DConversations:

Income Solutions in Defined Contribution Plans

Secure Retirement INSTITUTE®

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As the wave of Boomers retiring continues to build, and more of them (and future retirees) doing so without the safety net of a traditional pension plan, the topic of how individuals use defined contribution (DC) plans to generate the income they need in retirement becomes increasingly important.

For individuals, for employers, and for the industry, retirement income is a critical issue. The notion of "guaranteed" retirement income, generated from existing sources of savings such as DC investments, has been historically as much a marketing effort as a bona fide attempt at helping individuals build an income stream for retirement.

For decades, DC plans (which, in the private sector, were originally introduced only to be a supplemental savings benefit) have been introduced, enrolled, communicated, and positioned as investment vehicles. The options within plans are investment options rather than income-generating vehicles.

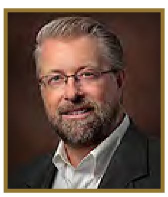
Issues such as dependable income sources for retirees and access to workplace retirement savings for more workers have moved to the forefront of national attention. However, solutions that help individuals use their DC plans and investments to create an income stream are nothing new to the market; individuals have always had the opportunity to roll DC investments into income-generating annuities, for example. In-plan investment options with attached guaranteed income building features have been available for several years, but uptake has been slow. The SECURE Act, passed in December 2019, contained provisions that were designed to help address what have been considered common challenges to adoption of in-plan guaranteed options at the plan level: Portability and Safe Harbor. SECURE also contained a provision requiring DC plans to illustrate the income stream that would be achieved from an existing DC account balance.

Secure Retirement Institute® recently spoke with several industry thought leaders, representing various product, legal, and topical organizations in the industry about the DC retirement income landscape. This series of in-depth interviews explored the pre-SECURE state of income options and expectations about how the law may impact this market.

Participating Executives, Thought Leaders, and Organizations

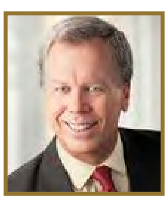
Nevin Adams,
Chief Content Officer,
American Retirement Association

Tamiko Toland,
Head of Annuity Research,
CANNEX

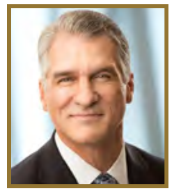


Ben Norquist,
Principal,
Convergent Retirement
Plan Solutions

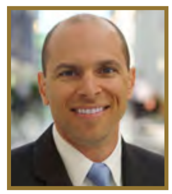
Michael Kreps,
Principal,
Groom Law



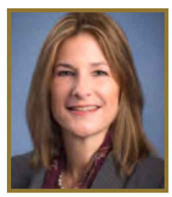
Robert Melia,
Executive Director,
Insured Retirement Income Council



Ralph Ferraro,
Senior Vice President,
Retirement Plan Services Product Solutions,
Lincoln Financial



Matt Condos,
Vice President,
Retirement Plan Services Product Development,
Lincoln Financial



Roberta Rafaloff,
Vice President,
Institutional Income Annuities,
MetLife

Sri Reddy, CFA,
Senior Vice President,
Individual Savings and Retirement Income,
Principal

Doug McIntosh Jr.,
Vice President, Investments,
Prudential

Pre-SECURE Income Space

Today there are three main constructs for using a DC plan to create retirement income:

- *Strategies or "best effort," which lack guarantees and may or may not be advisor aided.*
- *"Hybrid," or investment options within plans (with an added income-building component), which offers some upside potential, with downside income protection at retirement.*
- *"Fixed income," or the option to annuitize an account balance into a fixed annuity at retirement.*

The hybrid option has been the focus of much recent industry attention.

MCINTOSH

We think of the first main type of in-plan income solution as being non-guaranteed or best effort. And that could be as simple as, "I'm going to try and do it myself." It could be as sophisticated as having an advisor help with a laddering strategy, or using a spend-down fund, such as many of the big mutual fund players have put together.

Another bucket is the so-called fixed payout or fixed annuity option, and in this instance, you definitely do have a guarantee. What you don't have is an explicit cost and something you can actually observe. What you have is the payout, which is the inverse or the other side of the coin, relative to cost. You can't strike a daily value, so it's very hard to put these vehicles inside of a plan. One of the benefits of these for participants though, is that it's immune from interest rate moves and what the market does; the flip side of lacking a daily valuation.

Also, guarantor credit starts to matter when there's a guarantee.

Then there's a hybrid bucket, or the GMWB or GLWB bucket. There's a fee and a daily value. When there's a daily value, it can be a QDIA and there's comfort for plan sponsors in that. It's easier for advisors and participants to understand. It's an accumulation vehicle; by its very nature, it's payroll deduct. It's just another investment option.

RAFALOFF

Retirement income options have been offered by public sector defined contribution (DC) plans for many years. In recent years, we've seen the emergence of products geared toward private sector/ERISA DC plans. A range of products and solutions are being offered along the retirement income spectrum as providers seek to find features and positioning that will meet emerging plan needs and DC plan participant preferences. We view these options as part of a spectrum that ranges from maximum income flexibility to maximum income guarantees. A systematic withdrawal plan, which offers flexibility but no guarantees, would be at one end of the spectrum and an immediate or deferred fixed income annuity, which may offer limited flexibility but guaranteed income for life, would be at the other end.

