Guaranteed Income for 401(k) Participants

How to Comply with the SECURE Act Requirements

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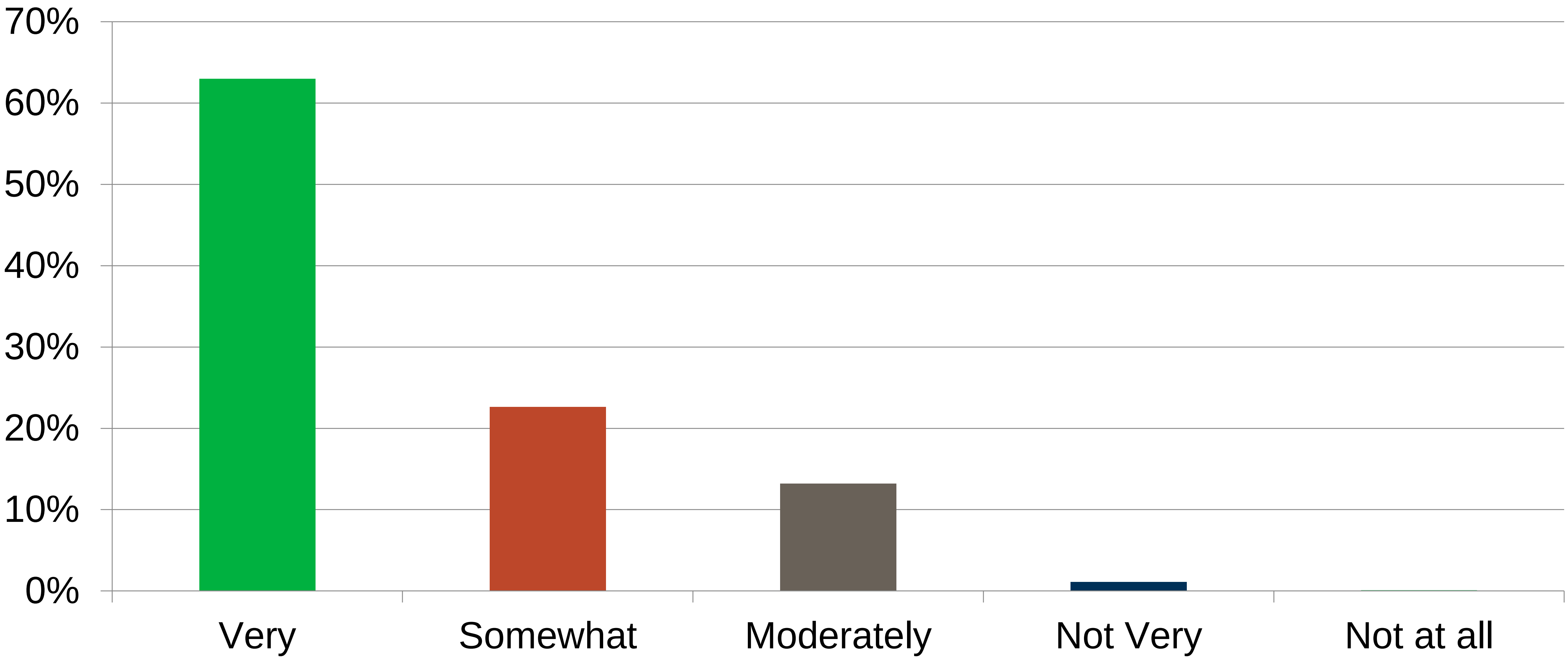
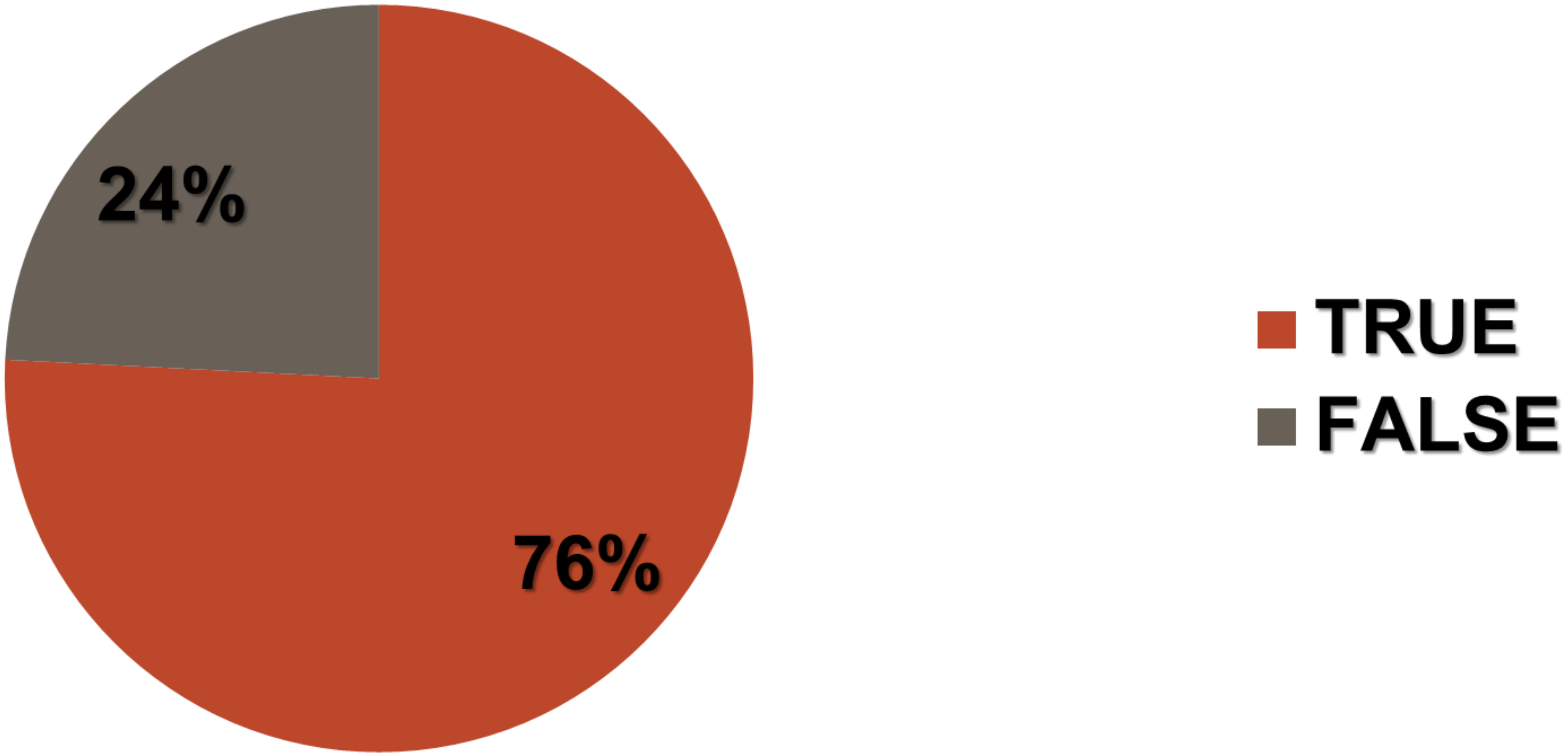
In your retirement investments, how important is it to know how much income you'll be able to safely spend each year?



