The Critical Questions (and Their Answers) to In-Plan Income Solution Adoption

How the retirement industry is meeting evolving needs for retirement income solutions.

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Introductions

The increasing popularity of Defined Contribution (DC) plans with employers, and the concurrent decline in number of Defined Benefit (DB) plans, has resulted in a shift of retirement income risks from institutional experts to workers. As a result, plan sponsors need to think critically about their objectives for offering a DC plan and how plan design supports them. For example, once the plan has accomplished its initial purpose of savings accumulation, is the objective to provide a single, large distribution at retirement, or provide a source of income during retirement?

While historically most plan sponsors and their participants favored full distribution of their account balance upon retirement, there has been a shift toward retaining account balances in the plan after retirement. This decision benefits plan sponsors by maintaining economies of scale, reducing costs for all participants, and enhancing overall value. Participants, in turn, are able to incur lower investment management costs through institutional pricing, access retirement education and services from a reliable source, and retain additional protections under ERISA-regulated plans. See this guide[1] or webinar[2] for additional information on these retirement income issues.

But then what? When a plan sponsor has determined it is a) advantageous to retain retirees' assets in the plan and b) the purpose of their DC plan involves both accumulating savings for retirement and also providing a source of income during retirement, which plan design and features best support these goals within the context of their environment will need to be considered.

The good news is that the obstacles plan sponsors have historically faced when considering in-plan retirement income solutions are being reduced and the options for plans to deliver a stream of retirement income continues to expand. This document is intended to inform plan sponsors, advisers, and consultants about the evolving landscape they will encounter when evaluating in-plan retirement income solutions.

Why Retirement Plans Should Provide Retirement Income

Retirement income has long been an important and valuable employee benefit, but the topic has grown in significance since the Global Financial Crisis of 2008. The extensive period of destabilization underscored the realization that market volatility can create uncertainty for retirees striving to establish a dependable income source from their savings, potentially impacting their retirement stability.

By offering in-plan guaranteed solutions, a managed account solution with a sophisticated spend-down feature, or a combination of the two, plan sponsors can give their participants the tools they need from a trusted source—the employer—to navigate volatile markets.

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1 https://iricouncil.org/wp-content/uploads/2019/09/plan-sponsor-guide-to-retirement-income-decision-beleifs-ii.pdf

2 https://iricouncil.org/wp-content/uploads/2019/10/Webinar-1-WHY-Retirement-Income-from-a-Plan-Design-and-Settlor-Function-Perspective.mp4

In fact, research published by T. Rowe Price[3] suggests that 20% of plan sponsors served by surveyed advisers and consultants are considering adding in-plan retirement income solutions to their DC plans for various reasons including the following:

To Fill A Growing Need

Historically, DB plans have provided employees with guaranteed income in retirement; however, younger generations have less access to DB plans and their confidence in the viability of Social Security is declining. According to LIMRA Secure Retirement Institute, each successive generation has a lower expectation of being able to rely on traditional sources of **guaranteed income** during retirement. However, the **desire for guaranteed income remains high** with 7 out of 10 participants interested in protected lifetime income products.[4]

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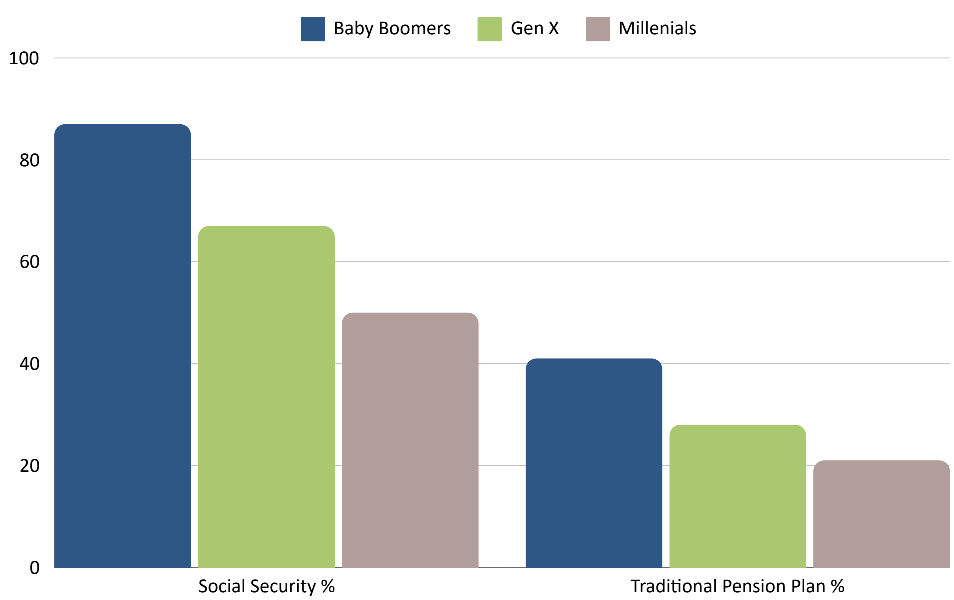

