FEATURE | PLANSPONSOR February-March 2020

A Changed Perspective

What sponsors should know to navigate the new safe harbor for annuities.

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Whether you call them annuities, lifetime income solutions or guaranteed income, the recent passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act has eased the way for employers to offer these products in their retirement plan. Notable among the act's provisions is a safe harbor clarification, which reduces sponsors' potential liability in choosing a provider.

But while many employers may be eager to help participants worried about outliving their income, questions remain about the best way to incorporate these features into a plan—and whether employees will actually use them.

"The SECURE Act, at a high level, creates a bit more flexibility for plan sponsors and makes it a little easier for them to offer in-plan annuities," says Dylan Huang, senior vice president and head of retail annuities at New York Life in New York City. "I don't think that in itself will translate—at least not in the near term—to a dramatic increase in adoption of in-plan annuities."

The SECURE Act was one of the few bipartisan bills to pass Congress late last year, amid growing agreement that workers need more tools to adequately prepare for potentially a long lifespan in retirement. Six in 10 employers surveyed by Willis Towers Watson this past September, before

Annuities and other similar products allow consumers to buy into a contract—either all at once or via contributions—in exchange for a guaranteed monthly payment for the rest of their life. Most plan sponsors have not offered annuities as investments in their plan, and many experts suggest this has been partly from sponsors' fear of liability, if the insurer they have chosen later fails.

Checking the Boxes

Under the SECURE Act, rather than having sponsors vet insurance companies themselves to meet previously vague requirements, sponsors may use documents the insurer itself provides that prove it was vetted by insurance agencies and found viable.

"With the help of an adviser, it's going to be relatively easy for plan sponsors to check the required boxes," says Alexander Papson, manager of fiduciary solutions at Schneider Downs Wealth Management Advisors in Pittsburgh. "The regulations really spell it out in extraordinary detail."

In addition, the SECURE Act makes it easier for plan sponsors to switch annuity providers without triggering tax consequences for participants.

A Range of Products

Plan sponsors interested in adding in-plan lifetime income options will be limited to those available on their recordkeeper's platform. While options are relatively few for now, here are some of the products they might see.

- **Guaranteed investment products.** Participants purchase the product either with a lump sum at or near retirement or with regular contributions from their paycheck. Either way, the owner is paid a guaranteed return, say 1% to 3%, beginning at a specific date in the future. If interest rates surge, such contracts may include a provision that bumps up the potential returns.
- **Guaranteed minimum withdrawal benefits tied to a target-date fund (TDF).** These products guarantee the owner a minimum withdrawal—e.g., 4% or 5% per year—based on a specific high-water mark for the account. In exchange for the guarantee, the participant pays a fee, such as 60 to 100 basis points (bps) annually. If he no longer wants to pay the fee, he may transfer the money to another investment without penalty. Or, he may put new contributions into other investments and continue paying the fee on the "old" investment, maintaining the guarantee on that account.
- **Target-date funds with an annuity replacing part of the bond-fund allocation.** As the participant ages, the allocation to the annuity grows, creating a guaranteed income stream that kicks in at retirement.
- **Traditional annuities.** Here, a plan participant converts all or part of his nest egg into an annuity at retirement. One version is the qualified lifetime annuity contract (QLAC), into which participants can put as much as 25% of their plan balance, capped at $135,000, and start receiving payments at any time up to age 85. Unlike with other annuities, money in a QLAC does not count in required minimum distribution (RMD) calculations.

"Generally speaking, all of these, within the context of the SECURE Act, signal an increased acceptance of qualified retirement plans serving as decumulation vehicles, not just accumulation vehicles," Papson says.

Keep It Simple

Still, experts say, plan sponsors considering in-plan annuity options for the first time should focus on straightforward products, not the more complex variations. The simpler the product, the easier it will be to understand the pricing and convey the product's benefit to participants.

Partners in Louisville, Kentucky. "Something that's a simple accumulation vehicle that you can turn into an income stream makes a lot of sense. Once you start adding a lot of features, it starts getting expensive and difficult for nonprofessionals to understand them."