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TOLAND

Years ago, there was a class of products that were meant to be market differentiators, but not really market builders, especially for smaller sponsors. And I think that hasn't been incredibly helpful because those didn't really help build, and I think there was some expectation that momentum would start.

MCINTOSH

SECURE's design is focused on ensuring that the products that exist today clearly fit into QDIA and can continue to be used in a manner that's straightforward and simple for plan sponsors.

MELIA

The introduction has been sporadic and lower than insurers and providers thought it would be. The development of products generally followed the success of the annuities that were successful in insurers' retail marketplaces. The introduction to plan sponsors was generally a sales pitch touting the benefits for participants.

In hindsight, the introduction should have been from the plan sponsors' perspective. Why should they design a plan with an income feature? Does the income feature make the plan a better human resource management tool? Does the income feature help further the organization's goals? In short, what's in it for the sponsor?

Income Solutions

	"Best effort"/DIY		Hybrid	Fixed
Examples	▪ Managed accounts ▪ Managed payout funds	▪ Systematic withdrawals (SWP) ▪ Spend-down strategies	▪ Guaranteed component on an investment option	▪ Payout annuity
Emphasis	▪ Accumulation	▪ Decumulation	▪ Accumulation/ Income	▪ Income
Guaranteed	▪ No	▪ No	▪ Yes, after a point	▪ Yes
Valuation	▪ Daily	▪ Daily	▪ Daily	▪ Benefit, not account value
Investment Growth?	▪ Yes	▪ Yes	▪ Yes	▪ No
Downside Protection?	▪ No	▪ No	▪ Yes, after a point	▪ Yes

Challenges to the Income Marketplace

Product complexity for all involved — advisors, plan sponsors, and participants — has historically hampered widespread adoption of these in-plan guarantee investment options (the "hybrid" construct). Additionally, concerns about both portability and fiduciary responsibility for the selection of a guarantee provider have limited advisor willingness to recommend (and likely by extension, sponsor willingness to adopt) these options. They are viewed as innovative yet risky, and a clear value proposition for plan sponsors has not been forthcoming. Finally, until very recently, efforts to enroll, communicate with, and engage participants in the DC experience have focused on accumulation rather than income.

NORQUIST

Complexity has certainly been a historical problem for income options, for both distribution and consumers buying them. On a positive note, employers' fiduciary concern about the liability of adding them is an area addressed by the SECURE Act.

I also think, to a certain extent, inertia is one of the big challenges. If you look back at a traditional pension paradigm; people got Social Security and pensions, people are used to looking at their accrued benefits in the context of a projected monthly income. But, when everything started evolving around the 401(k) plan and individuals, and the focus shifted entirely to that accumulation nest egg in that lump sum distribution.

Complexity has certainly been a historical problem for income options, for both distribution and consumers buying them.

One of our greatest impediments over the past 40 years has been the outsized focus on that account balance versus any form of monthly or annual retirement income-based care.

ADAMS

There have been serious efforts made to adjust product design and features to accommodate expressions of interest by participants (and perhaps plan sponsors) in guaranteed income, and there do seem to be a lot of choices. But the products themselves are still difficult to understand and communicate, tricky to "port" from one plan (or provider) to another. Perhaps most importantly, plan sponsors have never gotten over their concern about the extent of their obligation as fiduciaries for the long-term financial stability of the issuing organization (if they have any involvement at all).

FERRARO

One of the biggest challenges (to income products) is tied to COVID. It's had a significant impact on the dynamics of the DC marketplace overall. Sponsors are having to deal with the fallout of the pandemic in different ways. Small employers are just trying to keep their businesses running. That's a current challenge; it will be overcome over time as we get the economy going again.

NORQUIST

There's not a demand from the participant level up asking for it. So, I think that's one consideration. In fact, it is more of an industry push than a consumer pull at this juncture.

MELIA

Currently, the income products in DC plans are complex for participants. There's also a perception that they are expensive (when compared to management fees of institutional investments), even though they are significantly less than retail counterparts, so sponsors can be fearful of making them part of the default alternative.

There are also portability problems, and the funds often had to be proprietary product of the provider — though that is changing.

Also, the low interest rate environment caused challenges for insurers.

REDDY

Over time, we've seen employees in small businesses not even offered DC plans. You can't participate if you don't have access. When you do participate, if you're not engaged, we can't talk to you. So, you already have two ends of the spectrum that are underserved from a saving and income perspective. Another challenge is that the conversation always focuses around account balance.

Now in spite of that, there's been some level of industry uptake because plan sponsors who are paternalistic recognize that if you traditionally offered a pension plan, this may be a good surrogate for employees. But what did we learn in the last 15 years of doing this? We've learned that if you put an income option in-plan and you don't make it a default, your uptake is really low — 3 percent or less.

It's a lot of work. There's fiduciary oversight and potential risk for a very small subset of people who are taking it. And there's a debate about whether sponsors want people to stay in the plan after they retire.

The stock market also creates an interesting storm. Being conservative and mindful when planning for the future doesn't matter when the stock market is having a bull market. People wonder why they need protection when their account values are going up. People are more complex than fear versus greed. We need to focus on optimizing peace of mind, satisfaction, self-reliance, and happiness. It changes the conversation.