LIMRA Secure Retirement Institute, Retirement Income Reference Book, 4th Edition, 2019[4]

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3 https://www.troweprice.com/personal-investing/resources/insights/three-themes-shaping-the-us-retirement-landscape.html

4 LIMRA Secure Retirement Institute, Retirement Income Reference Book, 4th Edition, 2019

To Answer the Question: How Much Can I Safely Withdraw?

Winner of the 2017 Nobel Economics prize, Richard Thaler, once said, "For many people, being asked to solve their own retirement savings problems is like being asked to build their own cars." [5]

William Sharpe, the mastermind behind the Sharpe Ratio and the Capital Asset Pricing Model (CAPM), echoed that sentiment when he described the decumulation of retirement assets as the "nastiest, hardest problem in finance."[6]

If you ask any plan participant how much income they need, how long their money will last, or how much they believe they can safely withdraw, you'll end up with confusion, guesses, or - as detailed below - fear. By adding a retirement income solution to the plan, plan sponsors are able to assist participants with the area of retirement planning that can be the most difficult to navigate.

To Encourage Retirees to Make Good Choices

Converting one's life savings into an income stream is a daunting task and it is unrealistic to expect employees to become experts when they retire. By offering retirement income solutions in-plan, those nearing retirement will have access to education and guidance from a trusted source when they need it most.

Just as some plan sponsors require a participant to speak with a plan representative before taking a plan loan or hardship withdrawal, some plans now automatically set up retirement counseling sessions. These are intended to support those nearing retirement to take advantage of the resources and features of the plan and prevent inertia from getting in the way of making strong decisions.

To Reduce Employee Angst

In a survey recently conducted by Lincoln Financial Group, participants were asked about their thoughts and concerns as they approach retirement. The responses received illustrate a range of emotions, revealing the fear of the unknown as the most prevalent emotion cited. Some responses included:

- "I fear my retirement savings won't last long enough while retired."
- "I fear losing my savings due to market volatility when in retirement."
- "I fear I did not save enough and will have to live with my children when I'm old."
- "I want to make sure I won't lose the value of my investments by the time I retire."
- "I don't feel confident my money will last for 20 years after retirement." [7]

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5 See: https://www.nytimes.com/2013/04/07/business/an-automatic-solution-for-the-retirement-savings-problem.html

6 See: https://www.barrons.com/articles/william-sharpe-how-to-secure-lasting-retirement-income-51573837934

7 Lincoln Financial Group – 2018 Participant Retirement Confidence Survey

Additional research results in similar findings that, without a retirement income plan in place, participants' anxiety and financial stress increases:

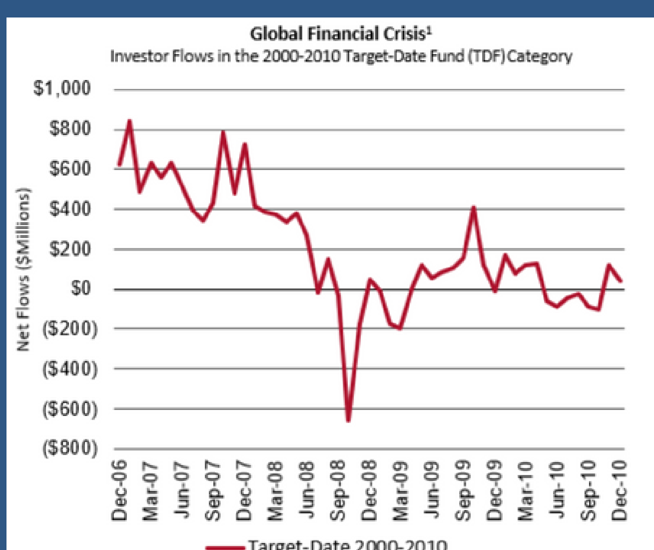
- 75% of workers say income stability is more important than preserving account balances or maintaining wealth.[8]
- 93% of workplace savers are concerned future market volatility will impact their retirement savings.[9]
- 89% say having guaranteed retirement income would positively impact their well-being now.[10]
- 71% would save more if their plan offered them a retirement income solution.[11]
- Only 21% are very confident they will have enough money to last through retirement.[12]

"...without a retirement income plan in place, participants' anxiety and financial stress increases..."

