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RESEARCH SUMMARY

ILLUSTRATING RETIREMENT INCOME FOR DEFINED CONTRIBUTION PLAN PARTICIPANTS
A Critical Analysis of the Department of Labor Proposal

Devising the best retirement income strategies is a challenge facing all Americans with individual retirement accounts. The Department of Labor recently proposed that personal retirement accounts include an illustration of the retirement income producible from the assets in the account through an immediate life annuity. This is a step toward helping people who are making decisions about saving for retirement and managing their assets during retirement, but the proposal can and should be improved.

A new study for the Mercatus Center at George Mason University is the first to rigorously assess the details of the proposed regulation using empirical methodology widely accepted in the financial industry and comparing the proposed illustration to the Social Security statement. The regulation would require all defined contribution plans to inform their participants of the life annuity income equivalents of the current and projected balances in their individual accounts. The study examines several changes the Department of Labor can make to improve its proposal.

To read the study in its entirety and learn more about its author, economist Mark J. Warshawsky, please see "Illustrating Retirement Income for Defined Contribution Plan Participants: A Critical Analysis of the Department of Labor Proposal."

SUMMARY

When workers retire, they will have to manage their financial accounts in a responsible manner. Even for those with experience and understanding of personal financial management, it can be a daunting task to ensure that the money saved will be spent wisely and will still be around many years into the future. One way to assist workers who are planning their investment and spending choices is to provide an income illustration based on the funds in their account and projected to be in their account at the time of retirement.

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The Social Security Administration already provides such personalized information about the projected annual Social Security retirement benefits that workers can expect to receive if they retire at various claiming ages. This statement, automatically mailed to all covered workers every five years (and now available online), is designed to be used as part of the broader retirement income planning process.

The Department of Labor's proposed regulation would require defined contribution retirement plans to provide a similar statement, showing workers the income they could claim from their account at certain periods of time. Empirical analysis shows that the proposal could be effective if it incorporates some key improvements. There are several ways in which Department of Labor should make the statement more informative and relevant to workers as they plan their retirement and their retirement income strategies.

KEY RECOMMENDATIONS

The Department of Labor can improve its proposal in several ways:

- *Make the illustrations inflation-indexed.* The proposal should reflect an inflation-indexed life annuity rather than a nominal fixed annuity.
- *Base the illustrations on annual income.* The illustration should be based on annual rather than monthly income, consistent with the way salaries and many financial reports are structured.
- *Show a survivor annuity.* The proposal should show individual and joint-and-67%-to-survivor life annuity rates at the normal retirement age to all workers, rather than individual and joint-and-50% contingent rates just for married workers. Many insurers offer joint-and-67%-to-survivor life annuities, while joint-and-50% contingent options are not typically offered.
- *Use gender-distinct illustrations.* The illustrations should be provided on a gender-distinct rather than a gender-neutral basis (unless a gender-neutral annuity is offered within the plan). Few annuities are currently offered on a gender-neutral basis.
- *Provide data for several retirement ages.* The illustration should show older workers projections for several retirement ages, like the Social Security statement does.
- *Provide the illustrations annually.* The illustrations need not be provided more frequently than annually, which is the same frequency that the Social Security Administration provides such personalized information to its participants.
- *Use the 10-year Treasury rate.* The assumed 7 percent investment return for projecting account balances forward is too high; illustrations should use the 10-year Treasury constant maturity rate instead.
- *Include IRAs.* The proposal should include individual retirement accounts.

CONCLUSION

The Department of Labor is on the right path when it proposes to require the illustration of the expected lifetime income that a 401(k) account can produce when its owner retires. However, its proposal can be improved to produce a more useful illustration for retirement planning and the selection of a retirement income strategy.