From Auto-Enrollment to Auto-Escalation to Auto-Income: How DC Plan Defaults Can Evolve to Improve American Retirement Security

Evolving solutions available to sponsors, addressing fiduciary and portability concerns, and next steps for plan sponsors, recordkeepers, insurers and consultants

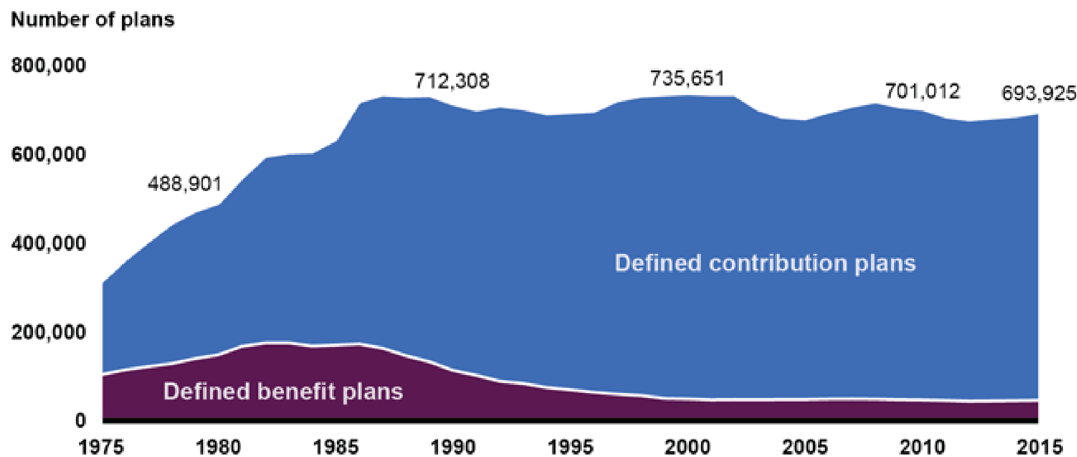
IRIC
INSTITUTIONAL RETIREMENT INCOME COUNCIL

"As the big bulge of baby boomers head into old age, as many as half are coming face-to-face with a new American economic reality: Retirement means a descent into relative hard times, because the systems put in place when this generation was just entering its peak earning years have failed. And one way or another the whole country will feel the consequences."

—The Washington Post[1]

According to the U.S. Government Accountability Office, "fundamental changes have occurred over the past 40 years to the nation's current retirement system, made up of three main pillars: Social Security, employer-sponsored pensions or retirement savings plans, and individual savings. These changes have made it increasingly difficult for individuals to plan for and effectively manage retirement. In particular, employers have shifted away from offering traditional defined benefit (DB) pension plans to offering defined contribution (DC) plans, such as 401(k)s, as the primary retirement vehicles. This shift to DC plans has increased the risks and responsibilities for individuals in planning and managing their retirement. In addition, economic and societal trends — such as increases in debt and health care costs — can impede individuals' ability to save for retirement."[2] As recently as 1979, nearly 40% of private sector workers participated in an employer-sponsored DB plan, whereas by 2017, that number had dropped to well under 5%.[3]

Figure 1. Trends in Private Sector Retirement Plans Since 1975[4]



Source: GAO analysis of data from the U.S. Department of Labor. | GAO-18-111SP

Although DC plans were previously designed to serve as supplemental savings vehicles, they have evolved into the primary accumulation vehicle for many Americans' retirement savings. Amending their automated features is critical to the well-being of future retiree generations. Automated features are important because participants often trust their employers and focus less on long-term financial planning, resulting in greater acceptance of plan defaults. Particularly critical to the equation of American retirement security will be our retirement income experts' ability to help more participants connect with sources of income they can't outlive to successfully manage basic expenses and perhaps more.

IRIC would like to thank the following members and industry professionals who assisted in the drafting of this paper:

- **Michelle Richter** – Fiduciary Insurance Services, LLC
- **Geoff Dietrich**
- **Nneka Landrum**
- **Phil Maffei**
- **Olympia Moukas**
- **Jeff Rudloff**
- **Martha Tejera**

[1] https://www.washingtonpost.com/business/2020/05/04/baby-boomers-retirement/

[2] https://www.gao.gov/products/gao-18-111sp

[3] https://www.ebri.org/docs/default-source/fast-facts/ff-329-retplans-6jun19.pdf?sfvrsn=82ae3f2f_4

[4] https://www.gao.gov/products/gao-18-111sp

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In this vein, Charles Millard, former head of the Pension Benefit Guaranty Corporation (PBGC), is quoted as saying in Pensions & Investments: "Employers that offer 401(k) type plans should be required to automatically enroll workers in an option that provides lifetime income. Only then will employees finally have lifetime security in 401(k) plans that is similar to the lifetime security in traditional pension plans."[5]

> "Employers that offer 401(k) type plans should be required to automatically enroll workers in an option that provides lifetime income. Only then will employees finally have lifetime security in 401(k) plans that is similar to the lifetime security in traditional pension plans."
>
> *—Charles Millard, former head of the PBGC*

Moreover, a popular "discussion draft" bill, circulated by Rep. Richard Neal, chairman of the House Ways and Means Committee, would go even further along this path, requiring that at least 50% of every vested account in a 401(k) or 403(b) plan must be available for distribution in a form that provides guaranteed income for life.[6]

Improving access to guaranteed income sources may prove particularly timely, given the shaky ground on which Social Security currently sits. If reserves in the Old-Age and Survivors Insurance (OASI) trust fund are depleted, which is currently on track to occur around the year 2030, all Social Security recipients — both current and future — would only receive approximately 75% of their promised benefit.[7]

Given the current lopsidedness of the historical three-legged stool of American retirement, auto-income — the practice of defaulting a portion of DC account balances into investment vehicles that make protected lifetime income a default from which participants could opt out — could well prove to be an appreciated plan benefit. Some employers have previously been reluctant to implement auto-enrollment and auto-escalation of plan contributions because they feared employees would either be unaccustomed to or dislike these features. However, most employees in a survey conducted by Principal Financial Group feel good about the retirement plan doing some of the work in increasing retirement savings for them through features like automatic enrollment and automatic escalation. Specifically, Principal's study found that:

- 90% of participants stay in the plan once they're automatically enrolled.
- 83% of employees say they're okay with automatic enrollment at a 6% deferral percentage.
- 42% of participants say automatic features helped them start saving for retirement earlier than if they had to enroll on their own.[8]

Given that almost half of Americans — 49% — cite running out of money as their chief retirement concern,[9] perhaps the time for auto-income has arrived.