To Mitigate Risks of Investment Loss

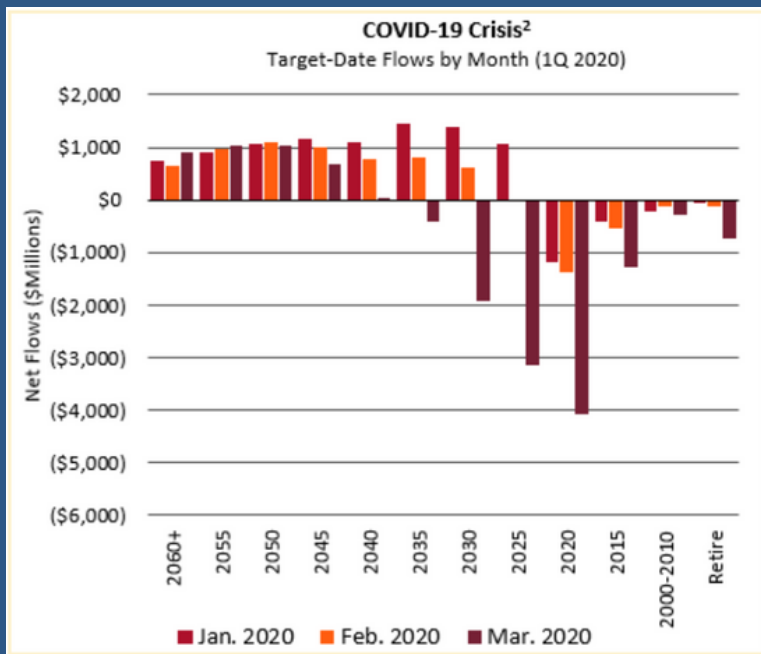
Investment losses can devastate retirement lifestyle expectations if retirees have not taken steps to anticipate and mitigate the consequences.

- On average, downturns of >20% have occurred every 8 years[13]
- After falling, the market can take many years to regain previous highs:
  - Tech Bubble: ~7 years to reach previous highs[14]
  - Global Financial Crisis: ~ 5½ years to reach previous highs[15]
- Taking account distributions further hinders a participant's account from achieving principal recovery after losses



FactSet, S&P 500 Index Returns, 1/1/1929 - 9/30/2020

Target date fund outflows during the Global Financial Crisis indicate that investors sold at the wrong time – when markets were down.



Morningstar as of 3/31/2020

In the recent COVID Crisis, selling occurred among those nearest to retirement – a precarious time to lock-in losses.

To Address Concerns About Outliving One's Assets

Average life expectancy continues to increase, which is generally considered a positive. However, it's important to remember that "average" life expectancy is a midpoint, not an endpoint, and a given participant may need to consider the probability of living perhaps 30+ years in retirement.

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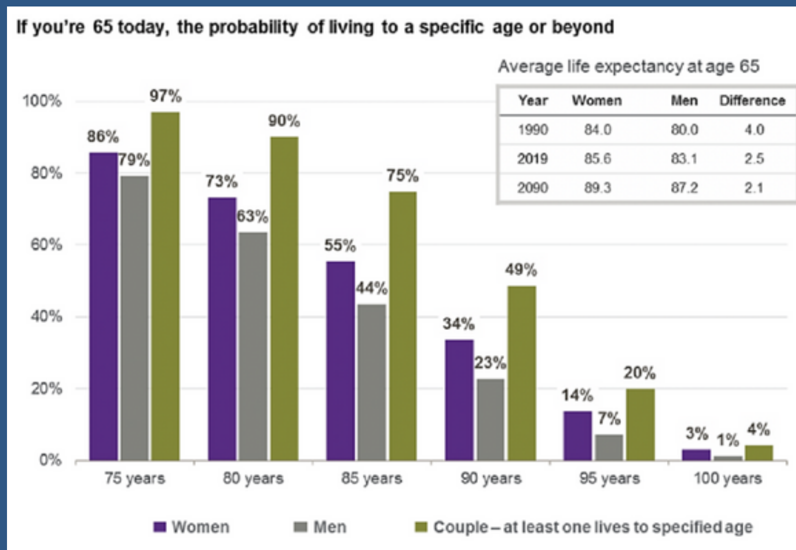

Social Security Administration, Period Life Table [16]