One of the biggest challenges (to income products) is tied to COVID.

RAFALOFF

Competition and innovation around retirement income solutions can create significant confusion for both sponsors and participants. For example, one area of experimentation, first in retail and more recently in the institutional retirement arena, is a product category called guaranteed lifetime withdrawal benefits (GLWB). This product combines systematic withdrawal with a potential income guarantee. While many participants and sponsors may find the concept of these guarantees attractive, the products may be difficult for the average participant to understand and complicated for sponsors to successfully communicate and implement.

Competition and innovation around retirement income solutions can create significant confusion for both sponsors and participants.

Behavioral Finance

Literally, every conversation mentioned behavioral finance in some measure. Overcoming participant inertia in the form of defaulting into a QDIA was a common theme. Participants also brought up how exploring income in the form of an illustration might help individuals visualize the transition from an account value to an income stream — though there was disagreement about whether it would be empowering or disheartening. The need to reframe how DC plans are positioned — from strictly accumulation-focused to a means to build and establish income, from a perceived account value to an income stream — also resonated with interviewees.

NORQUIST

A lot of it goes back to things like behavioral finance and the emotional frame. Historically, the anecdotal information you pick up from advisors is that it's a difficult sell to get someone to take a chunk of their nest egg and allocate it towards a lifetime income annuity when they view it from a loss aversion perspective. So in that simplistic way, to me, the gradual accumulation of lifetime income products versus the abruptness of making a major decision at retirement has fewer psychological barriers to it.

MCINTOSH

In our industry, the participant's super-power is inertia. Few people take the action everyone tells them is the right thing to do… so if it's a QDIA, that gets participants in automatically. The green light for auto-enroll came with the PPA (Pension Protection Act) in 2006. Then in 2007, the DOL ruled that if we add a guarantee to a vehicle that's already a QIDA, it's still a valid QDIA.[1] That was really important for plan sponsors and for participants.

[1] *Federal Regiser,* October24, 2007; https://www.fdic.gov/regulations/examinations/trustmanual/appendix_e/qdia-dinalrule.pdf (see section (e)(4)(vi, page 60480

ADAMS

If you don't make it easy — and perhaps find a way to make it a choice they don't have to make (say, a plan default), participants are unlikely to put their money there.

TOLAND

If we really want adoption, it's got to be the QDIA. The prevailing philisophy is that for anything to be successful it's got to be QDIA. In the absence of a system that overcomes participation inertia, there is no question about this.

REDDY

Human beings are resilient. They find ways to close gaps. And they can make choices that are difficult. As an industry, it's our job to help them do that and protect the things that they can't afford not to save for. So we can help them take care of non-discretionary expenses. And when factoring in Social Security and that many people retiring in the next 5 to 10 years may still have some form of a pension plan, the gap isn't nearly as bad as they might think. The $300 to $500 may make the difference. It may not be much, but there's something there.

Using Behavioral Finance to Improve Income

Reversing Inertia

Income Visualization

Framing Conversations

Plan Sponsor Perspectives

DC plans are integral to benefits programs, and key tools for employers to manage human resources. Still, there's question as to whether including an income option helps further that objective or simply adds unnecessary liability and complexity to a plan.

REDDY

If you're overseeing employee benefits at a company, if you're the head of HR or the CFO, what's your motivation to offer this?

There are three types of sponsors interested in this. Paternalistic ones that feel an obligation to take care of their employees. Then, a second type where they're reducing benefits. If they are sun-setting a pension plan and moving to a cash balance or getting rid of a cash balance plan… they want to offer an income option as a substitute to show they are giving employees something in return. The third grouping views themselves as innovators. They want to be on the leading edge and try new things. Of course, there can be, and is, overlap among these "types."

MELIA

After a careful analysis, a plan sponsor needs to determine if adding an income option or options makes their plan a better human resource tool, and Finance and the CFO support that position. If employers start to go through that analysis — and they decide that it indeed does help their organization, then sponsors will want to adopt guaranteed products within their plan and make the offering part of the default path. Pre-retiree and retiree tiering services will be important here as well.

We have reached a tipping point with sponsors. They want money to stay in plans; they see the DC plan's primary objective as generating a retirement stream of income (versus accumulating a nest egg), and they will undergo a plan design review regarding income options. Many will conclude that their plan is a better plan with income than without it.

KREPS

Plan sponsors provide these plans on a voluntary basis; they don't have to do anything more than law requires. They provide the plan as a participant benefit, or because their workers want it, or as a recruitment/retention tool. It's a labor force management tool.

And unless participants are asking and saying, "We want annuities in our plan," then sponsors are going take the lowest risk option for that plan. The CIO or the HR person who does something really creative with their plan and really makes a cool design or a cool investment product, a cool lifetime income solution, may get a little bit of kudos internally but, for the C-suite, the plan is not a priority.

There's just a reluctance in the plan sponsor community in some cases to be really innovative or to be outside the herd for fear of the litigation risk.

ADAMS

There still seems to be a lot of risk and little, if any, reward in offering these products from a plan sponsor/fiduciary perspective. Why would you stick your neck out for something that nobody is asking for, that has a reputation for being hard to understand and communicate?