A Review of the Qualified Default Investment Alternative (QDIA)

The Pension Protection Act (PPA) signed into law in 2006 removed impediments to employers adopting automatic enrollment plans. Such impediments included the possible legal liability of investment fluctuations and concern that automatically enrolling participants would need to comply with state laws for wage garnishment and wage withholding. To soothe plan sponsor concerns, the PPA contained two important provisions:

1. The act removed any legal liability regarding state garnishment laws that might prohibit automatic enrollment and created a clear exemption in ERISA permitting automatic deferrals.
2. The act provides relief for fiduciaries who must select the default investment for automatic enrollment and directed the Department of Labor (DOL) to issue regulations that provided automatic 404(c) protection to the fiduciary's selection of default investments. Thus, sponsors would not be liable for losses incurred if the plan sponsor adhered to the rules set out by the DOL.

[5] https://www.pionline.com/industry-voices/commentary-its-time-make-401k-plans-real-pension-plans

[6] Ibid

[7] https://www.ssa.gov/oact/trsum/

[8] https://www.principal.com/businesses/trends-insights/why-your-401k-needs-automatic-escalation

[9] https://www.aarp.org/retirement/planning-for-retirement/info-2019/retirees-fear-losing-money.html

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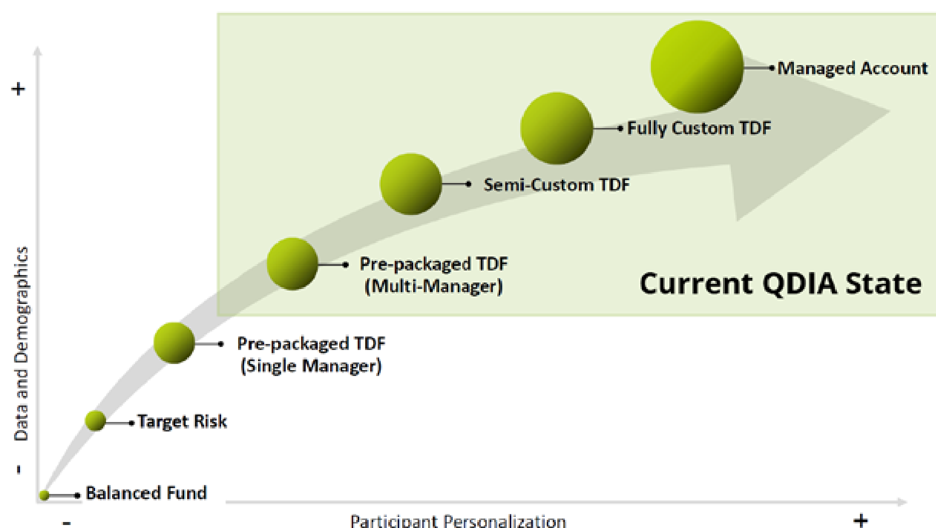
Figure 2. QDIA Evolution to Customization



In issuing the regulations for automatically deferred contributions, the final regulations provided that a number of conditions needed to be met in order to obtain safe harbor relief from fiduciary liability. Those requirements included a provision that assets must be invested in a QDIA as defined in the regulation, and participants must be given several notices and disclosures providing them the ability and the information needed to change their investments if they so desire. If met, plan fiduciaries are not liable for any loss that is the direct result of investing all or part of a participant's or beneficiary's account in any QDIA.

As a result of the PPA, target-date funds (TDFs) became the predominant QDIA and the subject of ensuing QDIA regulations. In 2002, most plans did not have a TDF, and many plan sponsors were unaware of these new innovative investment funds. Some 10-plus years later, in 2013, TDFs reached the $500 billion mark. By the end of 2020, TDFs continued to be a popular QDIA and investment option, with assets reaching $2.8 trillion and 93% of plans currently using them.[10]

In 2006 and 2007, U.S. legislators and regulators — seeing the societal benefits of automatic deferrals and diverse, customizable default investments — cleared obstacles to plan sponsors offering retirement security by shielding them from liability with respect to these choices. A variety of new legislation, letters, rulings and guidance is now called for to again promote the public good of additional retirement security by authorizing and promoting guaranteed income within a plan's QDIA. Specifically, we note the following:

- The original QDIA regulations addressed annuities somewhat narrowly, by stating that an investment that otherwise meets the requirements will not fail to be a QDIA because the QDIA is offered through a variable *annuity or similar contract.*
- In 2014, Treasury and the EBSA (see IRS Notice 2014-66 and EBSA companion letter) issued favorable regulations and guidance by authorizing the use of guaranteed income in the form of deferred fixed annuities as part of a plan's QDIA. Phyllis C. Borzi, the assistant secretary of labor, stated in her letter to Treasury that: "The use of unallocated deferred annuity contracts as fixed income investments, as described in the Notice, would not cause the Funds to fail to meet the requirements of the QDIA regulations. It is also the Department's view that the distribution of annuity certificates as each Fund [reaches] its target date is consistent with the QDIA regulations."

