Institutional Investment Advisors and Consultants Forum: *Developing Expertise and Insights*

FIDUCIARY CONSIDERATIONS

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INSTITUTIONAL RETIREMENT INCOME COUNCIL

Innovation, Communication, Evaluation

Agenda

- Review of “The Case”
- Existing Regulatory Guidance
- Addressing key fiduciary risks
- Committee due diligence -- fiduciary selection criteria

Review of “The Case”

Retirement readiness is the issue:

- Benefit adequacy
- Sustainable retirement income
- Retiree risks

Review of "The Case" (continued)

A number of risks threaten the sustainability of lifetime retirement income.

- Longevity risk
- Sequence-of-return risk
- Withdrawal rate risk
- Inflation risk
- Cognitive risk

Review of “The Case” (continued)

A number of insurance and investment products are designed – or at least intended – to provide lifetime income.

- Insurance: Traditional annuities
- Insurance: Longevity insurance
- Securities: Managed payout and retirement income mutual funds
- Securities: Managed retirement income accounts
- Blend: Guaranteed withdrawal benefits (GWB or GMWB)

Existing Regulatory Guidance

- There is no requirement under ERISA for plans to provide investments, products, or services for retirement income
- If offered, though, they must be prudently selected and monitored
- Existing regulatory guidance is sparse
- Future guidance is not expected in the near future

Existing Regulatory Guidance (continued)

- Issues requiring additional guidance include non-discrimination, application of QJSA rules, RMD rules, and participant communication
- Recent Revenue Ruling offers some help on non-discrimination issue but only for certain products that include annuity features
  - Notice 2014-66
- A few Private Letter Rulings on QJSA issue

Existing Regulatory Guidance (continued)

The Portability Issues

- Portability for participant distributions can be solved through IRAs maintained by providers
- But the issues for changes of recordkeepers are more complex
  - Several organizations are developing middleware solutions to help address this issue

Existing Regulatory Guidance (continued)

- On the fiduciary issue, there is a DOL “safe harbor” for selection of annuities in defined contribution plans
- The “safe harbor” spells out a process but not what to look at
- So fiduciaries don’t get a lot of help
- That said, the selection of an annuity provider is not inherently different from any other decision that must be made by plan fiduciaries

Addressing Key Fiduciary Risks

- Key factors are
  - Selecting a provider
    - Our focus today
    - Assume an insured product
  - Portability
  - Cost
  - QDIA status

Addressing Key Fiduciary Risks (continued)

The DOL "safe harbor"

- Engage in an **objective, thorough and analytical search** to identify and selecting an insurer
- **Consider** information to assess the ability of the insurer to make future guaranteed payments.
- **Consider** the cost of the annuity contract in relation to the benefits and administrative services to be provided
- **Appropriately conclude** that, *at the time of the selection*, the insurer is financially able to make future payments
- If necessary, **consult** with a knowledgeable consultant

Ok, but what does a fiduciary look at?

Fiduciary Selection Criteria

- Financial strength of company
- Evaluation by rating agencies
- Commitment and success in the insurance industry
- Diversification of business lines

Criteria developed by Martin Schmidt, HS2 Solutions

Fiduciary Selection Criteria (continued)

Evaluation of Rating Agencies

Ratings given by each of the rating agencies to determine the consistency (or lack of consistency) among the agencies. Ratings over a multi-year period to determine if the trends have been stable over time or have fluctuated during economic cycles.	➢ Insurance provider; or ➢ Individual rating agencies: • http://www.ambest.com • http://www.fitchratings.com • http://www.moodys.com • http://www.standardandpoors.com	Should have ratings higher than the following: ➢A.M. Best = A- or better ➢Fitch = A or better ➢Moody's = A or better ➢Standard & Poor's = A or better

Committee Due Diligence

Demographic Considerations for selecting

- DC plan sponsors who are comfortable with innovative ideas as part of their culture
- Plan sponsors with older employees who want orderly transition of workforce and long-term focus for younger employees and recruits
- Plan sponsors who perceive responsibility for their employees
- Plan sponsors who discontinued DB plans and seek analogous guarantees

Committee Due Diligence (continued)

Demographic Considerations for not selecting

- 401(k) and 403(b) are a supplement to generous defined benefit plans
- Companies that, as a matter of culture, tend to be late to adapt to change
- Plan sponsors that prefer the status quo, rollover, individual responsibility for retirement
- Plan sponsors with young, high-turnover workforce