In-Plan Guaranteed Lifetime Income:
Debunking Portability Myths

Defined contribution plan assets are now recognized as a primary source for income for future retirees. With this shift has come increased attention to the issues of selecting and offering a guaranteed lifetime income product within a DC plan. Portability is frequently cited as an obstacle to offering a lifetime income product due to both its importance and the widely held view that portability options do not exist or are not feasible. In fact, portability solutions and options are available today but are not well recognized. Much has changed in the last 10 years with product designs, industry standards and new technology all working together to help plans and participants keep guarantees. These FAQs, in line with IRIC's mission, address the most common concerns and questions.

Q1: What is portability?

> Portability is the transferability of a participant's guaranteed lifetime income benefit if a:
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> 1) plan moves between recordkeepers or
>
> 2) participant moves to an IRA product.

Portability applies to in-plan guaranteed lifetime income products where risk is shared with the product provider, thus conferring to a participant an individual guaranteed benefit. Examples of guaranteed products:

- Guaranteed Minimum Withdrawal Benefit (GMWB)
- Deferred Income Annuity (DIA)
- Longevity Insurance, including Qualified Longevity Annuity Contract (QLAC)

In all of these cases the plan sponsor has included the guaranteed lifetime income product both as an investment and as adistribution option in the plan.

Q2: What exactly is being "ported" for guaranteed lifetime income products?

> It is a guaranteed lifetime income amount that is calculated specifically for individual participants who have invested money into a guaranteed lifetime income fund offered within a DC plan.

Insurance companies can offer the best benefits at the lowest cost when they understand the risk associated with the guarantee (i.e., they are able to do some underwriting). This translates into gathering existing basic information about participants and their transactions and tailoring a benefit to each participant. This is often described as an individualized or allocated benefit. The most common data elements are: age (date of birth), gender, financial transactions associated with the guarantee, and current market value of the guaranteed investment option. This requires recordkeepers to send out participant data files from their system and to subsequently receive participant benefit data back for display of the guaranteed value to the participant. Portability is directly a function of how easily the guaranteed benefit value and data file sharing can be transferred across recordkeepers.

After some trial and error beginning around 2004, in-plan guaranteed lifetime income products have settled into a standard administrative form acceptable to plan recordkeepers. This model is consistent with the capabilities and processes for recordkeeping daily valued and traded funds (e.g., mutual funds). This is codified in the SPARK[1] income data file standards that are used by guaranteed lifetime income product providers today, as well as the recently published SPARK touchpoint guidelines.

We now operate in a more mature income product market where recordkeepers handle basic processing for guaranteed lifetime income products within existing processes like trading, enrollment, contributions, exchanges, and display of account value.

Q3: Why is portability important?

> Portability allows the transfer of existing guaranteed lifetime income benefits from

1 SPARK: The Society of Professional Administrators and Recordkeepers

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one recordkeeping platform to another. Without portability, a participant would lose the guaranteed benefit because their benefit under the guaranteed contract would be liquidated (surrendered) as a result of the transfer to the new platform.

The value of portability should be considered in the selection process of a guaranteed lifetime income product and the associated recordkeeper. Portability is generally associated with administrative concerns, where both the insurance company and the recordkeeper (or successor recordkeeper) would need to support the administration and recordkeeping of the guaranteed product and would need to utilize the SPARK file feeds and SPARK guidelines (discussed above). An investment provider or insurance company may initially offer their guaranteed product only on their proprietary platform. However, many insurance companies and many recordkeepers are willing to support portability and will build out the capabilities as demand for this grows in the marketplace. With the number of plans offering in-plan guaranteed lifetime income products now topping 33,500, both recordkeepers and insurance companies are increasingly willing to build out the capabilities needed to enable portability from one platform to another.

On the recordkeeper side a similar dynamic exists. The ability of a recordkeeper to support a guaranteed lifetime income product into their education, display or disbursement experience requires thought, strategy, and time. Not all recordkeepers have yet made that investment. Again like the product side the first question is to ascertain if the recordkeeper is willing to support portability before worrying about their current capability. History has shown that open fund architecture is invariably the end state and that guaranteed products will continue to evolve toward portable solutions. The level of portability across the entire industry may not occur, but competitive forces are causing all recordkeepers to determine their strategy and level of portability that they intend to support.