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—Phyllis C Borzi, former assistant secretary of labor

[10] https://www.willistowerswatson.com/en-US/Insights/2019/04/qdia-evolutions-moving-defined-contribution-plans-into-the-future

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- In a 2016 letter issued to TIAA by the DOL, the department affirmed that transferability restrictions of an annuity contract included in a TDF would cause the TDF to fail to be a QDIA. However, the letter went on to say that a reasonable plan fiduciary could prudently select as a default fund an investment with guaranteed lifetime income elements *even if the lifetime income did not have full transferability or liquidity.* The department noted that if the investment complies with all the QDIA regulation requirements except liquidity and transferability restrictions, a plan sponsor could still prudently select such an option as the plan's default investment.
- Finally, in the SECURE Act of 2019, plan sponsor liability was again significantly ameliorated with the annuity safe harbor provided in the SECURE Act. Specifically, the legislation provides that: "A fiduciary which satisfies these requirements listed above shall not be liable following the distribution of any benefit, or the investment by or on behalf of a participant or beneficiary pursuant to the selected guaranteed retirement income contract, for any losses that may result to the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the terms of such contract." Such limitation of liability is provided to fiduciaries/sponsors for any guaranteed income product offered either inside the plan's QDIA or as a stand-alone investment option. Additionally, the liability protection is provided both for the initial selection of the insurer and the ongoing monitoring of the insurer with a straightforward safe harbor testimony by the insurer to the sponsor.

"A fiduciary which satisfies these requirements listed above shall not be liable following the distribution of any benefit, or the investment by or on behalf of a participant or beneficiary pursuant to the selected guaranteed retirement income contract, for any losses that may result to the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the terms of such contract."

—The SECURE Act of 2019

As was done in the past, policy makers are looking to partner with businesses/plan sponsors to promote the societal goal of retirement security by issuing regulations, guidance and legislation that protects sponsors from liability in exchange for an efficient delivery of guaranteed retirement income. Our DC system can efficiently deliver income solutions. Integrating income solutions into a plan's QDIA will significantly increase America's retirement security by defaulting participants into an institutional solution selected by a fiduciary that can utilize the bargaining power of the plan's assets, thereby delivering additional income to plan participants. As such, we believe that there is at least one more chapter to be written in the history of QDIAs, and it is starting to be written by innovative companies and their service providers determined to bring forth the next generation of QDIAs that deliver not only professional money management during the accumulation phase of a worker's life but also retirement assurances during the decumulation phase via the integration of guaranteed income into plans' QDIAs. According to market research firm Cerulli Associates, the majority (92%) of firms expect managed payout options and annuity allocations will be incorporated into future target-date fund series, so it behooves all market participants to prepare for these trends.[11]

Figure 3. Offer Better Retirement Income Options[12]

[11] https://www.cerulli.com/news/recent-regulatory-developments-open-target-date-funds-to-lesser-used-investment-products

[12] https://insights-north-america.aon.com/defined-contribution/aon-driving-dc-plan-success-us-summary-screen-survey

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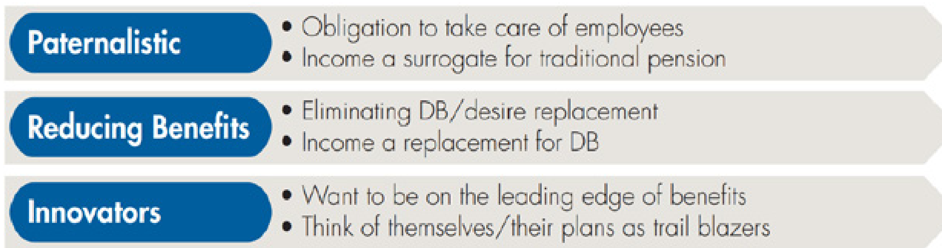
Figure 4. Sponsor Interest in In-Plan Income[13]



Are DC Plans for Savings or Retirement Income?

With retirees living longer, more sponsors are revisiting the purpose of their DC plans and asking a central question: Are plans only for supplemental savings, or have we established them to help participants draw a meaningful retirement income for life?

Clearly, the need for lifetime income is strong and growing, and plan sponsors looking to move in this direction have a lot to consider if they want to deliver customizable income solutions that work for every participant.

Design flexibility is important, such as the means to "buy into" income guarantees over time with some added protection from market downturns.

There are softer but equally impactful benefits, such as giving participants peace of mind that they'll be able to retire when they want and on their terms. With 56% of participants in our survey saying their top savings goal is to ensure a secure retirement income, an in-plan option with hands-on control can also be an effective tool for employers to recruit and retain talent.

As fiduciaries, plan sponsors that offer an income solution throughout the working years can also build participant appreciation and trust in it, as opposed to something made available at retirement from a source outside the plan. And because in-plan options accompany participants over a long time period, plan sponsors can provide ongoing education and guidance to support employees and help them customize their savings strategies.[14]

Participant engagement is also key. As the industry ramps up to address the growing need for strategies to help participants begin drawing income from their accounts, it's increasingly clear that both employees and sponsors overwhelmingly find guaranteed income options appealing. Participants have further demonstrated they want something simple, certain and controllable. As we see it, plan sponsors should give these solutions strong consideration.

"[B]ecause in-plan options accompany participants over a long time period, plan sponsors can provide ongoing education and guidance to support employees and help them customize their savings strategies."

Employer Advantage to Offering QDIAs That Include Annuities

According to a recent white paper published by Micruity, Inc.:

> For much of the 20th century, a [DB] pension plan was not only an employee benefit, it was perceived as a right. Many workers — probably most workers — planned their retirement around a guaranteed monthly paycheck from their former employer. But DB plans, more commonly known as pension plans, did not survive the leap into the 21st century. It is rare for a retiree to have a pension benefit in today's environment and the new generation of workers likely don't even know what a pension plan is. Defined contribution plans have become the standard tool to financially prepare for retirement. In truth, DB plans were incredibly valuable beyond just the guarantee. A DB plan provided security to participants while they

[13] https://www.limra.com/siteassets/research/research-abstracts/2020/dc-conversations-income-solutions-in-defined--contribution-plans/2020_incomeconversationresearchsummary-research_briefing.pdf, p.4

[14] https://seekingalpha.com/article/4411289-as-retirement-income-needs-grow-dc-plan-sponsors-weigh-solutions

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were still working, it provided confidence when folks retired, and it provided a low-touch experience. Can a DC plan do all these things? At Micruity, we believe it can, but it won't be as simple as annuitizing a portion of a plan participant's assets at retirement. To build security, instill confidence, and to create a frictionless user experience, the industry needs to be thoughtful about the products they offer.