Under the SECURE Act, plan sponsors still must consider the cost of a given product and make sure it is "reasonable" relative to the product's features. But this requirement also provides necessary clarity to plan sponsors. They do not have to choose the cheapest option, for one thing.

"Fortunately, the reasonableness of costs relative to features is something that the marketplace determines," says Fred Reish, a partner in the Los Angeles office of Faegre Drinker Biddle & Reath and chairman of its fiduciary services ERISA [Employee Retirement Income Security Act] team. He explains: "Advisers and plan sponsors can obtain marketplace data, and the data will suggest that, for a particular kind of guaranteed product, the prices fall within so much on the low end and so much on the high end. That's the range of reasonableness."

The range of reasonableness may go down as the marketplace matures. Insurance companies are likely to start providing more institutionally priced, transparent products, as that is what the 401(k) market is used to, Reish says.

Even as many experts increasingly see annuities as a necessary piece of the decumulation puzzle, the products still have a bad rap with consumers. According to the 2019 Cannex Guaranteed Lifetime Income Study, almost half of those surveyed (46%) said annuities have too many terms or conditions, and the same percentage said they are hard to understand and put you at risk of losing access to your money.

While the SECURE Act removed a significant barrier to in-plan annuities, it likely represents only the first step on a long road to widespread adoption.

"The purpose behind this part of the SECURE Act is to encourage plan sponsors to include guaranteed products in their 401(k) plan," Reish says. "I think it may well succeed in that. The next question is whether participants will use the products."

The Education Component

To encourage participants to consider in-plan lifetime income options, employers and providers will need to invest significantly in education.

Teaching employees the true value of annuities may take more than supplying income projections and digital calculators. Some of the latter oversimplify the strategy and ignore the important nuances. After all, two individuals with the same asset balance may have very different income needs in retirement, depending on the person's lifestyle, risk appetite, other funding sources and health profile.

Plus, annuities are typically not an all-or-nothing option. Participants can—and often should—opt to put just a portion of their nest egg into an annuity, rather than investing it all or avoiding the product entirely. "There is a broad range of needs and preferences for guaranteed products," says Keri Dogan, senior vice president and tribe lead, retirement income, at Fidelity Investments in Boston. "Some people—even if the guaranteed products make sense—are risk averse and don't want to part with their assets in order to buy a guaranteed product. As people move closer to retirement, there are a variety of needs, and that's making it hard for sponsors."

Just as there is no one-size-fits-all annuity product, there is no single education solution. Employers will need to tailor their approach to the demographics and needs of their employees. For example, most annuities do not make sense for young people to purchase, because of the many years they will be paying fees. So, employers with a younger participant cohort might stress them less than an employer with many near-retirees.

needs to improve its communication with consumers and should consider standardizing some of the language it uses, he says. "Some products call the same features by different names. Standardization of language and simplicity of products is really important," he says.

Looking Ahead

In some ways, sources suggest, the market for in-plan annuities may resemble the one for target-date funds after passage of the Pension Protection Act of 2006 (PPA). Before being endorsed as a qualified default investment alternative (QDIA), TDFs were not widely used or well-understood. But today they are the QDIA that defined contribution (DC) plans use most often and make up the majority of DC fund flows.

"In 15 or 20 years, annuities will have become an integral part of the defined contribution plan," says Frank O'Connor, vice president, research, at the Insured Retirement Institute (IRI) in Washington, D.C. "It starts by changing the thinking of participants to orient that toward, 'This is my pensions that I'm creating, not a bucket of money I can do what I want with.'"

Lifetime Income Annuities Can Help

Baby Boomer Confidence as to Key Aspects of Retirement

	Own an annuity	Don't own an annuity
Will be able to live comfortably	**48%**	20%
Am preparing well	**52%**	22%
Will be able to afford health care	**51%**	25%
Will withstand major market correction or recession	**27%**	16%

Source: Insured Retirement Institute

Does your plan offer any of the following features options to help participants build retirement income?