TOLAND

Plan sponsors have a lot of responsibility. And it's onerous to manage these plans.

And, we're trying to make employers fix a problem that's just a fundamentally different problem. 401(k)s were never designed to replace the pension.

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RAFALOFF

For plan sponsors, facilitating the ability of participants to generate income for retirement from the plan may be as important as any program enhancement they make — particularly when you consider that retirees may spend 20 – 30 years or more in retirement. Our research shows that a large majority of plan sponsors surveyed believe that retirees need a source of guaranteed income they cannot outlive (88 percent); that increasing life expectancy is negatively impacting workers' retirement security (87 percent); and that workers are delaying retirement because they feel "financially trapped" (81 percent), according to MetLife's Evolving Retirement Model (ERM) Study, released earlier this year. Even if their plan participants aren't yet asking for them, it may be prudent for plan sponsors to explore the options that are available in the marketplace.

Sponsor Interest in In-Plan Income

Paternalistic	• Obligation to take care of employees • Income a surrogate for traditional pension
Reducing Benefits	• Eliminating DB/desire replacement • Income a replacement for DB
Innovators	• Want to be on the leading edge of benefits • Think of themselves/their plans as trail blazers

Financial Wellness

Is "retirement income" or "retirement readiness" integral to "financial wellness?" Recent events especially, have highlighted the importance of financial wellness initiatives and programs for workers. Including an income option in a DC program may help support and round out a wellness offering.

CONDOS

The industry has moved toward embracing financial wellness tools, and discussions about them will help out quite a bit. As these things converge, I think guaranteed retirement income and retirement income in general will get a boost.

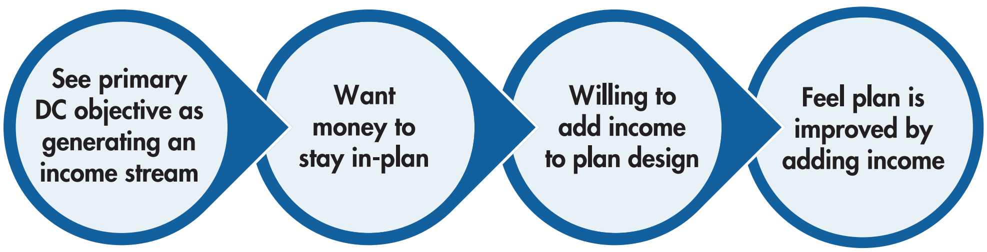
At the beginning of this year, there was a lot of talk about the SECURE Act and its implications. And that quickly turned to the CARES Act. Once we get through the CARES Act, I think we'll come back to the SECURE Act again. Certainly, what the nation and industry have been going through the past several months highlights the importance of financial wellness, so that's certainly going to come back around. When it does, we'll have some really good conversations with participants. There will be a lot more interest in a full range of solutions.

There are opportunities for recordkeepers to engage more with participants and talk about financial wellness and about how to re-generate and sustain retirement income.

Using the DC Plan to Generate Retirement Income

The decision to use a DC plan as a strategy for and to establish retirement income is not a binary yes-or-no situation. Still, it's a logical and convenient starting place.

Evolution in Sponsor Approaches to In-Plan Income



KREPS

Trying to improve the 401(k) system to include a good lifetime income solution makes it a lot easier for participants to access lifetime income through a plan than on their own.

REDDY

It's combination of in-plan and out-of-plan, or retail. Let's look at why would you want to even do this in a DC plan?

There's a cost advantage because of institutional pricing. There's a plan sponsor oversight advantage. And from a standpoint of a manufacturer, there's scale, which lowers the cost of acquisition and can pass through to even lower pricing. So, those are the reasons it makes sense in a DC plan.

But there are also reasons it doesn't make sense in a DC plan, because not every participant situation is the same and in most DC plans there's only going to be one flavor. A lot of people want options and choice, which are harder to get with an in-plan option. The other aspect of a DC plan that makes it challenging is that you're probably only looking at a portion of the participant's available assets. So in-plan might not be the best place to do it. So said differently, if someone has significant Roth assets elsewhere, trying to derive income in a DC plan, possibly forcing people to have higher taxable income when they have means testing, etc., may not the smart thing to do for the participant.

TOLAND

The education piece for the participant is critical, whether or not it's QDIA. People don't understand what the pile of money is versus an income stream. The income stream is thin. The participant has a big pile of money and that turns into this little tiny thing that comes for a long time. People don't get what the value of that is. They don't understand how it affects their retirement income planning. Making that decision is really tough. There are lot of things that they don't really understand.

In the next 5 to 10 years, I wouldn't be surprised if we see the eventful migration towards a federally-sponsored option where people might default to 25 percent or 50 percent of annuitization, but they can opt out of it. That's the type of legislative change that could really move the needle dramatically while maintaining the flexibility to give people the option to not annuitize if they don't want to.

RAFALOFF

We are starting to see more active interest in ways to incorporate guaranteed income annuities into DC plans. Plan sponsors are working with their consultants to better understand the solutions that are available.

As plan sponsor and participant comfort levels with, and understanding of, retirement income solutions increase, we expect demand to grow and that the market will respond with additional flexible and customizable solutions that give sponsors and participants more options.