Consider an investment vehicle that provides a drawdown strategy to get a plan participant from retirement to age 85, when they start to receive a monthly paycheck from an insurer. Compared to a DB plan, this approach offers:

- Security — the projected outcomes can be clearly communicated
- Confidence — by sticking to the spending schedule, they get to the known guarantee
- A seamless user experience — including education, ease of purchase for the guarantee, ongoing communication of the drawdown strategy and insurance guarantee

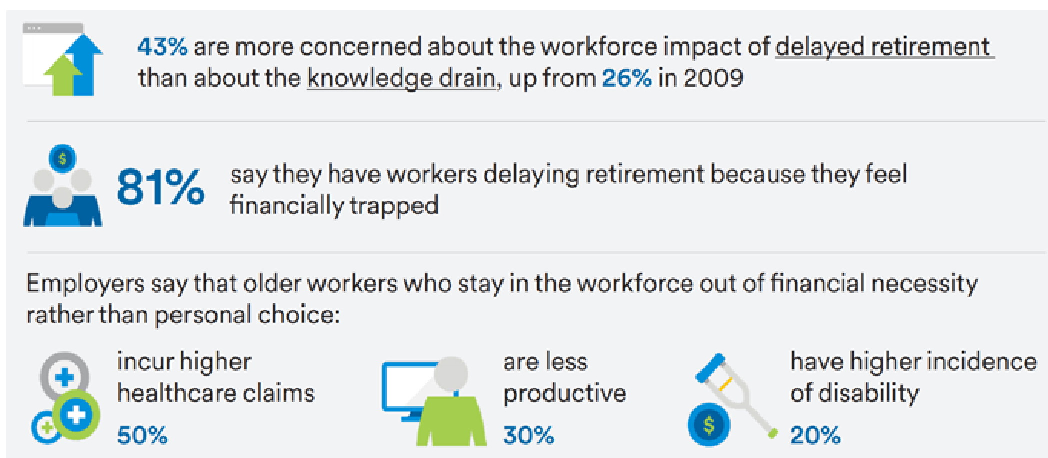
However, this approach fails if the model doesn't deliver the intended results. At Micruity, we believe Americans deserve simple and secure solutions that provide financial confidence in retirement.[15]

Importantly, from the perspective of the employer, DB plans were effective HR management tools and valuable benefit plans. But they also introduced material concerns for employers, including the cost of providing lifetime income to former employees enjoying ever-longer longevity, the costs of contributing to the PBGC to cover the possibility of plan failure as pension costs rose, financial statement volatility not correlated to the employer's core business and a societal trend toward job mobility causing employees to work for many employers during their career, thus reducing the value of lifetime income benefits earned via tenure with one employer.

> "[I]ncluding guaranteed lifetime income in plans can help employees retire when they want to and, in so doing, mitigate costs associated with retirement in place."

Annuities are the only privately available product that can provide a lifetime stream of income, as was enjoyed by DB recipients. Annuities offered in DC plans give employees the opportunity to lock in a lifetime income stream without introducing for the employer the above-mentioned risks and obligations of DB. Furthermore, including guaranteed lifetime income in plans can help employees retire when they want to and, in so doing, mitigate costs associated with retirement in place.

Figure 5. Employer Concern About Delayed Retirement Has Grown[16]



[15] https://micruity.com/wp-content/uploads/2021/05/Micruity-IncomeConnect.pdf

[16] https://www.metlife.com/content/dam/metlifecom/us/homepage/evolving-retirement-model-study/key-findings/Impact-of-Delayed-Retirement.pdf

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According to research from Prudential Insurance Company of North America, a one-year increase in average retirement age results in:

- Incremental annual workforce costs of about 1.0%–1.5% for an entire workforce. For an employer with 3,000 employees and workforce costs of $200 million, a one-year delay in retirement age may cost $2 million to $3 million.
- An incremental cost of over $50,000 for an individual whose retirement is delayed. This represents the cost differential between the retiring employee and a newly hired employee.

This is before considering the psychological cost to employees of feeling forced to work once they would prefer not to. Helping align the goals of employers and employees results in improved outcomes for all parties.

Here are some best practices for employers to help their employees be financially secure so they may retire on time:

- Consider adopting retirement programs with features that help employees retire on time.
- Provide education to help employees proactively make informed financial decisions.
- Adopt a holistic approach to improving employees' financial wellness.
- Consider using data analytics to customize the cost of delayed retirement analysis for your organization."[17]

With 81% of employers offering only DC plans to new hires, the stakes have never been higher for DC plans to facilitate successful retirement outcomes for American workers.[18]

Lastly, through-retirement solutions that include annuities can help to retain assets in plan — thus lowering recordkeeping costs for all participants — and can potentially reduce the risk that in the future, plans may be viewed as inferior or uncompetitive if guaranteed income options are not included, particularly once the DOL requirement to translate account balances into guaranteed income on participant statements becomes effective later in 2021. Participants will expect to be able to effectuate converting their retirement balance into retirement income once this requirement is finalized.

Auto-Income as a Financial Wellness, Recruitment and Retention Tool

Embedding annuities in a QDIA can help provide an additional solution for retirement readiness at a low cost to both employers and employees. As discussed earlier in this paper, the risk to employers of employees who find themselves financially unready while psychologically ready to retire of "retiring in place" and not making room for junior employees to move up may be far higher than is the cost of adding retirement income to their plan. This is a material motivator in why plan sponsors report high interest in TDFs that allocate a portion to lifetime income.