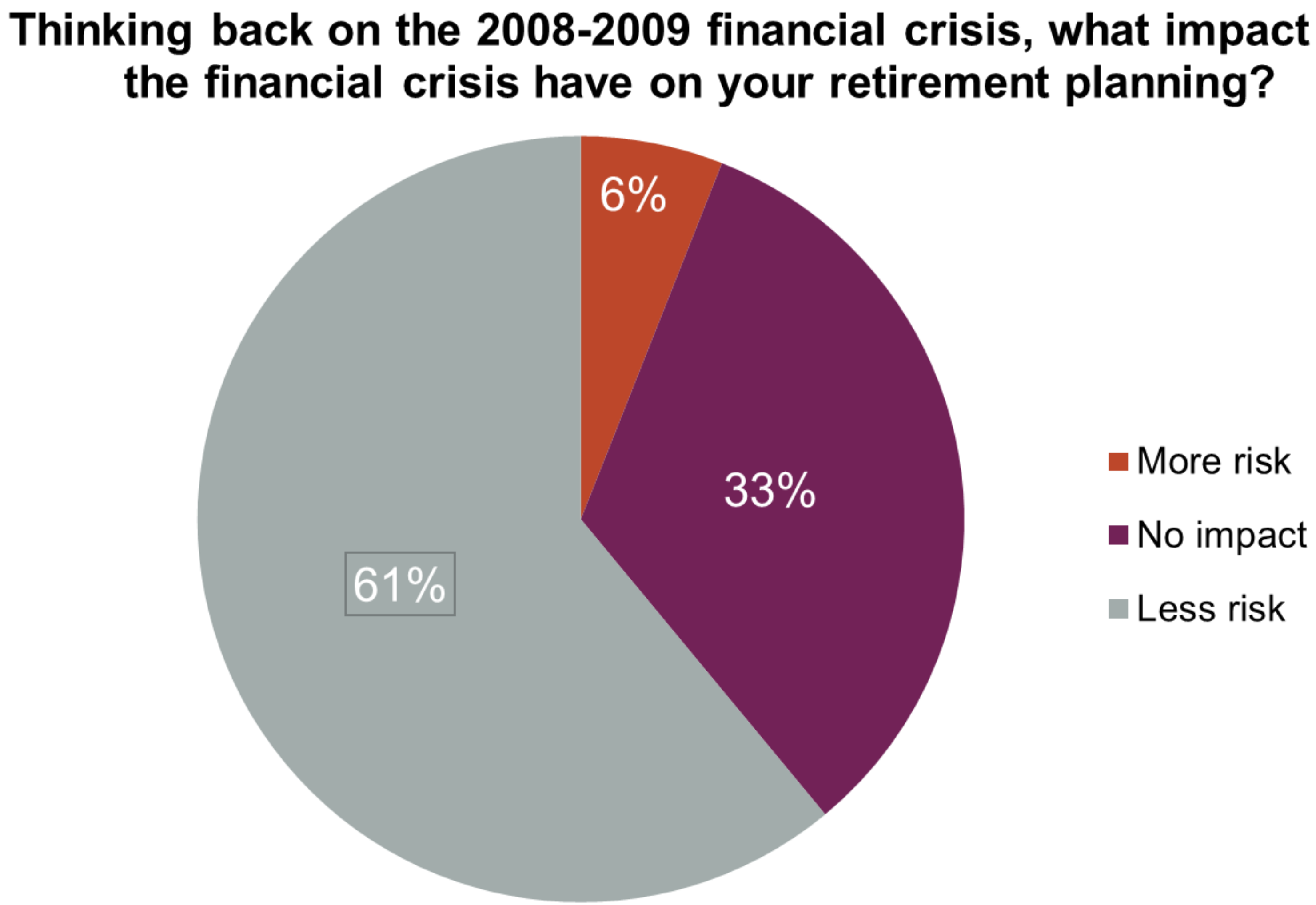
Finke, 2016

When thinking about retirement income, income certainty is more important than the performance of my investment portfolio.

