Retirement Income
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The Overlooked Income Vehicle

By Kerry Pechter *Wed, Jun 17, 2015*

Systematic withdrawals from 401(k) plans are a widely-available but rarely-used way to create retirement income. Perhaps because electronic transfers are virtually free, nobody's championing them.

At a recent convention in San Diego, the CEO of the American Retirement Association, Brian Graff, told a ballroom full of plan advisers that only 52% of the 401(k) plans in the U.S. allow retired participants to take systematic withdrawals from their accounts.

His point: A lack of distribution options in plans forces millions of retirees to roll their plan assets to IRAs. And that fact makes the DOL's pending conflicts-of-interest proposal, which could make it harder for some advisers to serve IRA owners, counter-productive and, in his eyes, ridiculous.

The DOL proposal aside, Graff's statistic about systematic withdrawals was striking. Hundreds of thousands of plan sponsors don't offer regular electronic transfers from plans to retiree bank accounts. If they do, oddly, they often don't know they do. And even when they know it, sponsors rarely promote this service. Not surprisingly, few retired participants use them.

At a time when the industry and the government and Baby Boomers are devoting a lot of attention to retirement income, the SWPs solution seems to be hiding in plain sight. But by neglecting the obvious, we may have overlooked one of the simplest, most flexible and least expensive ways to generate retirement income from DC plans, one that retirees can easily integrate with risk-reduction strategies, like income annuities.

Over three consecutive issues, *RIJ* will focus on systematic withdrawals as a retirement income solution. This week we'll look at the dimensions of SWP coverage in the retirement plan universe. Next week, we'll ask the experts why SWPs are so neglected. Then we'll hear about some recent recommendations for changing the status quo.

SWPs (not just for chimneys)

What are "systematic withdrawals," exactly? SWPs are recurring electronic ACH (automated clearinghouse) transfers of money from defined contribution plans to the bank accounts of retirees for the purpose of providing predictable income—not to be confused with cash-outs, "ad hoc" withdrawals, partial distributions or required minimum distributions at age 70½.

Overall, only 55.7% of the 600,000-plus DC plans in the U.S. offer systematic withdrawals, according to a 2014 survey by *PlanSponsor* magazine. The biggest plans are almost twice as likely to offer SWPs as the smallest plans. But only 64.7% of DC plans with $1 billion or more in assets offer SWPs. Plans with less than $1 million in assets offer them just 38.6% of the time.

Tellingly, more than one sponsor in five (20.3%) was “unsure” if its plan included a SWP option or not. (One reason for that: A lot of plans were designed decades ago, long before anyone dreamed that DC plans would replace defined benefit plans as a primary source of retirement income.)

“I’ll get a call from a client who wants to talk about in-plan annuities,” said one recordkeeper executive, who asked not to be identified. “But when I ask if they offer a systematic withdrawal, they say, ‘I don’t know.’”

Ironically, some plan sponsors who are getting on the annuity bandwagon have policies that force former participants to choose between leaving the money in the plan or taking all of their money out. “They’re enamored with the in-plan annuity, but meanwhile they’re pushing people out of their plan,” said the executive, who was speaking as a member of the Defined Contribution Institutional Investment Association, a trade group for large asset management firms and others. In May, DCIIA published a whitepaper, “Defined Contribution Plan Success Factors,” which advises plan sponsors to explore income options for their participants.

But even a plan that includes a provision that allows its service providers to offer SWPs, there’s not much take-up by participants. It’s not clear how aware participants are of the service, but big plan providers like Vanguard and Fidelity say that, while they offer free or near-free SWPs services, they don’t get much traction.

“We do offer a systematic withdrawal program for our retirement plans. We call it Guided Installments. The offer is available on all plans, but for certain Vanguard plan sponsor clients the existing plan provisions do limit the adoption of this program,” a Vanguard spokesperson told *RIJ*.

“There is no added fee to sponsors or participants. It is our simplest solution for DIY [do-it-yourself] participants, with personalized income/expense scenarios and a web-based modeling tool. It facilitates systematic withdrawals from plan accounts, and offers help with inflation and RMDs.”

Few active SWP-ers

But according to “How America Saves 2015,” Vanguard’s just-published annual review of its full-service retirement plan business, SWPs aren’t popular. Just six out 10 (59%) plan sponsors allow retired participants to establish installment payment programs (other than required minimum distributions starting at age 70½). About 13% of sponsors covering about 30% of all participants allow ad hoc partial distributions. (About one-third of large plan sponsors offer this type of distribution, making it available to about 35% of all participants.)

In 2013, the Vanguard Center for Retirement Research analyzed participant distribution behavior. The company wanted to know whether it made sense, in an age when most people seemed inclined to use rollover IRAs as their eventual retirement income platform, to introduce annuities or maintain customizable installment distribution plans for former participants.

Demand for SWPs was low. In a survey of participants over age 60 who left their Vanguard-administered plans between 2004 and 2011, no more than nine percent of those terminating in any given year were in the plan and taking installments from their accounts. Most separated participants over age 60 opted for a rollover. Within a year after leaving the plan, for instance, 56% had executed a rollover; within seven years of separation, 72% had.

At Fidelity Investments, the largest retirement plan provider in the U.S., the pattern is much the same, with fewer than 10% of retirees using SWPs. “The vast majority of our large employers, those with 5,000 or more participants, tend to offer SWPs,” said Meghan Murphy, a Fidelity director, in an interview with *RIJ*. “But out of more than one million retirees in our plans, we have only about 60,000 SWPs set up on our system.”

That’s unfortunate, because Fidelity has designed a highly flexible SWPs program. “There are a lot of options on how you can do SWPs,” Murphy said. “There are fixed dollar distributions; for instance, someone will say, ‘Pay me $5,000 a year.’ There are fixed percentage distributions. Some people say, ‘Just pay me what I earn in the market. There are requests for distributions from specific sources, such as Roth IRAs. We are able to accommodate all of those preferences. Some employers will say, ‘I only want to do annual distributions or quarterly distributions.’ Others will let the employees decide.”

At The Principal’s retirement plans, retirees can set up non-guaranteed, annuity-like income. “All of our plans are eligible for systematic distribution—the plan sponsor elects which distribution options are offered under the plan,” Jaime Naig, a Principal spokesperson, told *RIJ*. “We have a $10 distribution fee per quarter for installment distributions, paid by the participant.

“The participant, depending on plan provisions, elects fixed payments or fixed-period installments. With fixed payments, the participant chooses the amount and frequency of the payments, and receives them until the account balance equals zero. With the fixed period, the participant chooses the period and frequency of payments. The amount is re-determined each year based on the number of years remaining in the period.”

Why has the installment option been so neglected? We’ll try to answer that question in next week’s issue of *RIJ*.