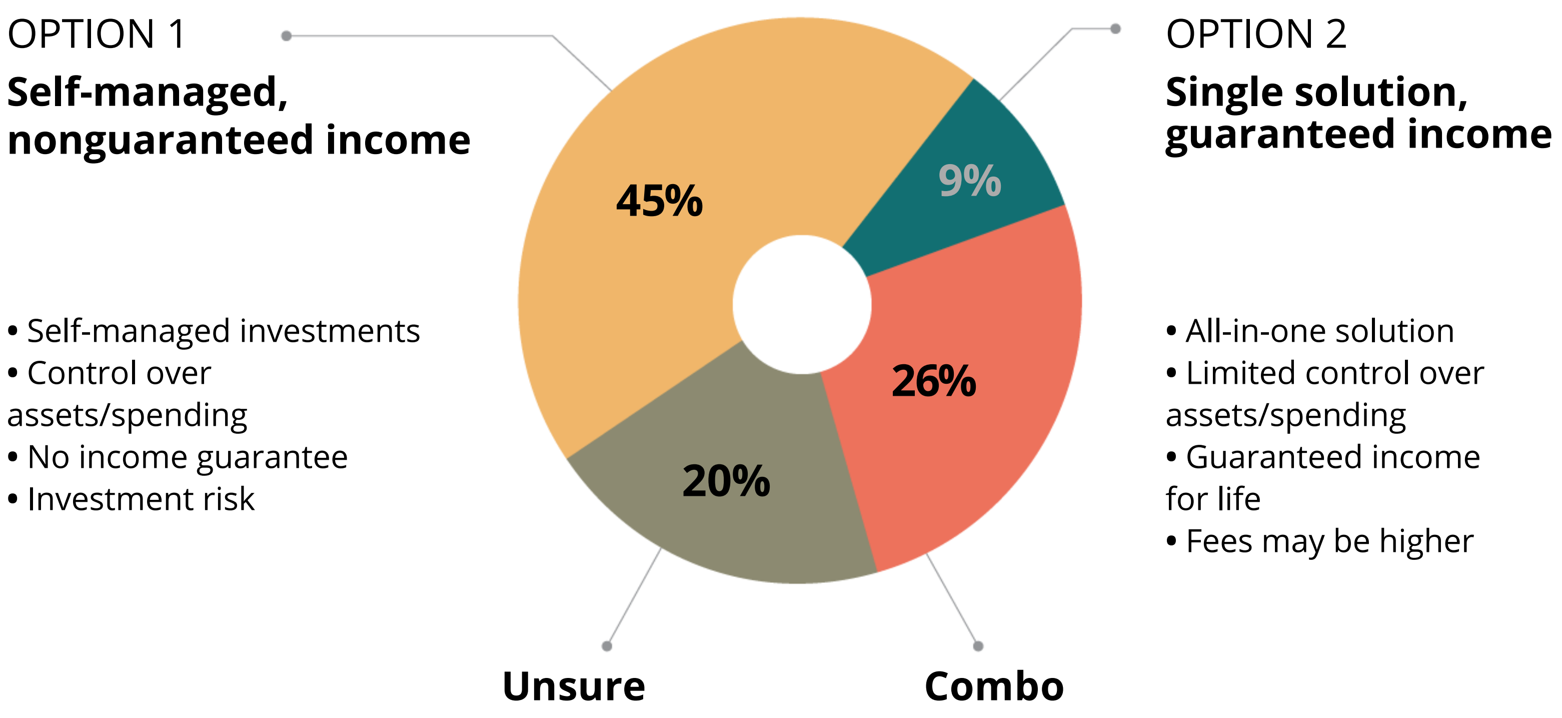
Systematic withdrawal plan	44.3%
In-plan managed account	24.4%
In-plan managed payout funds	10.0%
In-plan annuities	9.2%

No income solutions	47.7%

Source: 2019 PLANSPONSOR Defined Contribution Survey

Retiree Income Investment Preferences

Retirees prefer self-managed investments and control to insurance guarantees. They were asked: Which of the following approaches to managing assets and generating income in retirement would you most likely take?



Source: EBRI/Greenwald Retirement Confidence Survey

Tags	Guaranteed Lifetime Income, SECURE Act
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