SECURE Act

Provisions in the SECURE Act aim to smooth the path for the "hybrid" income-investment option by offering definition around portability and Safe Harbor protection for the selection of a guarantor. Mandated income illustrations were also included, assuming that they will help individuals better understand the transition from investment to income. Whether or not the Act will be a game-changer in moving adoption of income options is subject to different interpretations among interviewees. Still, there is some consensus that SECURE is, at least, a "good start," but that it will take time.

SECURE Act Provisions Relative to Retirement Income

§109 Portability	• Participant "keeps" guarantee • Recordkeeper change at plan level • Separation from service
§204 Safe Harbor	• Sponsor protection • Guidelines for selection/vetting of guarantee provider
§203 Disclosure	• Projects plan balances as monthly income • Waiting for DOL assumptions/common guidelnes

REDDY

Anything that moves retirement plan access, participation, and adequacy further is a good thing. SECURE attempts to do that through MEPs and PEPs, through lifetime guarantees and lifetime income illustration, having some level of affordability, and the safe harbor for plan sponsors.

Still, even though SECURE may have paved the way for more product coordination, how do you create lifetime income solutions when interest rates are at zero?

NORQUIST

I think the SECURE Act is a positive step in the right direction. I don't think it's a game changer right now, but over time it will be. It's chipping away at some of the historical barriers and increasing the profile of income, but I don't think it's going to make radical overnight changes like some law changes do.

I sense that, as a result of the SECURE Act changes, we'll see more providers in the mix, which should spur additional competitive product design. This may help in trying to solve historical dilemmas of complexity and product placement. Hopefully, we'll also see more competition in the provider market in terms of figuring out the best way to present these products within the DC plan.

I think it will help providers who can say, "Congress passed a major reform. They want to make it work. You have protections now as a plan fiduciary, and your liability is more limited because Congress sees the need for these types of solutions." So the basic concept is now tacitly endorsed, so to speak.

It's one more chapter in the story of why this is a necessary component of a holistic approach to retirement readiness. We're seeing the needle move for employers; whereas 10 years ago they were looking at simple things like deferral rates, participation rates, now they are stepping back and broadening the lens and looking from the more holistic perspective of retirees.

KREPS

It definitely stripped out the barriers to income options, and I think that's a plus. You still have to convince the employer that they should exercise their own discretion to put people into a fund that, because it has guarantees, has higher fees. So, there's still litigation risk; the normal stuff they'd be worried about.

FERRARO

The SECURE Act will provide the effect we need, but it's going to take time. SECURE is probably the most significant piece of legislation going back to the PPA in 2006.

Looking at target dates and QDIAs coming out of PPA; they took time to grow. It's been a slow steady growth, so now 10 years in you have $1.5 trillion. In-plan solutions won't spike just as target dates didn't spike, but they more likely grow at a healthy rate.

We need to be able to figure out how to communicate more effectively the value — for participants — of an in-plan guarantee to plan sponsors, consultants, and advisors. And not just communication, but figure out how we come up with some kind of measure for that value, because too much of the focus has been on cost and not recognizing the value of the benefit.

This needs to fit into and leverage all of the benefits and the lessons we've learned from automated plan design options since passage of PPA. Starting with the premise that just as we do auto-enrollment and auto-escalate, we also need to create a default solution. They can opt out if they want to do something different, but we need to set them down with guardrails and a prescribed path forward.

It's the next phase in plan design: Auto Income.

We needed the government to give us safe harbor on QDIA Income. We're comfortable that the inclusion of a guarantee component with the current construct of a QDIA, a target date, a managed account, or a balance fund doesn't affect its qualification.

It's the next phase in plan design: Auto Income.

MCINTOSH

SECURE's design is focused on ensuring that the products that exist today and clearly fit into QDIA can continue to be used in a matter that's simple and straightforward for sponsors.

SECURE is having some very important effects. Advisors are waking up and asking about income again; there are advisors who use it as a differentiator. And sponsors feel very differently now. We've had a lot more interest from sponsors and are sending out more letters of representation as a guarantor.

TOLAND

Historically there are so many things in play with these options. Does SECURE Act hurt? Absolutely not. Does it help? Yes. But it's not going to be the big thing that changes everything. There's so much else to address. Well, we need a whole lot to happen, and some of it is legislative, regulatory. Some of it has to do with systems. Some of it has to do with understanding what the needs of the sponsors are. And there are a lot of different pieces. A lot of it is back office.

ADAMS

It's a step in the right direction, but I think the differences are on the fringes. It may reinforce a positive inclination to embrace the option, but I doubt it will change many minds.

RAFALOFF

The SECURE Act has the potential to be a game changer but right now we are only in the first inning and many of the key players are distracted by the global pandemic. With SECURE, the fiduciary barriers have been lifted and the number of employers offering guaranteed lifetime income options is expected to grow. However, we expect it will take some time to gain traction, especially with a current focus on the effects of COVID.

Income Illustrations

Like overall reactions to the SECURE Act, reactions are mixed about the impact of income illustrations. Will they create a groundswell demand from participants for help creating retirement income? Do they need more data points, and projections including ongoing contributions, for example, to be truly effective? Will participants be underwhelmed by the "size" of the income stream they may achieve from an existing account balance?