Q4: What creates the need for portability?

Moving from one administrative platform to another creates the need for portability. Since this can be a plan-to-plan move initiated by the DC plan sponsor when changing recordkeepers, or a plan-to-IRA move initiated by the participant who is exiting the plan the need for portability exists at both the plan level and the participant level.

Portability on a plan level

The obvious reason for portability at a plan level is the business or fiduciary decision to change recordkeepers. While the decision to move is a substantial commitment of internal resources, moving to a new service provider is driven by a host of reasons, including but not limited to:

- service level issues;
- fees;
- plan consolidation due to corporate mergers, acquisitions, or divestitures, and/or
- outgrowing the current provider services and capabilities.

Each of these decisions involves many factors, all with different weights. For sponsors who want to add a guaranteed lifetime income option, portability could be a factor in the decision to stay or to move to a new service provider.

An interesting dynamic supported by recent surveys is the increased interest in retaining assets in company-sponsored DC plans instead of rolling over to an IRA after termination or retirement. This trend will further promote consideration of providing guaranteed lifetime income investment options to offer participants additional retirement income alternatives. Defined contribution plans are no longer viewed as just a retirement accumulation plan. Rather, DC plans are becoming deccumulation vehicles for plan participants. In addition, the vast majority of participants in company-sponsored DC plans will pay lower fees than if they try to buy the same guaranteed lifetime income product on their own. For this reason, many participants will be better off if they keep their assets in company-sponsored programs where all the investments, including the guaranteed lifetime income options provided, are monitored by ERISA plan fiduciaries. Plan fiduciaries are able to use their bargaining powers to drive lower institutional pricing, which can provide participants a higher guaranteed lifetime income than the retail market provides.

Portability on a participant level

The need for participant-level portability arises when a participant eligible for a distributable event, like changing employers, makes the decision to move their investment to an IRA. Today, the majority of participants who are changing employers have three options with their defined contribution account balances:

1) A lump sum distribution
2) A full or partial rollover to an IRA or qualified defined contribution plan
3) Keeping their money in their former employer's plan

Because workers on average will change jobs 11.7* times during their working career, portability to main-tain a guaranteed benefit is critical for participants.

While the reasons are many, these few examples describe why annuity providers and fund companies should work toward partnering to mobilize these products and develop industry standards to make the products more portable.

*A recent report released by the DOL Bureau of Labor Statistic, "Number of Jobs Held, Labor Market Activity, and Earnings Growth among the Youngest Baby Boomers: Results from a Longitudinal Survey," people born in the years 1957 to 1964 held an average of 11.7 jobs from ages 18 to 48.

Q5: Does portability apply for a non-guaranteed income offering?

No, as there is no guaranteed benefit specific to individual participants that needs to be tracked or moved.

From the perspective of portability a non-guaranteed income offering is treated the same as any other investment option where the participant account is valued using a daily NAV. Non-guaranteed managed payout funds, managed accounts with drawdown features, and other drawdown modeling tools all rely on account value-based investment funds. These services and tools supply a distribution amount that is not guaranteed. Transition from one administrative platform to another is based solely on account value.

Q6: What is required to accomplish portability?

The key aspect is having a way to transfer the individual participant's guaranteed lifetime income benefit to the new recordkeeper. Depending on how the recordkeeper is connected, this may be done directly with a product provider or through an income middleware provider acting as a clearinghouse. Transference of all other participant records, account values, services, etc. is no different than other funds.

While recordkeepers can create one-off connections to various product providers and vice versa, income middleware has emerged as a solution to this challenge. Income middleware acts as a clearinghouse for guaranteed income data exchanges, requiring only a single, standardized connection by recordkeepers to accommodate multiple income products. In addition, income middleware is the central repository for participant-level income benefits, which are held separate of recordkeeper account records. The single simplified connectivity allows for easier transition of connections between recordkeepers. The centralized benefit records on income middleware allow benefits to be re-associated to the recordkeeper participant/account values once the recordkeepers have completed their normal conversion process.