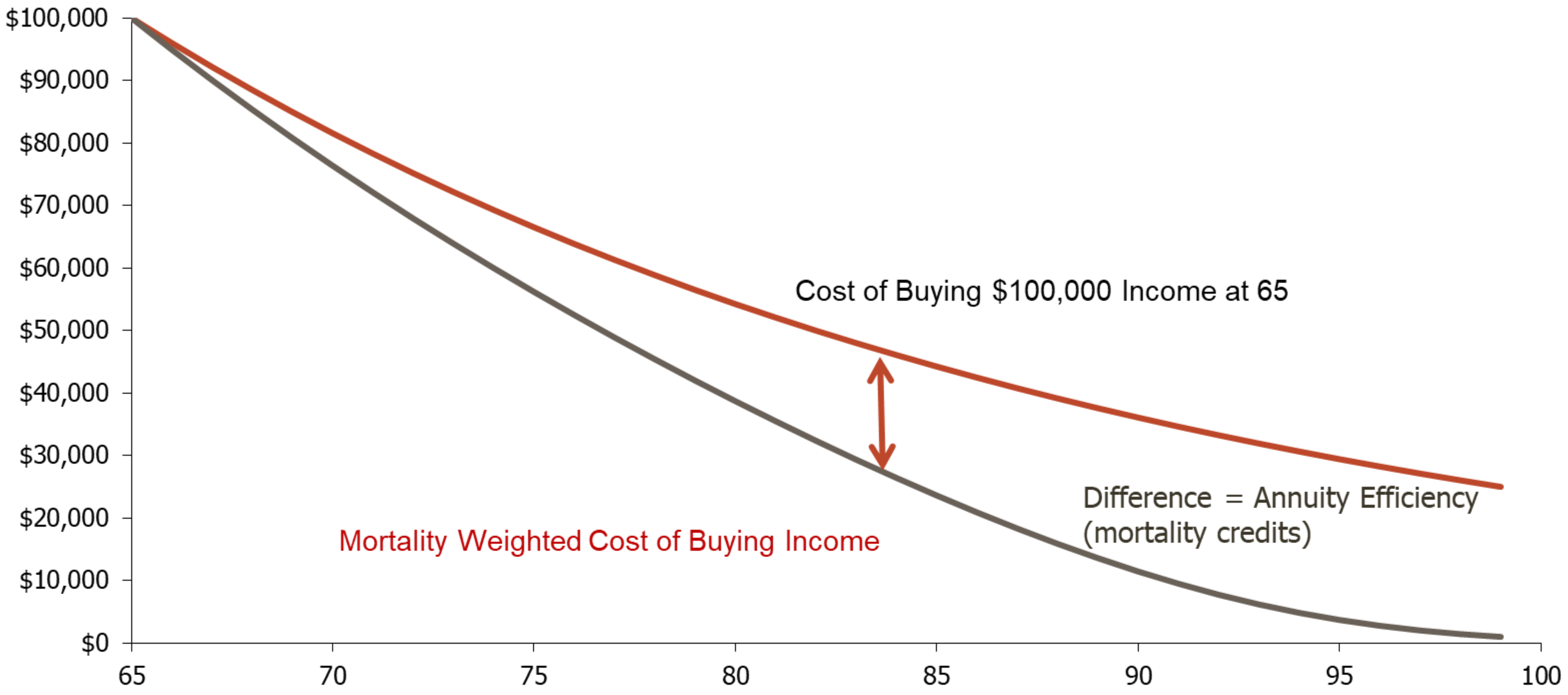


Finke, 2015