REDDY

I do think as people's awareness grows, they will start to translate a balance into income. I'm hopeful it will force more people to think about how to transition to a convertible income stream. How do they make it sustainable? My fear though, is the reverse. If someone has $100,000, and you show them that they're going to get $300 a month, will it be so off-putting that they'll just stop saving?

CONDOS

When the disclosure comes into play, when people get lifetime income illustrations but don't have it in their plans, that could create a grassroots effort to push for inclusion of that benefit in plans.

RAFALOFF

We believe that including lifetime income disclosures on DC benefit statements will have two important effects: First, it will help reframe the purpose of a DC plan from a savings plan to a retirement income plan and, secondly, it will encourage participants to save more in their DC plan once they realize how much income their savings can generate. We are hopeful that the disclosure will be in simple, easy-to-understand language for the plan participant. If kept simple, annual lifetime income disclosures like the benefits statements provided by the Social Security Administration can become one of the most instructive educational tools that can be provided to DC plan participants.

NORQUIST

For the average person, it's a huge challenge to take a lump sum balance and do any type of meaningful mental conversion to what it means in terms of retirement security or retirement income. So I think that simple step of starting to see it presented a different way annually, over time will start to have an impact.

If kept simple, annual lifetime income disclosures like the benefits statements provided by the Social Security Administration can become one of the most instructive educational tools that can be provided to DC plan participants.

KREPS

I actually think that that is going be very helpful for people. It's tough to get data around the effectiveness of it, but these are really retirement savings programs at their heart. And the point of a retirement savings program is to produce income in retirement.

I think when people see a $100,000 account balance it seems big, but when it only generates a few hundred a month in retirement, it doesn't seem so big. Reframing that could help people better understand their actual financial positions.

ADAMS

Lifetime income equivalency results are already being presented for three of the four 401(k) accounts in which I still have a balance (albeit not with DOL assumptions) , and I assume for millions of other participants - and have been for some time. Despite concerns that there will be an adverse reaction, or hopes that there will be encouragement to save more/differently, I've heard/seen no wave of response, positive or negative as a result. But being on the participant statement can't hurt - and it may well provide an opportunity to have those discussions.

TOLAND

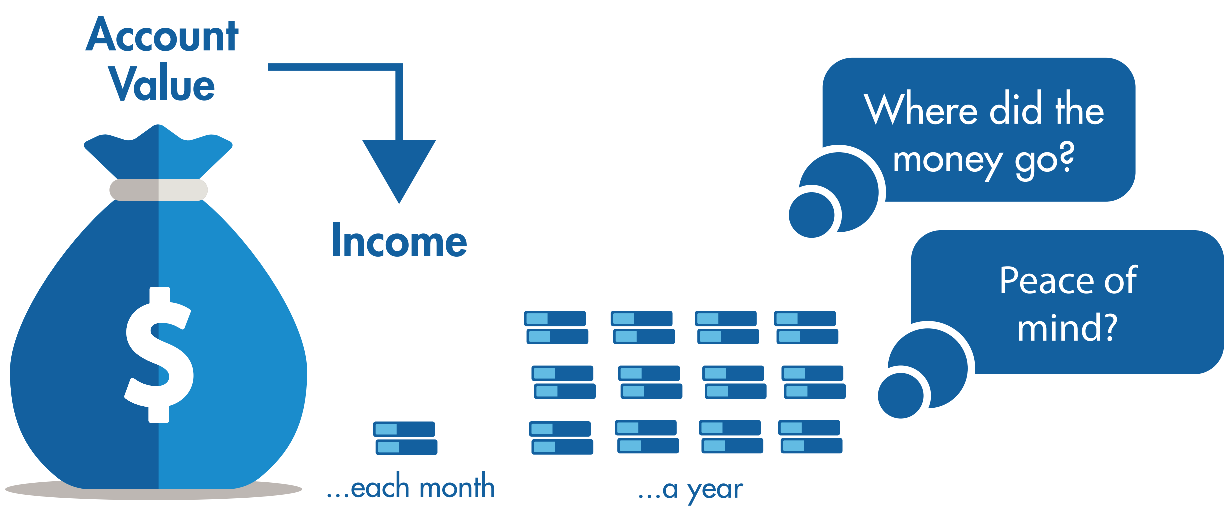
I do think also that the lifetime income disclosure is really important. I think that it solves the argument about the best way of doing it. It obviates the need to determine what is a reasonable set of assumptions around the money. Just tell people how much money they can get in an income stream.

And I also do feel strongly that knowing, based upon the amount that someone's currently saved, what that will be in income is helpful because it provides context. It can also be motivating to see how much more you really need to save to generate the income stream you want.

FERRARO

It's going to depend on the methodology. If we're only going to illustrate what the current balance is and what that turns into income, some of those numbers early on will be very small. And they won't provide the type of positive reinforcement that we need, even from a default perspective. But if we can show a projection of what the balance may grow to over time, that could be a really positive reinforcement.

