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No one rushing to add annuity income option

Despite removal of legal obstacle, plans not predicted to make major push for feature

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PIMCO's Rick Fulford believes the new law won't 'open the floodgates' for annuities offered by defined contribution plan sponsors.

The SECURE Act, which provided a safe harbor for DC sponsors, addresses only one hurdle for adding annuities to DC plan lineups.

For years, defined contribution executives have complained that one big reason for avoiding in-plan retirement income options, such as annuities or guaranteed minimum withdrawal benefits, was the lack of an adequate safe harbor to protect them from lawsuits if an annuity provider failed.

The SECURE Act, recently signed by President Donald Trump, gives them the safe harbor. So, what's next?

The law will help make sponsors more attentive to such options, according to interviews with DC consultants, providers and attorneys. However, sponsors won't rush to offer them partly because the DC industry moves slowly on innovation and partly because many hurdles — such as cost and complexity — are beyond the scope of the law.

"I don't think this will open the floodgates for annuities in DC plans," said Rick Fulford, executive vice president and head of the U.S. defined contribution business for [Pacific Investment Management Co. LLC](#), Newport Beach, Calif. "It protects sponsors in choosing an annuity provider (and) it will increase sponsors' willingness to include annuities."

The law protects sponsors if they obtain "written representations" from an insurance company/provider affirming financial health, meeting reserve requirements in all states that it does business in and is licensed to offer guaranteed lifetime income products. Sponsors aren't required to conduct their own evaluations of an insurer's health.

The law allows sponsors to evaluate many criteria in choosing a provider, and it doesn't require them to select the lowest-cost provider.

The SECURE Act "is necessary but not sufficient" to encourage the use of in-plan annuities, Mr. Fulford said. "Behaviorally, participants are not inclined to use it," owing to the structure and complexity of annuities.

Still, he praised the law because it "raises the profile on the needs of retirees."

'The first step'

The law provides "the first step" in encouraging greater use of in-plan options among DC plans, said Phil Waldeck, the Newark, N.J.-based CEO of [Prudential Financial](#) Co.'s workplace solutions group. Prudential is a major provider for DC plan lineups through a target date series that offers guaranteed lifetime income. The annuities embedded in the target-date series represent \$2.47 billion in assets. Mr. Waldeck declined to say how many sponsors offer this feature or how many participants use it.

Mr. Waldeck pointed out that target-date funds and auto enrollment weren't immediately embraced by the DC industry when first introduced. "These sorts of changes emerge over time," he said,

It took the 2006 Pension Protection Act to spur interest and usage of these features, and he hopes the SECURE Act will have a similar effect on lifetime income products. "It won't be a sprint," Mr. Waldeck said. "It will require thoughtful discussions."

Although some Prudential clients felt comfortable with existing safe harbor regulations, Prudential has found that potential clients' unfamiliarity with annuities, concerns about fees and questions about product structure and guarantees caused them to defer action, Mr. Waldeck said.

ERISA attorneys said the new law should increase interest — and perhaps some action — for adding in-plan retirement options.

"I haven't seen a real clamoring" for in-plan annuity products, said Andrew L. Oringer, a New York-based partner at Dechert LLP and co-chairman of the firm's ERISA and executive compensation group. *(See related story at [pionline.com/income](#).)*

Thanks to the law, "I think there will be a desire to expand" offering of such products, he said. "This is a very user-friendly approach, but you still have to do your homework."

Michael Kreps, a Washington-based principal at the Groom Law Group, said he has talked to about a half-dozen megaplan clients recently. "Some will dip their toes into this," he said.

Even if plans decide to act, it can take a year or more to complete a plan-design change, suggesting that 2021 will be the earliest for plans to incorporate the in-plan options, he said.

Despite the safe harbor, Mr. Kreps added, sponsors may still balk due to general concerns about litigation risk unrelated to the safe harbor. "Litigation risk makes everyone a little gun-shy," he said.

When contemplating adding an in-plan retirement income option, "sponsors have to be comfortable in justifying the product and the fees," he said. "The benefits to participants must be justified by the costs."

Not a panacea

Retirement-oriented trade groups said the new law will help the industry even though it isn't a panacea.

The safe harbor is "low-hanging fruit," said Aliya Robinson, senior vice president, retirement and compensation policy for the ERISA Industry Committee, Washington. "It's a helpful first step. It will help providers move forward in marketing to sponsors."

Acknowledging that there is "not much demand from participants," she said the law could "create a pathway to providing more education, which could lead to more interest."

Lynn Dudley praised the law for "providing clarity," but she added that it "doesn't solve the problem."

Ms. Dudley, senior vice president, global retirement compensation policy for the American Benefits Council, Washington, said sponsors will want more information about price and terms.

The law "gives the industry an opportunity to be creative," she said. "There will be a lot of innovation in the retirement space thanks to the SECURE Act."

Ms. Dudley predicted that sponsors most willing to offer an in-plan annuity or similar product will be those with experience in offering annuities or those that have defined benefit programs.

"Defined benefit plans have to offer an annuity as a form of benefit," she said. "An annuity is a common benefit form for DB plans so the plan and its fiduciaries have to be able to handle those."

Based on his experience, Robert Melia, the Pennsauken, N.J.-based executive director of the Institutional Retirement Income Council, said benefit managers who have DB as well as DC plans experience will probably be the most amenable to an in-plan annuity for their DC plans.

"I saw it firsthand," said Mr. Melia, recalling that he visited about 75 DC sponsors as vice president of product development for the retirement plan services unit of [Lincoln Financial Group](#), Radnor, Pa. "The ones who were the most receptive (to a Lincoln in-plan product) were those with defined benefit plans."

Employers with DB plan experience "understand the value of pension income, they know their participants are more secure with guaranteed pension income and they know that their plan is a better human resource management tool when it offers guaranteed income," he said.

Mr. Melia said the SECURE Act will help both the insurers and sponsors because the requirements are relatively simple. The sponsors must evaluate the unique demographics of their workforce, the type of annuity and the cost before they act, he said.

Mr. Melia added that fees for institutional annuities will be lower than retail annuities. The latter "by definition have commissions associated with them while institutional annuities offered in the DC market would not pay commissions," he said.

DC consultant Christopher Lyon shared Mr. Melia's optimism about the law's long-term impact even if sponsors choose options that aren't covered by the safe harbor law.

"Over the past year, we have seen a noticeable pickup of discussions of retirement solutions broadly defined," said Mr. Lyon, principal and head of defined contribution for [Rocaton Investment Advisors](#), Norwalk, Conn. He expects a "significant increase" in discussions with clients in 2020 about a broad range of retirement income options.

"This may include a wide array of investment products such as managed payout and target maturity bond strategies (and) managed accounts with a retirement income focus, as well as a variety of tools and education to help participants plan for and manage through the distribution phase," he said.

The law, plus more discussions between sponsors and providers, "will lead to increased product development and more choices — some with annuities and some without annuities," he said.

Retirement income options are "at the top of the minds of plan sponsors," he said. "There's a lot of interest in doing something more for participants with retirement income."

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