Automating retirement income is just one financial wellness aspect that a plan can use to help create a better retirement experience for diverse employees, thus helping with recruitment and retention. A 2014 paper by Vanguard Investments, "Diversity and Defined Contribution Plans: Differences in 401(k) Retirement Wealth," showed that retirement savings differences by racial and ethnic group are largest among voluntarily enrolled participants. Along with auto enrollment, the researchers found that higher default deferral rates and annual auto escalation "can help narrow wealth gaps and generate sufficient retirement savings for all participants."[19]

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[17] https://www.prudential.com/corporate-insights/employers-should-care-cost-delayed-retirements

[18] https://www.willistowerswatson.com/en-US/Insights/2019/04/qdia-evolutions-moving-defined-contribution-plans-into-the-future

[19] https://www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/401k-auto-escalation-favored.aspx

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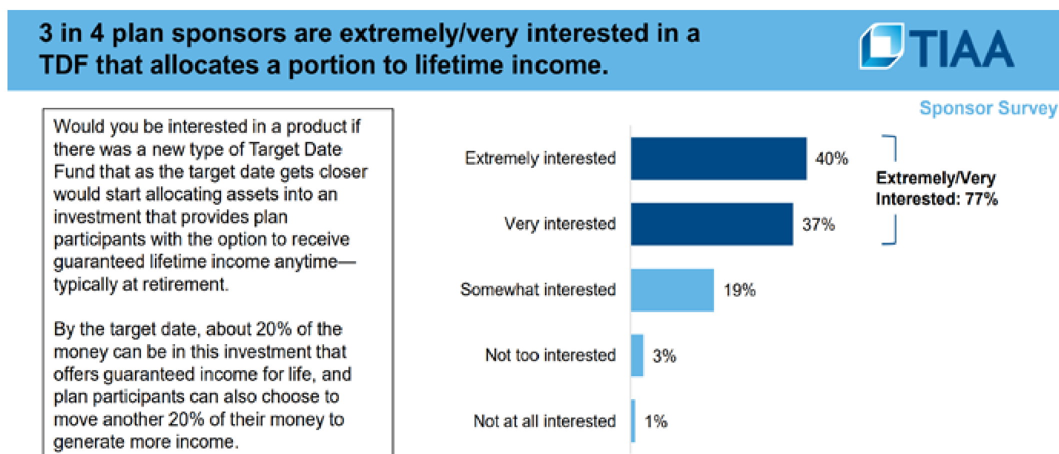
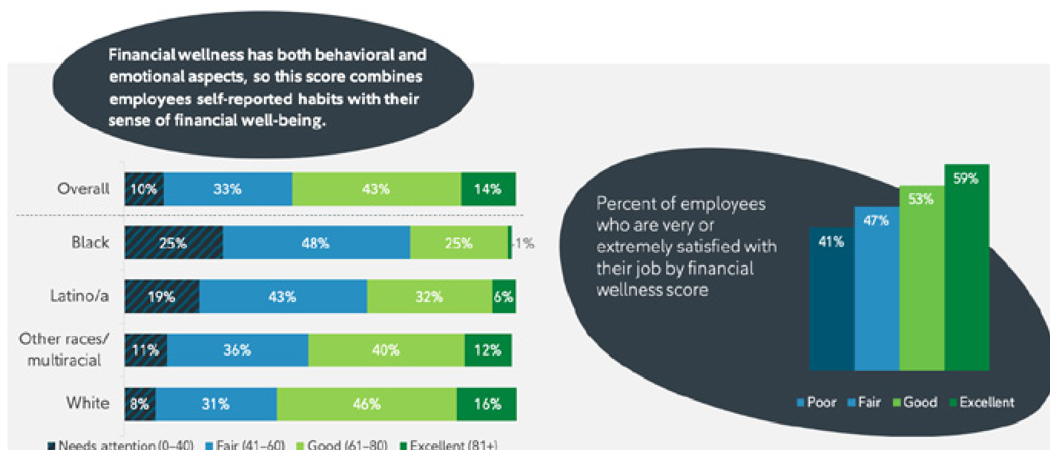
Figure 6. Interest in TDF With Guaranteed Lifetime Income Feature[20]



Further, research by Fidelity demonstrates the efficacy of financial wellness in improving job satisfaction among diverse employee populations. Employers benefit by attracting diverse talent through offering modern and inclusive financial benefits programs, and using creative solutions to engage and educate talent. [21]

Figure 7. Financial wellness scores by race/ethnicity among employees with access to a workplace retirement savings plan[22]



Annuities in QDIAs Can Help Protect Employees From Financial Impacts of Cognitive Decline

Studies in cognitive aging show that older respondents experience a decline in cognitive processes closely related to financial decision making. A 2011 study by Michael Finke, et al., finds that financial literacy scores decline by about 2% each year after age 60, but that confidence in financial decision-making abilities does not decline with age. Increasing confidence and reduced abilities can explain poor credit and investment choices by older respondents.[23] Therefore, securing lifetime income streams through their trusted employer's plan can be an important mitigant against the risk of cognitive decline affecting an employee's ability to maintain financial security in retirement.

[20] https://www.tiaa.org/public/pdf/the_tiaa_retirement_insights_survey.pdf, p.18.

[21] https://www.plansponsor.com/thought-leadership/fid-racial-inequalities-financial-wellness/

[22] Ibid.