Income Illustrations: Shifting the Conversation and Participant Perceptions



Portability and Safe Harbor

Portability and Safe Harbor were included in SECURE to address these two common-wisdom sponsor obstacles to including income in their DC plans. Several interviewed feel that these provisions go hand-in-hand, each magnifying the other's effects. Another mentioned that these provisions may now "turn the tables" and make including income the responsible design decision from a fiduciary perspective, while another questioned whether sponsors will find new objections to income options.

MCINTOSH

Portability is much more important now that Safe Harbor's stronger… portability will matter more.

CONDOS

These two provisions have a multiplier effect because they're packaged together in the SECURE Act. If only one of those was included, it might be a help but nowhere near the power of when both of them are combined. Safe Harbor might get sponsors over the fiduciary hump, but they won't implement without portable solutions. Likewise, if there were portable solutions but without fiduciary relief, they probably wouldn't implement it either. So it was very important to have those things combined here.

FERRARO

Before the SECURE Act, the fiduciary concern for the sponsor in selecting the guarantor was the predominant obstacle to adopting an in-plan solution. For the small- to mid-sized employer that might not have the resources to have done the evaluation on an insurer, the annuity safe harbor and the ability to rely on representations of a company like Lincoln is a huge benefit to them. It removes a major, major obstacle. The large mega-employers probably have had more resources over time to look at this, but this will probably still offer some benefit. The twist on it is that potentially, now large mega-plan committees will feel a fiduciary responsibility to make sure they are actually giving consideration to an in-plan solution. Portability is another important component, because we know that very few people work at the same company for their entire careers. Addressing both of these, as the SECURE Act did, is key to the adoption of in-plan solutions.

RAFALOFF

I believe the two most important provisions for expanding the use of lifetime income options are the fiduciary safe harbor for selecting a lifetime income provider and disclosure regarding lifetime income.

For many years, those in the insurance industry advocated for a workable annuity carrier selection safe harbor for 401(k) plans to permit reliance on state insurance regulators to confirm insurers' financial strength. This allows plan sponsors to focus instead on provider and product selection process requirements, as is customary with other fiduciary safe harbors.

This new safe harbor utilizes state insurance regulators and an annual certificate provided to the employer confirming an insurer's solvency. We think that will be effective in expanding the offering of guaranteed lifetime income products. This simplifies the insurer review process for employers, negating the need for them to conduct an ongoing review of an insurer's capital requirements, liquidity, and solvency. Instead, the employer is able to rely on written representations from the insurer.

The twist on it is that potentially, now large mega-plan committees will feel a fiduciary responsibility to make sure they are actually giving consideration to an in-plan solution.

ADAMS

Acknowledgement of the portability issue likely serves only to remind sponsors that were on the fence of the potential complications ahead. Safe harbor effectiveness ultimately depends on how the extension of the safe harbor is perceived. Mostly, I think the operational impediments – perceived and/or real – will continue to impede widespread adoption.

KREPS

Fiduciary isn't the only concern — it is one of a series. There are material legal questions that remain about how lifetime incomes products are structured, and how they operate. At Groom, with our clients, we've worked through those issues and have a pretty good handle on them.

For example, the technical operation of the rules and getting spousal consent, and insurance pricing, in light of the fact that people can get married anytime, becomes a little difficult to work through. Also, most lifetime income products have some sort of age restrictions. Those age restrictions then necessitate that the employer do testing to confirm that they don't benefit highly compensated employees. That is easy in large plans, especially with auto-enrollment. It's tougher in small plans, because then there's a high probability that there's only the CEO or only senior management in a lifetime income option, and that results in a failure of that testing.

I think the shorter version is that the law really tries to ensure that the plans don't discriminate in favor of the C-suite. And those rules are a little bit incompatible with the good intentions of lifetime income product providers.

REDDY

I think it's too early to tell. Here's what happened. The industry asked for portability and asked for safe harbor for plan sponsors because those are the objections you were getting. How do you go from recordkeeper to recordkeeper until a solution was introduced? I wonder if sponsors will find other reasons not to adopt these options.

MELIA

Portability and primary fiduciary concerns have been solved by SECURE.

KREPS

In its simplest terms, safe harbor says, "You have to prudently vet the product including the fees and services. It doesn't have to be the cheapest product, but you do need to vet it." So it's pretty easy for the employer to ask that question and get the list of documents.

And it's kind of like automatic enrollment, you could do automatic enrollment prior to 2006. But we didn't get broad adoption until Congress made the fiduciary safe harbor for default investment.

With the portability issue, Congress did a good thing by saying, "Look employer, if you decide that you no longer want to offer this lifetime income product, your participants can essentially take a rollover of the guarantees to their IRA." Improving the portability on the legal side is really helpful because, for the plan sponsors, it solves for the risks if they change their minds.

TOLAND

Figuring out portability, from a technical perspective, is huge. Figuring out how you hook all these pieces up is not easy to do. Coming from a DCIO mindset, which is really much more commoditized, moving mutual funds around, knowing how much you have is super easy. Doing the same thing with annuities is not at all easy. And there aren't existing tracks to use. So solving for portability will need a tremendous shift of mentality.

Innovation & Looking Ahead

SECURE, with provisions that offer some protection and clarity, can open the door to innovation and new players in the market. Technology and FinTech may well play a role in next generation options.