Q7: Is there a fee associated with "porting" a guarantee?

There could be. Moving a guarantee is incremental work for the recordkeeper but a very small task in the larger recordkeeper conversion effort. It will depend on individual recordkeeper's approach and pricing model for accepting new plans and would be part of the associated negotiations between the plan sponsor and the recordkeeper for the entire effort. There are no fees from a product provider.

Q8: What if the recordkeeper I'm moving to already has my guaranteed lifetime income product on the platform?

Portability won't be problem if the destination recordkeeper already supports the guaranteed lifetime income product you want to move.

A recordkeeper who already offers the product across their platform will have integrated the product into their participant experience. They also already have connectivity in place for sending data and receiving data relevant to individual participant benefits. As part of the normal recordkeeper conversion process, the party performing the benefit calculation – either the product provider or income middleware – will be notified and included in the transition process much like any other vendors (e.g., self-directed brokerage). Recordkeepers in some instances may support a product as an accommodation to a plan, so confirming support is recommended.

Q9: What are my options if the recordkeeper I'm moving to does not have my product on the platform?

There are a few different ways that recordkeepers could address this. Plan sponsors should ensure that the product provider initiates discussions with the prospective recordkeeper.

- **New recordkeeper agrees to recordkeep the product and to fully integrate guaranteed lifetime income into their services.**
  This requires an investment of time and resources by the recordkeeper and will probably impact the transition timeline. However, once complete, the investment can be mapped to the new recordkeeper and the accrued benefit can transfer over. On an ongoing basis, data will be passed between the recordkeeper and the product provider or income middleware and the investment can be fully integrated into the participant experience.
- **New recordkeeper agrees to recordkeep the product but not to integrate guaranteed lifetime income into their services.**
  In this case, the product becomes frozen to new contributions and new participants, but the guarantees continue to accrue. There is some build out on the part of the new recordkeeper that would slightly impact the transition timeline; the best practice here is to wait for the build out to be complete before transitioning the entire plan over. This scenario means that the recordkeeper would interact with provider or middleware for participant transactions, but would not be responsible for providing guarantee information to participants, unless it chose to make that information available in some areas of its participant experience. With the product on its recordkeeping system, the recordkeeper would be able to provide 5500 reporting to the plan.
- **New recordkeeper refuses to recordkeep the product and the sponsor wants to keep it in the plan.**
  If agreeable to all parties, assets could transition to the product provider who would recordkeep that portion of plan assets. As above, the product generally becomes frozen to new contributions and new participants, but the guarantees continue to accrue. The provider would send out statements on the product. Funds in the product would be completely separate from the rest of the plan's funds and participants would essentially have two sets of processes to follow, and the plan would need to compile data from two sources for 5500 reporting purposes.
- **New recordkeeper is an insurance company and agrees to "buy out" the guarantee as part of the conversion.**
  Some insurance companies are willing to "buy out" the contract and maintain the same or similar benefit under a new contract. With many income products, there are two values: (1) a market value and (2) a guaranteed lifetime income amount or value. Some insurance companies are willing to provide their new client the higher of the benefit offered by the prior insurance company or the benefit provided by the new incumbent insurance company. This puts the plan sponsor and the participant in a "win–win" situation where the sponsor can select the platform

provider of their choice while the participant keeps their old guarantee (if higher) or receives the new guaranteed lifetime income from the new insurance company if it is higher than the predecessor's.

An example can help illustrate this point: Joe, a participant in "Plan A," has a market value in his guaranteed investment of $200,000 and a benefit base of $250,000. Joe's employer is moving the plan to a new recordkeeper/ insurance company. The new insurance company and recordkeeper is willing to buy out the contract. The new recordkeeper, when they convert the plan into their own product, will provide a deposit of $200,000 into their guaranteed product (this is the market value) and the new recordkeeper will adjust the benefit base to be the same as the benefit base with the old recordkeeper ($250,000), thereby maintaining the benefit through the conversion to the new recordkeeper.

Q10: What if either my recordkeeper or the product provider will not support my product on the new platform and I still want to move?