[23] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1948627

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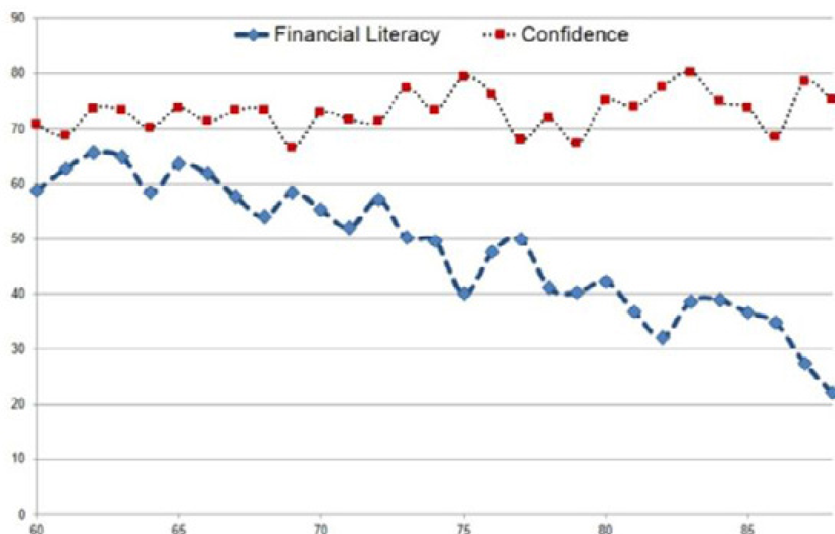
Employees who buy income/annuities while working and in their 50s and 60s do so with no degenerative decision-making capability. By annuitizing part of their retirement nest egg during their pre-retirement years, they have taken a prudent step to warding off the possibility that they will be the victim of fraud or the victim of poor decision making in the event their cognitive capability declines during their retirement years. Placing annuities inside the plan's QDIA will help reduce the risk of financial fraud and poor decision making with our older American population.

Figure 8. Financial Literacy and Confidence



Additional Benefits to Employees of Annuity Defaults in Plan

According to a 2019 Principal Financial study, "Most of the annuity owners said that having guaranteed income allowed them to be more comfortable accepting market volatility in other parts of their retirement savings. An investments-only approach means that a retiree's lifestyle is entirely dependent on the performance of stocks and bonds. With guaranteed income, retirees felt better able to maintain their spending, even in a down market, because they knew the annuity payments would not decrease or run out. One of the draws of the annuity payouts is to pay the property tax, utilities, cable, insurance expenses. To take care of those expenses so your investments can grow."[24]

"With guaranteed income, retirees felt better able to maintain their spending, even in a down market, because they knew the annuity payments would not decrease or run out."

—2019 Principal Financial Study

[24]https://storage.googleapis.com/wfhq_tomhegna/files/Pfau%26Finke%20Principal%20Article%20on%20Annuities.pdf

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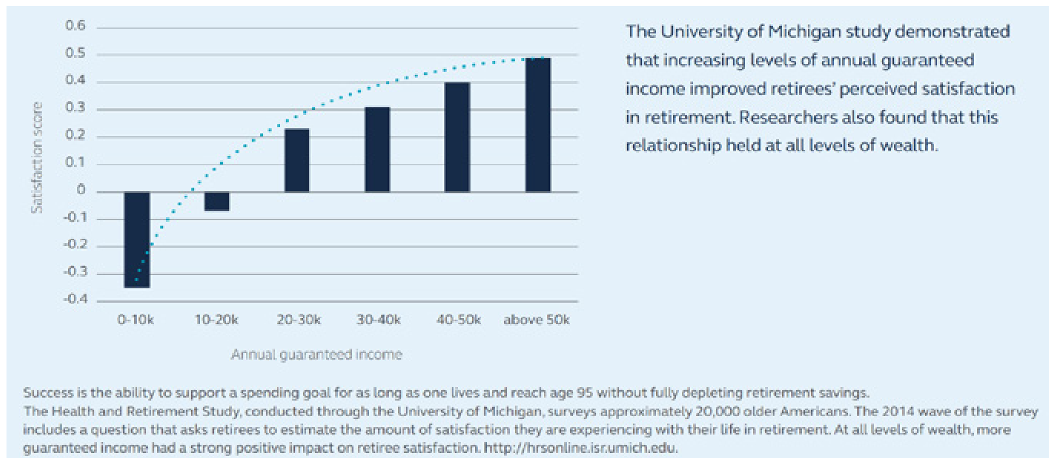
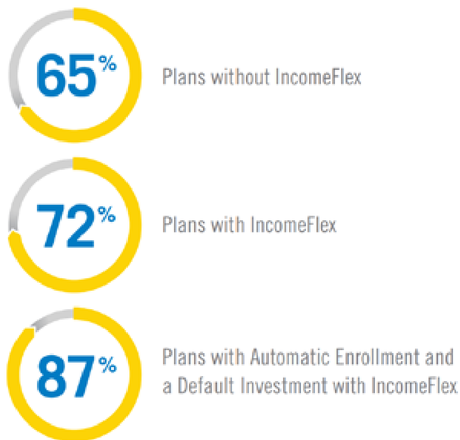
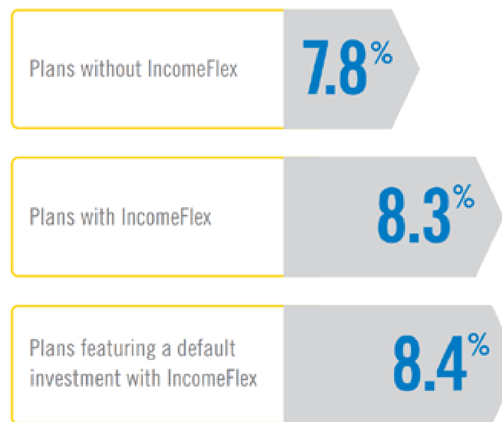
Figure 9. More Guaranteed Income Equates to More Satisfaction[25]



Including guaranteed income in QDIAs is proven to increase both plan participation rates and savings rates.

Figure 10. How Including Guaranteed Income in QDIAs Affects Plan Participation and Savings Rates





Studies by Prudential Financial, as demonstrated in Figure 10, show that when workers are left to their own devices in a plan without a guaranteed lifetime income benefit, the participation rate is 65%. While adding IncomeFlex to a plan's investment lineup improves the participation outcome, the highest rate is achieved by combining IncomeFlex with a default investment within an automatic enrollment feature.[26]

> "While adding IncomeFlex to a plan's investment lineup improves the participation outcome, the highest rate is achieved by combining IncomeFlex with a default investment within an automatic enrollment feature."