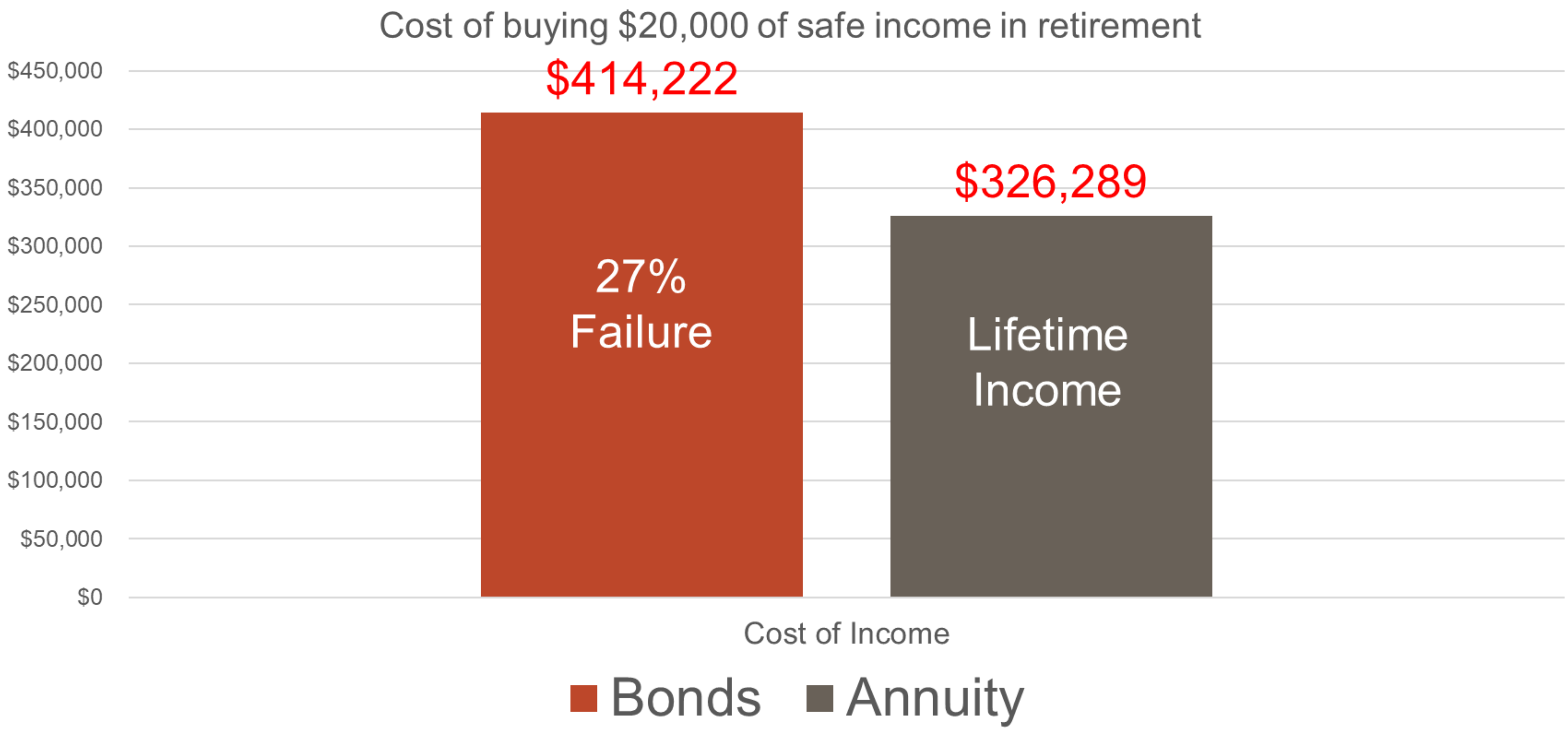
Impact of Last Financial Crisis on Investment Risk