A plan may move to a recordkeeper not supporting guaranteed lifetime income products. In this situation it is likely that the guaranteed lifetime income product will be liquidated, forfeiting participant guarantees. This is acceptable assuming certain conditions are met.

There are two interconnected fiduciary concerns behind this question:

- Is a plan locked into staying with a recordkeeper in order to preserve the guaranteed lifetime income product in which participants have invested?
- Is it a fiduciary breach to switch providers because the change will be detrimental to individual participants who lose the benefits of the product for which they have been paying?

The short answer to both of these concerns is "no." There is clear guidance from both the Department of Labor and the courts recognizing that the fiduciary obligations of prudence and loyalty run to the participants as a whole. In other words, in making a decision regarding what is prudent for the plan and in the interest of its participants, fiduciaries should consider the interests of individual participants but are not barred by those interests from acting. If it is prudent to replace a recordkeeper, the fiduciaries need to take that step, despite the fact that either the old or new service provider will not support the retention of the old recordkeeper's guaranteed lifetime income product in the new system. This is not to suggest that fiduciaries should act cavalierly: the loss of the guaranteed lifetime income product by some participants is a factor that fiduciaries will need to consider as part of their prudent process. But this factor alone should not guide their decision, since it is no more important than issues of the quality of the services, the availability of other investments, costs, service provider compensation, and so on.

Stated differently, if after considering all of the relevant factors the fiduciaries conclude that changing pro-viders will benefit the participants as a whole, the fact that it will disadvantage some individuals would not be a bar to making the change. This assumes that the change will benefit all of the participants more than the loss of the product will harm affected participants.

But what are the alternatives if such a prudent change is made and some participants do lose the product? The assumption in this question is that neither the old or new provider will support a transfer of the product to the new provider's platform or permit the transfer of the benefits from the old provider's product to one offered by the new provider. One solution exists for those participants who are able to take a distribution (those age 59 1/2 in a 401(k) plan that permits in service distributions) and roll over either the product or purchase an equivalent product in the provider's IRA without loss of benefits. At least they preserve what they have at the time of the recordkeeper change. Admittedly, this will probably be rare.

In the case of annuity products, it may be possible for the carrier to issue a certificate of insurance that is retained in the plan or transferred directly to participants, but again this may be an unusual set of facts.

The more likely situation is that the product investment is simply liquidated, the assets are transferred into a similar investment with the new provider, and the participants lose whatever guarantees are built into the product (unless, as stated above, the new record-keeper is an insurance company and willing

to “buy out” the guarantee.) In this situation, fiduciaries may want to consider whether there are other alternatives for helping their participants, such as adding deferred annuities as an investment alternative (assuming the recordkeeper can support such a product), offering a managed account service, and offering a managed account service, including investments or investments that offer a managed risk feature. While certain of these products may not offer the protection of a guarantee (other than the annuities, of course), they may provide a kind of proxy for helping furnish a source of lifetime retirement income.

Q11: Can I use an IRA rollover for portability?

Yes and no. Rollover IRAs can be used by participants as a portability option to remove their assets from the plan, but cannot be used to move a guarantee between recordkeepers/plans. Most product providers of in-plan guaranteed lifetime income offer this option to plan participants, and allow participants to carry any accrued benefit over to the IRA. Only participants who have had a distributable event will be able to utilize this option.

Plans can allow eligible participants to use this option when making the decision to move to a new service provider or to eliminate the product from the plan, in order to reduce the number of affected participants. However IRA fees are generally higher than plan fees, and not all participants will be able to utilize the option as each participant must have had a distributable event.

Q12: Can I move a benefit to a guaranteed lifetime income product from another Insurer?

No, moving a benefit from one guaranteed lifetime income provider to another is not possible. However, you can move assets from one guaranteed lifetime income product to another; and as suggested above, the new insurance company may be willing to preserve the guarantee in the new contract.

In the case where you move assets, the assets from the previous provider will need to be liquidated and those assets will then be used to purchase guaranteed lifetime income from the new provider. Benefits from the old contract will NOT be maintained, so this is not “true” portability – but as stated above, if the new insurance company is willing to “buy out” the guarantee, the new guarantee can have a very similar value as the old guarantee.

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