[25]https://storage.googleapis.com/wfhq_tomhegna/files/Pfau%26Finke%20Principal%20Article%20on%20Annuities.pdf, p.5, extracted from https://hrsonline.isr.umich.edu/

[26]https://www.institutionalinvestor.com/images/416/Guaranteed%20Lifetime%20Income%20White%20Paper.pdf, p.6-7

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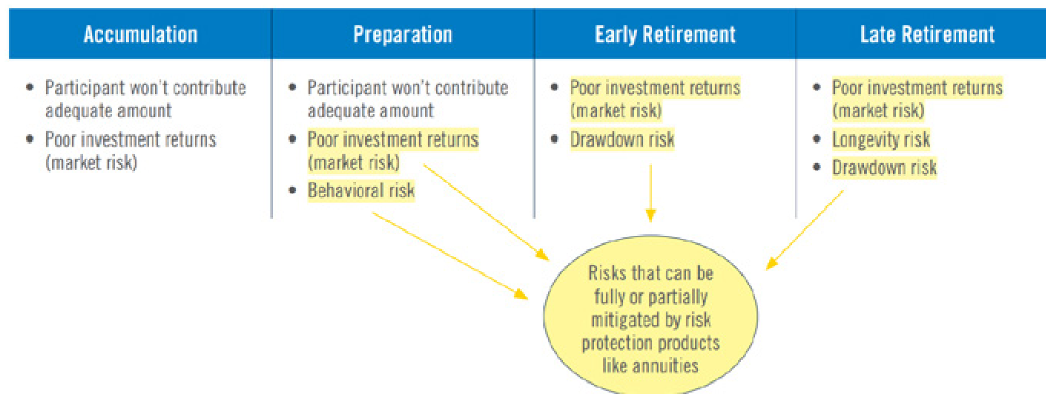
Figure 11. Risk Factors That Have the Most Impact on Retirement Income Originating from a DC Plan[27]



Retirement Income – Objections Overcome

At long last, sponsors are adopting and seriously considering inclusion of retirement income products within their DC retirement plans as well as income in innovative designs of their QDIAs. This has not always been the case, as several barriers often prevented retirement income from being included. Below is a review of some of the primary objections and potential solutions.

- **Perceived Fiduciary Risk.** Prior to the passage of the SECURE Act of 2019, some plan fiduciaries had reservations regarding the prudent review process needed to adopt retirement income products — especially guaranteed products offered by an insurance company. Specifically, sponsors and their consultants struggled with a fiduciary assessment on the claims-paying ability of the insurer. In short, fiduciaries were not sure what would happen if an insurer was not able to make good on the guarantees offered to their participants. Could affected participants file suit to force the sponsor to accept this liability? Fortunately, this barrier has been eliminated by the SECURE Act. Specifically, the SECURE Act states that a sponsor receiving appropriate testimonials from the insurer backing the guarantee to participant or beneficiary will not be liable for any losses to the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the terms of such contract.

- **Portability and Other Administrative Complexities.** Prior to the passage of the SECURE Act, sponsors were concerned that once a guarantee was offered, they would become entangled with the insurer and recordkeeper offering the guarantee.

  Consider the following example:

  Suppose a participant age 56 who wants to retire in three years had been defaulted into the plan's balanced fund/QDIA. Let's assume he/she had $200,000 of his/her contributions invested into the balanced fund that also offers a guaranteed minimum withdrawal benefit (GMWB). This type of benefit requires the insurance company to calculate the guaranteed income on the Income Base (the Income Base is the highest market value on the anniversary date of the contract) and not on the current market value of the investment. If the markets fell 20% over the next two years, the participant would be protected because the income he/she would receive would be based on $200,000 (the income base) and not the market value of $160,000. However, if the plan sponsor decided to no longer offer this GMWB investment, the participant would lose his/her guarantee; the fees he/she paid would have been for naught, and the participant would then have to invest the $160,000 into different available investment options within the plan. This participant would not have the security needed to retire when planned.

"[T]he SECURE Act states that a sponsor receiving appropriate testimonials from the insurer backing the guarantee to participant or beneficiary will not be liable for any losses to the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the terms of such contract."

[27] https://www.prudential.com/wps/wcm/connect/d34b3ce7-b376-454f-a4b7-5614407191e4/A-More-Paternalistic-Fiduciary-Lens-in-a-Post-SECURE-Act-World.pdf?MOD=AJPERES&CVID=nmOT6.U

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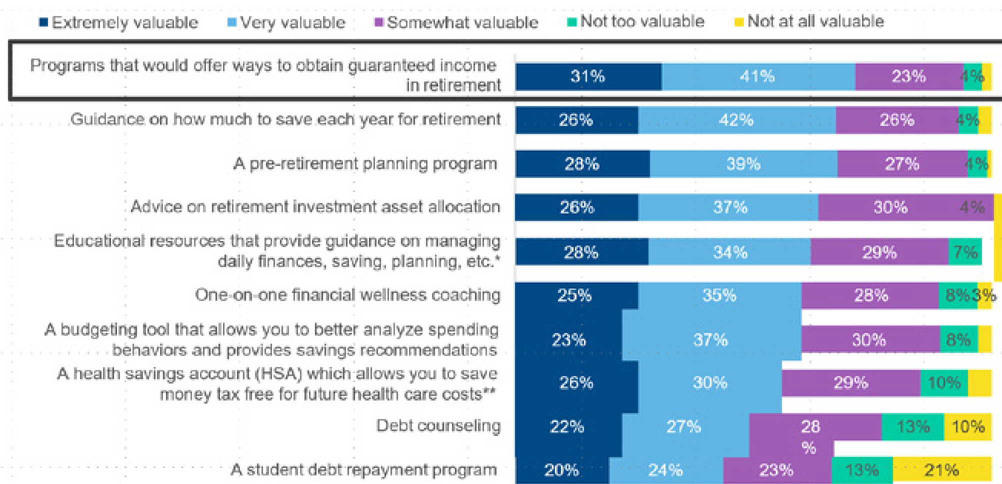
This type of scenario gave sponsors pause before offering a guarantee, as it seemed difficult to change recordkeepers or decide to no longer offer the investment — especially if participants' guarantees were "in the money" as described above. Again, the SECURE Act eliminated this objection, as the decision of a sponsor to no longer offer a guarantee would trigger a distributable event, thereby allowing the participant to receive a rollover IRA of the guarantee or a plan distributed annuity protecting the guaranteed income the participant had earned and wants to maintain. Further, a few IT firms are in development of standardized file feeds that would in fact enable the sponsor to continue to offer the guaranteed contract if the sponsor decided to move to a new recordkeeper. Just as plans can maintain their investment lineup in the event of a move to a new service provider, as middleware providers continue progressing, insurance products offering guaranteed income will likewise be able to move to the new recordkeeper as well.