Proliferation of In-Plan Spend Down Features and Options

There's clearly a need for an approach that will help participants navigate these risks and questions. The simplest, least disruptive approach a plan sponsor can take is to offer options upon retirement for how a distribution can be taken. Instead of offering a single lump sum distribution, a plan can offer scheduled distributions, e.g., monthly, quarterly or annually. These can be a fixed amount, for example $500 per occurrence, or a percentage of the account balance, for example 1% of the beginning of year account balance paid on the first of each quarter. Retirees would have the ability to change the distribution amount at any time. In addition, they could be given the ability to make an "on-demand" distribution request of any amount. The cost of adding this feature is minimal and once implemented is limited to administration of requests and paying distributions.

Many recordkeepers offer one or more managed account solutions on their platforms. Some of these managed account solutions have incorporated sophisticated spend-down strategies which cover both how to invest the account balance from among the investment funds offered by the plan, and how much can be withdrawn to generate a retirement income stream. The cost of adding these types of managed accounts vary depending on whether the plan sponsor chooses an opt-in or opt-out enrollment approach.

16 (chart): Social Security Administration, Period Life Table, 2017 (published in 2020), J.P. Morgan Asset Management.

Addressing Barriers to Implementing In-Plan Guaranteed Solutions

Although providing in-plan solutions comes with evident advantages, there are also potential obstacles and risks. It is crucial to address concerns and proposed solutions for both the benefits and risks associated with guaranteed solutions.

Concerns With Guaranteed Solutions

Some oft-cited reasons why plan sponsors have been hesitant to offer in-plan guarantees and the potential fix include:

Area of Concern	Risk	Potential Fix
Fiduciary	Litigation in the event of insurer failure after plan has made investments with the insurer[16]	Objective, thorough, and analytical search performed in accordance with SECURE Safe Harbor provisions
Connectivity/ Portability	A decision to implement a given retirement income solution now might restrict future choices for the plan or participant	Technological and operational support, in particular via middleware, and contract terms
Cost	Litigation related to unmerited costs	Conduct and document cost/benefit analysis as part of decision process (i.e., tradeoff between costs and benefits)

Social Security Administration [17]

SECURE Guidance on Guaranteed Solutions

Prior to the passage of the SECURE Act, plan sponsors had many unanswered questions about their responsibilities when introducing guaranteed solutions to plans. SECURE gave plan sponsors clear guidance that ERISA requirements meet a sound due diligence process that documents an objective, thorough, and analytical study of both costs and benefits.

According to Groom Law Group:
"...perhaps the most significant feature of the New Safe Harbor is a provision that deems the selecting fiduciary to have satisfied the conditions related to the adequacy of the insurer's financial capabilities upon receipt of a specified set of written representations from the insurer, subject to the proviso that, after receiving those representations, the fiduciary must not have received notice of any change in the insurer's circumstances or other information which would cause it to question the representations provided. The insurer is required to represent the following:

17 (table): Social Security Administration 2020 OASDI Trustees Report. Probability at least one member of a same-sex female couple lives to age 90 is 56% and a same-sex male couple is 40%.

1. the insurer is licensed to offer guaranteed retirement income contracts.

2. the insurer, at the time of selection and for each of the immediately preceding 7 plan years:
- operates under a certificate of authority from the insurance commissioner of its domiciliary state that has not been revoked or suspended;
- has filed audited financial statements in accordance with the laws of its domiciliary state;
- maintains and has maintained reserves which satisfy all the statutory requirements of all states in which the insurer does business; and
- is not operating under an order of suspension, rehabilitation, or liquidation.

3. the insurer undergoes, at least every 5 years, a financial examination by the insurance commissioner of its domiciliary state. The insurer will notify the fiduciary of any change in circumstances after providing the above representations which would preclude the insurer from making such representations at the time of issuance of the contract."[18]

One useful framework for how to systematically select and monitor Retirement Income Solutions is made available by Broadridge Fi360 here. It emphasizes prudent processes by which a fiduciary can organize, formalize, implement, and then monitor a retirement income program.[19]

Connectivity/Portability: Expanding Options from Recordkeepers

One reason plan sponsors have avoided in-plan guaranteed retirement income solutions was their recordkeeper did not currently offer the solutions that were being considered by the plan sponsor. In many cases, recordkeepers did not provide access to any in-plan guaranteed retirement income solutions, which prevents plan sponsors from implementing a solution unless they change recordkeepers—which is disruptive to both the plan sponsor and the participant and has significant risks associated with it.