TOLAND

I think we're going to see innovation. The market will respond to some level of demand, but right now the demand is not applying pressure for innovation; it's coming from the other side as the industry tries to figure out solutions.

KREPS

There's a fair amount of innovation in the market place. The legal structure is just very difficult to work in, but as plan sponsors are coming to understand this better and become more comfortable, the legal community is solidifying its view of various structures and arrangements. The older (income) gets, the more comfortable we get and the more likely the industry is to embrace it. Nobody wants to be the first one to take a medicine, but, five years later, 20 years later, everybody is okay with it.

There have been bills in the past that mandate that retirement plans have a lifetime income option, so that could always happen. It's unlikely in the short term, but we never know.

So I could theoretically see some future Congress saying, "All plans have to have a lifetime income solution." But I can't see it saying, "All Americans have to use it."

It is also important that annuitization is not an all or nothing proposition. Many individuals should consider purchasing an income annuity with only a portion of their retirement savings. Offering simple solutions enables participants to do this easily.

RAFALOFF

While it may be tempting for plan sponsors to believe they should alleviate potential participant objections by offering products with many features, including those structured as investment products, simplicity has proven to be a more effective guiding principle for the decision-making process. This is important because participant behavior has consistently shown that complexity, such as too many choices and features, often leads to participant inertia (i.e., avoiding taking any action).

It is also important that annuitization is not an all or nothing proposition. Many individuals should consider purchasing an income annuity with only a portion of their retirement savings. Offering simple solutions enables participants to do this easily.

CONDOS

It's a great opportunity for advisors in the DC space to be able to help their plan sponsor clients. They are looking for ways to differentiate their practice and here's a great opportunity. We've seen a huge uptick from consultants and advisors.

MELIA

Trying to gauge the effectiveness in terms of AUM, take rate/adoption rate and other quantifiable prognostications is difficult. After 5 – 7 years, I think a conservative estimate is that a quarter to a third of the DC money that currently gets distributed each year will be halted. These assets will remain in the DC system and will be distributed via the guaranteed income option or other institutional income solution adopted by plan sponsors. So in a given year, if 10,000 Boomers leave the DC system on any given day with an average of $100,000, in a year's time approximately $350 billion to $400 billion leaves the DC system. It would be nice if $150 billion was retained each year within the DC system.

Tontines with modern day features seem to pop up occasionally. Congressman Neal's bill "Automatic Retirement Plan Act" that requires plan sponsors to offer a retirement income solution could find its way back into consideration. That bill requires sponsors to offer a guaranteed income solution for at least half of a participant's balance. Sometimes what is in legislation has a way of becoming 'best practices,' where existing plans that are otherwise grandfathered from adopting this feature end up adopting it despite the grandfathering. Higher interest rates would help as well.

ADAMS

It will be uphill. Advisor interest/support seems even lower than plan sponsors - who, industry surveys notwithstanding, continue to maintain that this is not an option for which participants are pressing. I don't see much in sight for the next decade, barring some sort of government mandate.

NORQUIST

The alchemy of behavioral finance, artificial intelligence, and FinTech, collectively, I think are going to allow the industry to become better. Over time, the industry will figure out how to present these options in a way that helps individuals make good choices, and also helps them to better appreciate their value.

Bonus Insight:
MEPS/PEPs/PPPs and Income?

Like many discussion topics, especially the impact of SECURE overall, MEP/PEP/PPP clarifications are seen though different lenses. Some feel that they will help greatly in expanding coverage, and that including income options in a PEP design may help expand this market. Others opine that the new construct of PEPs/PPPs will not take off.

MELIA

To the extent that providers and MEPs/PEPs want to differentiate to sponsors how their plan will improve with a MEP/PEP, income solutions could be a good way for MEP/PEP to innovate and differentiate.

NORQUIST

I do think PEPs are a game changer, so I'm very bullish on the opportunity for PEPs to shake up the market, generate some good innovation and expand coverage. But in terms of a direct correlation between that and lifetime income solutions, I don't see connection yet. I suppose to a certain extent, it depends on which providers — big national entrenched providers — stake out a claim in that market and go after it aggressively. The players could make a big difference in that respect. Once you get the right provider with the right product mix, that can really exploit the opportunities of the PEP market.

KREPS

I worked on that legislation for years and was pretty happy it got over the finish line. But I will tell you that its impact is still to be determined. It doesn't do very much. There's a marketing opportunity, but even inside the marketing, from a legal perspective, it doesn't do very much. You could pool assets prior to the SECURE Act, you could do the whole thing, the only challenge would be that it wasn't treated as a single plan and you'd need to file lots of annual 5500s. There had to be multiple bonds. There were little administrative things. All the legislation does is say that you can treat this as one plan. So there's one 5500 every year — that's it. There's not much more. I think it still remains to be seen whether there will be a robust PEP marketplace.

ADAMS

PEPs might get (income) past the plan adoption barrier, and that might mean some movement. But I don't even see MEP/PEPs as being a big game changer for plan adoption overall.

The Secure Retirement Institute® was established in 2013 with the goal of providing comprehensive, objective research and education to help improve retirement outcomes. Our research agenda covers all aspects of the industry and examines issues related to saving, investing, and generating retirement income.

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