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Retirement Income Coming Soon to a 401(k) Near You

Experts believe that in the next few years, DC plan sponsors will embrace this option.

By Lee Barney

Defined contribution (DC) plans are at an inflection point, says Dana Hildebrandt, director of investments at Willis Towers Watson in Arlington, Virginia. “DC assets are now starting to exceed DB [defined benefit] assets for the first time ever, and as a result, sponsors are likely to address the different risks participants will face in decumulation,” she says.
Indeed, according to the 2019 Lifetime Income Solutions Survey by Willis Towers Watson, 30% of employers say they have adopted one or more lifetime income solutions in this year’s survey, up from 23% in 2016. Additionally, 60% say they would consider offering their employees lifetime income solutions in the future.
“Our clients are asking about retirement income, but it isn’t a topic of discussion every quarter,” says Martin Schmidt, a principal with MAS Advisors in Chicago. To date, MAS Advisors’ clients are gingerly approaching the retirement income dilemma by offering managed accounts, education and planning tools about retirement income and, occasionally, and out-of-plan annuity solution, Schmidt says.

While none of his clients are currently offering guaranteed income solutions, Schmidt expects retirement plan sponsors will begin to embrace that in the next three to 10 years. “This is going to become a major area of focus,” he says.

Adviser Opportunity Abounds

Retirement plan advisers should familiarize themselves with the various approaches to retirement income, says Bob Melia, executive director of the Institutional Retirement Income Council (IRIC) in Iselin, New Jersey. “Certain advisers are making this a centerpiece of their practice, or a value-add,” Melia says. “As retirement income becomes more important to plan sponsors, those on top of their game in terms of best practices are more likely to win new business when plans go out to bid for new advisers."

Melia is hearing from IRIC retirement plan adviser and consultant members "that although interest in retirement income stalled between 2013 and 2016, it has been reinvigorated by a number of factors. Plan sponsors are beginning to view their 401(k) plans not just as supplemental accumulation vehicles but as retirement income vehicles."

The executive director says that pending pieces of legislation, specifically "RESA" and the "SECURE Act," which promote retirement income, are driving this interest. "These pieces of legislation would give sponsors a straightforward safe harbor to offer guaranteed income products, provide for portability and require recordkeepers to issue statements for participants at least once a year that would show what their balance would equate to each year if it were annuitized," Melia says.

Additionally, sponsors are beginning to realize that "a plan with a retirement income component is a better HR [human resources] management tool, and that such a plan can enable older workers to retire when they want to retire," Melia says.

Legislative Momentum

Nuveen is hopeful that the SECURE Act will be passed and that plan sponsors will feel more confident about offering in-plan retirement income solutions, particularly annuities, says Christine Stokes, head of DCIO (defined contribution investment only) strategy at Nuveen in New York.

"There are three major gaps in the retirement system: the coverage gap, the savings gap and the income gap, the latter of which is complex," Stokes says. "The retirement industry, including legislators, have been focused on the first two gaps, but we haven't spent a lot of time addressing the income gap in retirement. There are three major vehicles for retirement savings: the 403(b) plans, DB plans and 401(k) plans, with the first two designed to generate income. The Pension Protection Act of 2006 essentially promoted 401(k) plans to become the most popular type of retirement savings plan in the country—but they weren't designed to perform the role that they fulfill today."

Stokes doesn't foresee sponsors embracing retirement income solutions en masse for a while. In the interim, she suggests that advisers consider "incremental plan design changes, such as making sure the IPS [investment policy statement] allows for systematic withdrawals from the plan in retirement as opposed to a lump sum distribution."

Stokes also believes that advisers should "make sure plan communications and documents highlight an income projection on employee statements to reframe their mindsets from total account value to income. Think about financial wellness solutions that have a tilt toward income projections and help participants identify what their retirement goals might be. This will begin to shift the dynamics and participants' frame of mind from simply savings."

'The Time Has Come'

Doug McIntosh, vice president of investments at Prudential Retirement in Hartford, Connecticut, thinks that the time has come for "advisers to be knowledgeable and experienced about income options" and that, certainly, retirement income solutions should be included in financial wellness programs. In fact, at the annual meeting of Prudential's top advisers, they are educated about retirement income options, McIntosh says.

Right now, there are three main approaches to retirement income, he says: best efforts, fixed annuities and guaranteed withdrawal. The best efforts include target payout funds, bond ladders and customized liability driven investing solutions. "Thoughtful asset management professionals and advisers are creating careful allocations, but there are no guarantees associated with them."

The fixed annuities are either immediate or deferred, and these provide guaranteed retirement income for the rest of the purchaser's life, and can include spousal benefits in the event of the owner's death, a set guaranteed number of years, as well as cash refund options, McIntosh says.

The guaranteed withdrawals are a hybrid of the first two and allow the owner to retain control over the underlying assets, he says.

“That is the landscape as it exists today—but we have not heard the end of it yet,” McIntosh says. “Innovation continues in this space. A lot of intelligent minds are working to expand the range of options, and we should start to see the fruits of that in the coming years.”

The Income Future

There are already some target-date funds that incorporate annuities as a person retires, but “these are geared to plans with $1 billion or more of assets,” Stokes says.

McIntosh also notes that retirement plan participants are thirsting for guaranteed income solutions. Prudential conducted an American Workers Survey this year that found 68% of workers believe public policy makers should support solutions that support turning savings into a guaranteed stream of income, and 61% said that if they were given the opportunity, they would turn part of their savings into a stream of income that would last the rest of their life. “This percentage continues to increase,” McIntosh says.

As to how advisers and sponsors can get up to speed on the options available, “the industry in general has become much more collaborative,” Hildebrandt says. “Asset managers are willing to educate people on how these products are constructed and how they are differentiated. That is an easy place to start.”

For instance, Prudential “is very supportive of solutions that help participants have sustainable income in retirement,” McIntosh says. “We believe a thoughtfully designed investment menu of guaranteed and nonguaranteed solutions is critical, and we are eager to partner with advisers who want to go down that road.”

IRIC is also a good resource, Melia says. “We have the most information and expertise on the subject and are leading the industry in terms of best practices for retirement income,” he says.