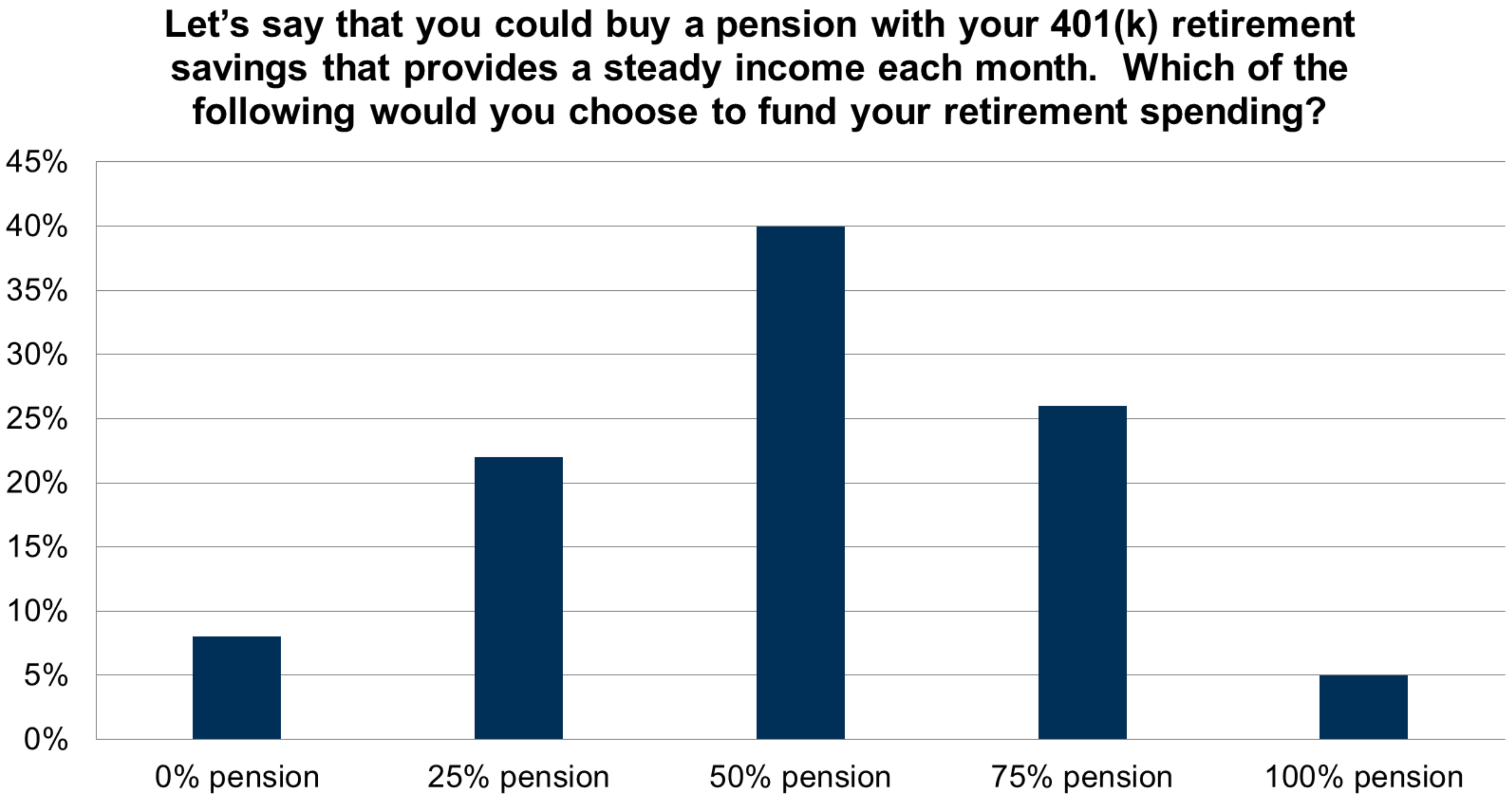
Understanding the Benefit of Annuitization