> "[A] recent TIAA survey demonstrates that interest among participants across potential plan enhancements is highest for programs that would offer guaranteed income."

- **Participant Demand/Adoption.** When surveyed, participants value guaranteed lifetime income more than anything else. In fact, a recent TIAA survey demonstrates that interest among participants across potential plan enhancements is highest for programs that would offer guaranteed income.[28]

Figure 12. Perceived Value of Resources for Employees[29]



However, they often are not sure about purchasing guaranteed income at retirement or investing in a fund with guarantees imbedded within the investment offering. By including the guaranteed income as part of the plan's QDIA, the sponsor, along with its consultant and provider experts, in essence makes this decision on behalf of the participant. In this manner, the communication, the value and the enhanced employer-employee relationship are all automatic, making the decisions and ultimate increased retirement security default actions. Just as auto-enrollment, auto-escalation and auto-investing have advanced retirement readiness, auto income will bring on a new retirement reality — Auto-RISE, or automatic retirement income security — for everyone. Complexity and participant uncertainty are no longer an objection to automatic retirement security.

- **One Size Fits All.** A common objection to incorporating retirement income solutions is their ability, or lack thereof, to meet the needs of a diverse employee base. The past 10 or 15 years have borne witness to a multitude of product launches by insurers seeking to supplement and take advantage of a continuously growing wealth management industry that serves the wealthy and mass affluent. Insurance agents/brokers can "customize" the solution to the specific needs of their clients by offering a variety of guarantees and annuities. However, if we go back 20 or 30 years, one size fits all was not an objection when pension plans

[28] https://www.tiaa.org/public/pdf/the_tiaa_retirement_insights_survey.pdf
[29] Ibid.

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offered SPIA with survivor benefits as the only distribution option. Social Security at its core provides a SPIA with a COLA and some survivor benefits. One size fits all is certainly not a criticism of our Social Security system. At the heart of this issue is the employer's perspective on what retirement income really is. Is it an outcome of the benefit plan offered by the employer that makes the plan and the retirement income offered a better human resource management tool? Or is retirement income divorced from the employer and benefit plan, living solely for the benefit of the advisor/broker world with employees/participants now becoming customers of the retail wealth management industry? We contend that retirement income is part of the benefit plan, just as it was 25 years ago, and sponsors need to reassert themselves and take command of this issue for their employees. Sponsors can always offer two or three retirement income generators to meet some of the different needs of their employees. Financial wellness programs certainly have afforded sponsors with a view of the different financial stresses that affect their diverse populations. However, sponsors cannot let perfection be the enemy of the very good; the current guaranteed options available in the DC market today that can be integrated into the plan's QDIA are, in fact, very good offerings.

- **Peer Offerings/Lack of Adoption by Competitors.** Retirement income is becoming more ubiquitous in DC plans. We anticipate a tipping point in the next five years where income solutions will be in the majority of plans, causing HR departments without a solution to add one to maintain a competitive benefit plan. Current evidence forecasting a high level of adoption is found in the 2016 and 2019 Lifetime Income Solutions Plan Sponsor and Recordkeeper Perspectives surveys conducted by Willis Towers Watson indicating that 30% of large plan sponsors have already added a retirement income option, and another 60% will consider adding a retirement income option in the next couple of years. In addition, a 2020 MetLife study, "Embracing the Retirement Model for the Next Normal,"[30] shows that 95% of employers surveyed believe that their employees should have a source of guaranteed income. In short, retirement income is becoming an integral part of DC plans. DC plans will be viewed as retirement income vehicles just as much as they are viewed as accumulation vehicles by participants today.

"[A] 2020 MetLife study, "Embracing the Retirement Model for the Next Normal," shows that 95% of employers surveyed believe that their employees should have a source of guaranteed income."

Concluding Remarks

A healthy retirement system is good for both employers and workers. The same reasons employers have become increasingly involved in helping their workers through financial wellness initiatives also apply to workers being able to achieve sufficient and secure income throughout retirement. Workers who are confident about their finances, including their retirement outlook, are less distracted while on the job. And employers are better able to manage productivity when workers can retire in a timely fashion.

Automatic features have addressed many of the issues that threatened the success of DC plans early on, such as getting employees into the plans (auto-enrollment), saving enough (auto-escalation) and investing their savings appropriately (QDIAs). These approaches have been embraced by many plan sponsors and are encouraged by the DOL.

But plan sponsors have taken a hands-off approach to helping workers convert DC plan account balances into secure income for retirement. It is time for this to change. Leveraging the principles of behavioral finance, integrating retirement income features within the QDIA is the logical "next best step" in the evolution of DC plans. As this paper illustrates, there are several approaches available today, with the refinement of existing products and exciting new products and services coming to market. And there is strong political and regulatory support for auto-features and retirement income solutions. It is a win-win for both employers and workers when workers can retire with confidence. Offering retirement income within a QDIA, by helping many workers achieve more secure income during retirement, will do just that.

[30] https://www.metlife.com/content/dam/metlifecom/us/homepage/institutionalRetirement/insights/LifetimeIncome/Benefits-Quarterly-Q4-2020-Issue-MetLife-Article-FINAL.pdf, p.11

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