

# Russell's beliefs on retirement income disclosure

The first step towards improving defined contribution participant outcomes is deceptively simple

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Washington has taken a great deal of interest in how defined contribution (DC) participants can make the most of their nest eggs. It's not hard to see why. As a group, DC participants are woefully unprepared for retirement. According to the Employee Benefit Research Institute's Retirement Readiness Rating (RRR), 47.2 percent of Early Boomers and 43.7 percent of Late Boomers may not be able to pay for basic expenditures and uninsured health care costs in retirement<sup>1</sup>. Washington's response has been to gather information on lifetime income options in DC plans. In February, 2010, the Department of Labor (DOL) and the Department of The Treasury (Treasury) issued a joint request for information on lifetime income and received nearly 800 responses. The two departments followed up with a joint hearing in September, 2010.

Bob Collie, representing Russell, testified to the DOL and Treasury committee on the topic of retirement income disclosure, something he's written about before in *The Retirement Plan Solution: The Reinvention of Defined Contribution*. This brief paper will explain why the topic matters and how plan sponsors can provide retirement income disclosure to participants in a simple yet effective way.

## Why does retirement income disclosure matter?

While DC plans were born as supplementary savings vehicles for highly compensated workers, they've since become the most prevalent retirement funding vehicle for American workers. We know from the RRR that participants have difficulty replacing their income, much less accumulating supplementary savings. DC plans need to be focused on addressing this retirement gap.

<sup>1</sup> Employee Benefit Research Institute, "The EBRI Retirement Readiness Rating: Retirement Income Preparation and Future Prospects," July 2010.

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*Problems with  
current retirement  
income disclosure*

- *Not featured on quarterly statements*
- *Complicated*
- *Not standardized*
- *Lack of meaning*
- *Unclear*
- *Uncertain*

Unfortunately, current account balance disclosure fails to make the connection between savings and investment choices and retirement standard of living. When a 65-year old participant sees an account balance of \$100,000 on her quarterly statement, she may think it's a lot of money. But how much monthly income can a 65 year-old female afford with \$100,000? A 4-5% inflation adjusted withdrawal strategy, typical among financial advisors, would provide just \$4,000-\$5,000 per year in today's dollars. Even an immediate fixed annuity, which locks in average longevity and hence allows for greater spending than self-annuitization, provides only \$6,780 per year (\$7,512 for males)<sup>2</sup>. For all but the extremely frugal, a \$100,000 nest egg at retirement will be totally inadequate. But participants may not know this.

Worse, current tools to calculate retirement income may be more harmful than helpful. In 2008, our colleague Bill Madden compared tools designed to measure retirement readiness<sup>3</sup>. For a hypothetical plan participant called Sharon, one tool indicated that Sharon was almost on track for retirement, while another advised her to save an additional 44% of her salary. Which of these numbers should the participant believe? Some of these models incorporated Social Security, while some did not; some ignored future contributions, while some did not; and some simulated a range of market outcomes, while some did not. What's more, they reported these findings using different frameworks. Since the stakes for obtaining adequate retirement income are so high, participants cannot afford to be confused about the outlook for their standard of living.

**Russell advocates simple, clear, meaningful disclosure**

At the joint hearings, other firms on Russell's panel focused on disclosing projected retirement income to participants. As we've already discussed, there are many assumptions involved with this complicated process. Even if the government decreed a standard procedure for all plans to follow, any projection would require lengthy disclosure that few participants would take time to understand.

In contrast, Bob proposed a simple, clear supplement to account balance disclosure: the account balance divided by an immediate annuity factor — call it the annuitized wealth value (AWV). This amount would inform the participant what annual lifetime income a hypothetical older version of her could expect to receive. For example, anyone who had saved \$100,000 would have the same annuitized wealth value, regardless of age. It could be provided for several retirement ages and show that delaying retirement allows for higher lifetime income. The look and feel would be similar to a Social Security retirement benefits statement. For an example, see the sample disclosure at the end of the paper.

The AWV approach would offer many improvements over current account balance disclosure. Most importantly, participants would realize that having \$100,000 might not be enough. It would convey this message simply and consistently across plans, using standard assumptions for the annuity calculation. The new disclosure's clarity would mitigate the chance of participant confusion, and equating current account balance to retirement income would be meaningful. Since the calculations do not involve projections, the figure provided would be an objective best estimate of the lifetime income one could afford today. The AWV would also include a reminder that future savings and returns will improve the retirement income figure.

Participants should be told what their accrued account balance will buy. Yet accrued assets are only one source of retirement income — future contributions and investment returns are also important. Our sample disclosure includes this information for

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<sup>2</sup> Estimated quotes for a single life annuity, [www.immediateannuities.com](http://www.immediateannuities.com), accessed 1 October 2010.

<sup>3</sup> Madden, Bill. "Will I have enough to retire?" 23 May 2008.

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participants. There's also a place for specific retirement income projections. However, since AWW offers greater clarity, certainty and meaning, it should be the primary disclosure supplement to the account balance.

**"A force toward a better system"**

At the hearing Bob summarized the benefits of simple retirement income disclosure as follows: "This is a simple change but a fundamental one. It aligns disclosures with the objective of the system. Disclosure of progress in terms of retirement income would be a force toward a better system, because, as has frequently been said, what gets measured gets managed."

Exhibit 1:

<p>Name: John Q. Public</p> <p>Age: 40</p> <p>If you were ___ years old today and wanted to retire, you could afford a <b>monthly lifetime income stream</b> of*:</p> <p style="text-align: center;"><b>60</b> years old...<b>\$300</b></p> <p style="text-align: center;"><b>65</b> years old...<b>\$400</b></p> <p style="text-align: center;"><b>70</b> years old...<b>\$550</b></p> <p>*You have 20 or more years to contribute to and collect returns on your account. If you are married at retirement, you may want to purchase a joint-and-survivor annuity, which would provide less income than the figures reported above.</p>
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