Buying Income with Safe Bond Assets



Allocation of Retirement Wealth to an Annuity



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Introduction

- The SECURE Act creates a fiduciary safe harbor in connection with the selection of a guaranteed retirement income contract…at least for part of the selection.

- A guaranteed retirement income contract is defined as:

  "The term 'guaranteed retirement income contract' means an annuity contract for a fixed term or a contract (or provision or feature thereof) which provides guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant or the joint lives of the participant and the participant's designated beneficiary as part of an individual account plan."

Fiduciary Protection

- Here's what SECURE says is protected

  "A fiduciary which satisfies the requirements of this subsection 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."*** [Emphasis added]

Comment: In other words, the "safe harbor" gives protection for selection of the insurer but not for selection of the contract.

Selecting the Insurer

"*With respect to the selection of an insurer for a guaranteed retirement income contract, the [prudence] requirements of [ERISA Section 404(a)(1)(B)] will be deemed to be satisfied if a fiduciary—*

> *A. engages in an objective, thorough, and analytical search for the purpose of identifying insurers from which to purchase such contracts*"

Selecting the Insurer *(cont.)*

- In addition, SECURE then says

  "B. with respect to each insurer identified under subparagraph (A)—

  i. considers the financial capability of such insurer to satisfy its obligations under the guaranteed retirement income contract…"

- After engaging in this process and consideration, a fiduciary must then conclude that [subsection (C)(i)]

  "i. at the time of the selection, the insurer is financially capable of satisfying its obligations under the guaranteed retirement income contract"

Where's the "safe harbor"

"*A fiduciary* ***will be deemed to satisfy*** *the requirements [for selecting the provider] if—*

"*(A) the fiduciary obtains* ***written representations*** *from the insurer that—*

"*(i) the insurer is licensed to offer guaranteed retirement income contracts;*

"*(ii) the insurer, at the time of selection and for each of the immediately preceding 7 plan years—*

"*(I) operates under a certificate of authority from the insurance commissioner of its domiciliary State which has not been revoked or suspended;*

"*(II) has filed audited financial statements in accordance with the laws of its domiciliary State under applicable statutory accounting principles;*

(*continued*)

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Where's the "safe harbor"? *(cont.)*

"(III) maintains (and has maintained) reserves which satisfies all the statutory requirements of all States where the insurer does business; and

"(IV) is not operating under an order of supervision, rehabilitation, or liquidation;

"(iii) *the insurer undergoes, at least every 5 years, a financial examination (within the meaning of the law of its domiciliary State) by the insurance commissioner of the domiciliary State (or representative, designee, or other party approved by such commissioner); and*

"(iv) the insurer will notify the fiduciary of any change in circumstances occurring after the provision of the representations in clauses (i), (ii), and (iii) which would preclude the insurer from making such representations at the time of issuance of the guaranteed retirement income contract…."

Where's the "safe harbor"? *(cont.)*

- ***But***, the safe harbor *isn't* available if

  "(B) after receiving such representations and as of the time of selection, the fiduciary **has not received** any notice described in subparagraph (A)(iv) **and is in possession of no other information** which would cause the fiduciary to question the representations provided."

Comment: In other words, the fiduciary has no adverse information that would contradict or make it imprudent to rely on the insurance company's written representation.

