetical target date strategies are discussed herein. In general, the target date of a target date strategy represents the year in which investors likely may begin withdrawing assets. Such strategies typically gradually seek to reduce market risk as the target date approaches and after it arrives by decreasing equity exposure and increasing fixed-income exposure. The principal value is not guaranteed at any time, including at the target date.

All investing involves risks, including the possible loss of principal. There can be no assurance that any investment strategy will be successful. Investments fluctuate with changes in market and economic conditions and in different environments due to numerous factors, some of which may be unpredictable. Each asset class has its own risk and return characteristics.

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