And while plan sponsors could request their recordkeepers offer in-plan guaranteed retirement income solutions, most shy away from being "early adopters"to avoid unnecessary risk.

Several recordkeepers have recently established in-plan guaranteed retirement income solutions, with some even offering multiple retirement income solutions. These trends provide plan sponsors with expanded options to meet the retirement income needs of their participants.

Participant Level Portability

Issues related to participant portability have discouraged plan sponsors from implementing in-plan guaranteed retirement income solutions. Plan sponsors were justified in their concern that if a plan participant accrues an income benefit as part of a product offered within their plan they would not be able to roll the benefit to a new employer plan or to an individual IRA. The SECURE ACT 1.0 requires all retirement income products to provide portability, eliminating this issue as a key concern.

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18 FactSet, S&P 500 Index Returns,1/1/1929 - 9/30/2020, v American Century Institutional Income America presentation FactSet, S&P 500 Index Returns, 1/1/1929 - 9/30/2020 Morningstar, as of 3/31/2020EBRI, Retirement Confidence Survey, https://www.ebri.org/retirement/retirement-confidence-survey

19 https://www.fi360.com/uploads/media/Assets/RIS_PrudentPractices_eBook.pdf

Portability at the Plan Level

Plan sponsors have also been concerned about the ability to change recordkeepers if the in-plan guaranteed retirement income solution they are interested in adopting is not widely available across multiple recordkeepers. As referenced previously, the launch of multiple in-plan guaranteed retirement income solutions across recordkeepers is making the portability of these benefits much easier.

One-to-many connections via retirement income middleware providers have helped recordkeepers access multiple products through a single connection. These middleware technology solution providers are also able to assist with income benefit portability and product conversions, because they are housing participant income benefits within their platform. Retirement income middleware providers also offer the important service of program oversight, freeing the recordkeeper of this administrative burden, and in so doing making it more feasible for the recordkeeper to offer a suite of solutions to their plan sponsor clients.

As recordkeepers continue to launch and expand their in-plan guaranteed retirement income programs, plan sponsors will feel increased confidence in implementing these types of solutions, due both to increased retirement income product choice and to improved portability options.

Cost Considerations

Plan sponsors have historically been hesitant to add in-plan guaranteed retirement income solutions to their plans due to the perception of higher fees relative to traditional investments. However, this perspective needs to be revised.

Considering costs without also considering benefits is misleading. The cost of “doing nothing” should also be considered. ”Doing nothing” essentially leaves participants to “do it themselves” and prevents them from realizing the benefits of guaranteed solutions, manifesting for participants as lower lifetime income levels, higher chances of running out of money, or both.

Notably, the SECURE Act provides safe harbor protection to plan sponsors offering in-plan guaranteed retirement income options, even if the solution they select does not have the lowest explicit fee when compared to other solutions. This framework is similar to QDIA rules in that plan sponsors are not required to select the target-date series with the lowest explicit fee if they can document why they concluded a different series will better serve the interests of their participants.

When evaluating in-plan guaranteed retirement income solutions, it is important to take a holistic cost/benefit approach and analyze both explicit fees and opportunity costs.

*All guarantees subject to the claims paying ability of the underlying insurer or insurers.

Conclusion

Retirement planning for participants requires managing life's uncertainties. Life expectancy is uncertain; market returns are uncertain. While no one can remove these uncertainties entirely, there are tools available that can protect participants from their effects. These tools are more widely available than ever before due to innovations with in-plan retirement income solutions. Utilizing these solutions can give participants greater confidence in their ability to manage their savings during retirement.

Plan sponsors and their advisers have an expanding array of retirement income solutions and plan features they can tap to help workers better manage their savings in retirement.

While challenges to adoption of in-plan retirement income solutions exist, the retirement industry, regulators and solution providers have worked to address them. The inclusion of spend-down strategies within managed account solutions gives retirees access to tools to manage their savings while drawing income.

SECURE Act and its progeny have given plan sponsors a clear and descriptive process to attain safe harbor when choosing an in-plan guaranteed solution. Technology has evolved and given rise to middleware firms with tools to bridge the gap between the recordkeeping and insurance systems to reduce administration costs associated with in-plan guaranteed solutions.

And importantly, the retirement industry is becoming better informed about the need for retirement income solutions and how to evaluate, implement, administer and communicate in-plan retirement income solutions.

The future is brighter for new and aspiring retirees as in-plan retirement income solutions become more accessible and prevalent. Participants need help, plan sponsors want to provide it, regulators are supportive and the industry is responsive.

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