Selecting the Contract

- After engaging in the process for selecting the insurer, a fiduciary must then take another step [subsection (B)(ii)]

  > “*[consider] the **cost** (including fees and commissions) of the guaranteed retirement income contract offered by the insurer **in relation to the benefits and product features** of the contract and **administrative services** to be provided under such contract…”* [Emphasis added]

- And the fiduciary must then conclude that [subsection (C)(ii)]

  > *“ii. the relative cost of the selected guaranteed retirement income contract as described in subparagraph (B)(ii) is reasonable.”*

Note: The SECURE Act says there is no obligation to select the lowest cost.

Monitoring

- The SECURE Act provides that the monitoring duty is met with respect to *selection of the insurer*

  "if the fiduciary periodically reviews the continuing appropriateness of the conclusion described in paragraph (1)(C) [i.e., that the insurer is financially capable] with respect to a selected insurer…"

Analysis Framework Concepts

- For lifetime income investments, primary focus is value, not cost
  - Cost is one component of value in the analysis framework

"Cost is what you pay. Value is what you get."
-Warren Buffett

- The definition of value is a combination of two factors:
  - The level of wealth maintained through retirement
  - The level of protection against financial ruin in retirement

Analysis Framework Considerations

- Lifetime income products are not “one size fits all”
  - Must consider demographics of plan participants
  - Focus on key election and retirement ages

- The best solution may be more than one product
  - Offer portfolio of products
  - Analysis of each product should be performed with the portfolio concept in mind

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Three potential strategic frameworks for how annuities could come to be offered in plans

Neither supply nor demand for in-plan income has yet reached critical mass, but continued positive signs…

1. Annuity guarantee associated with an investment

Currently available, some well-tested options

- In some offerings, the income guarantee is wrapped around a single TDF itself
- In other offerings, income guarantees can be unitized within the TDF

■ Annuity

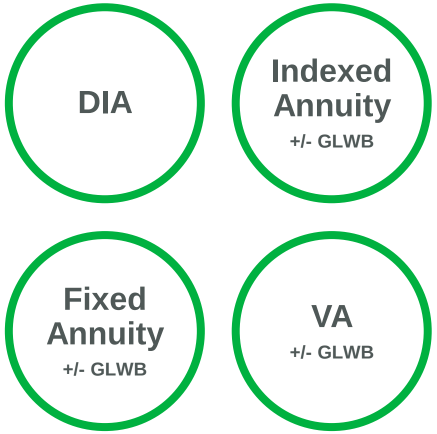
2. Annuity embedded within managed account/model, with annuity held in plan

Will require strategic integration amongst recordkeepers, model providers, insurers and technological integration with middleware

- Annuity embedded within asset allocation
- These have been envisioned with many different annuity types embedded (VA, Fixed Deferred, Indexed, and DIA/QLAC)
- Glidepath to annuity allocation created by model manager, annuity allocation typically begins around 50
- Annuity uptake typically not automatic in these constructs, more participant education will be helpful

3. Stand-alone annuity maintained in plan on recordkeeping platform

Will require continued strategic and technological integration amongst recordkeepers and insurers

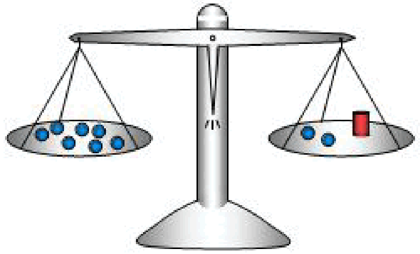


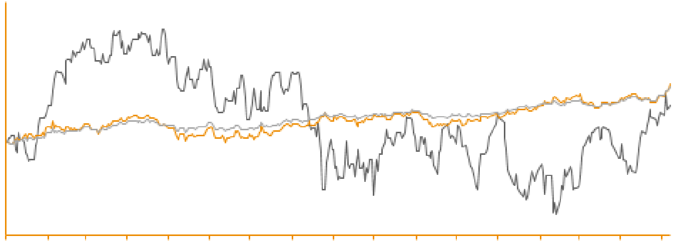
- Annuities stand alone as a plan offering for employer match only, QDIA, or fully optional
- We expect to see significant additional product development in this space in the near/medium term

Each product offered within each framework can be both qualitatively and quantitatively evaluated

Choosing a Partner

- Begins with Sponsor Needs Clarification
- Bespoke Product Features (Better Benefits, Better Employees)
- 1st Round RFP Tailored to Plan Sponsor Needs
- 2nd Round to Narrow Selection
- Carrier Soft Features
- Potential for evaluation services to be considered allowable plan expense.





QUESTIONS?

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