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ABSTRACT

Many participants in 401(k) plans would benefit from guaranteed retirement income to protect them from risk factors, such as underestimating how long they will live, overestimating the rate at which they can spend their retirement savings without the risk of running out of funds, investment risks, cognitive impairment risks, and inflation, as well as the seemingly contradictory risk of being too frugal with their retirement savings. Prior to the SECURE Act, perceived fiduciary liability and practical constraints were barriers to the inclusion of guaranteed retirement income contracts in 401(k) plans. The enactment of the SECURE Act, with its fiduciary safe harbor, its expanded distribution option to address portability, and the requirement to educate participants on the retirement income their accounts will provide, has been a significant step in removing those barriers.

THE RETIREMENT INCOME CHALLENGE IN 401(K) PLANS: OVERCOMING LEGAL OBSTACLES

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INTRODUCTION

The first generation of participants in 401(k) and other participant-funded and -directed retirement savings plans are now retired or approaching retirement, and they need to use those defined-contribution benefits to provide themselves sustainable lifetime income in retirement. Unfortunately, most participants do not have the knowledge, education, or experience to evaluate the issues such as life expectancies, withdrawal rates, investing for decumulation, and use of insured income products. To remedy that situation, participants need education, services, investments, and insured products to help them understand those considerations and to generate sustainable lifetime income from their retirement savings.

Plan sponsors have been reluctant to offer some of the available products, such as annuities, in their retirement plans because of concerns about their own fiduciary responsibility to prudently select and monitor insurance companies and insured lifetime income products, as well as possible fiduciary liability if the insurer were to become insolvent.

Historically, the US Department of Labor's (DoL) guidance was so demanding and, in some regards, so vague that plan sponsors either believed that they could not satisfy the standard or were reluctant to rely on it because of a lack of certainty. And, to compound the problem, there were few consultants who would serve as fiduciary advisors to plan sponsors for that purpose.

In addition, the practical solutions developed by the retirement plan industry apparently were not viewed by plan sponsors as efficient or effective in response to the perceived problems (e.g., portability of benefits, and processes for evaluating insurance companies and their insured products).

The adoption of the Setting Every Community for Retirement Enhancement Act (SECURE Act) of 2020 at the end of 2019 added legal protections and practical solutions designed to overcome the perceived legal hurdles and plan sponsor concerns. Those protections include a fiduciary safe harbor for selection of insurers, portability to preserve benefits where an insured product will no longer be supported by a plan, and illustrations of retirement income for participants.

As a result of the SECURE Act, plan sponsors can now offer insured income products to enable their participants to convert retirement savings into sustainable retirement income with little, if any, actual fiduciary responsibility for selecting and monitoring the insurer and with a specified fiduciary process for selecting the particular insured product.

The first generation of participants who will rely on their 401(k) plans or other participant-funded and participant-directed retirement savings plans for retirement income are now retired or approaching retirement. Because of the transition from defined-benefit to defined-contribution plan coverage, those participants cannot rely on a pension plan to provide them with guaranteed retirement income. Instead, they must look to their 401(k) plans, along with other personal assets and Social Security retirement benefits, to replace their paychecks and cover their expenses in retirement.[1] This reality has placed burdens on employees, many of whom are ill-equipped to determine how much to save and how to invest to accumulate benefits while working (the accumulation period), and how to invest and withdraw funds for living expenses in a sustainable manner in retirement (the decumulation period).

During their working years, employees are required to become savers and investors in order to accumulate retirement benefits. When they retire, those employees will need to turn their retirement accounts into streams of income, and to invest in and withdraw from their investments in a thoughtful and sustainable manner. However, they may lack the knowledge to withdraw and invest in a manner that does not exhaust their retirement benefits before their death.

Fortunately, there are options that can compensate for that lack of knowledge and, therefore, for the risk of failure. An allocation of retirement savings to annuities or other insured retirement income contracts (e.g., guaranteed minimum withdrawal benefits, or GMWBs) can provide a base of insured income that, combined with Social Security retirement benefits, can provide retirees with a secure foundation of lifelong income. Unfortunately, plan sponsors have been reluctant to offer insured solutions, such as in-plan annuities or other insured retirement income products. The reluctance has been fueled to a large extent by perceived legal constraints.[2]

There are obvious benefits to including insured income products in a plan to help participants deal with risks they will face in retirement. One benefit is that insured retirement income can offset the possibility of retirees spending their retirement savings too quickly, so that it will not last for their lifetimes. Insured retirement income can provide participants with fixed payments of income that will last for their lives (and that of their spouses, if a participant elects a joint and survivor contract). Another benefit is that it can offset a tendency to spend too little in retirement out of a concern about outliving their savings (Blanchett and Finke 2021). As discussed in section 1 of this paper, some commentators refer to this tendency as a license to spend that will help produce a better standard of living during retirement. Another benefit is that insured retirement income guarantees a base of ongoing income that will continue throughout a retiree's lifetime, no matter how long the retiree lives. That is, the insured benefits will not be exhausted through mistakes in making withdrawals or in investment decisions.

A recent paper by David Pratt (2020) addressed these barriers in detail, and readers are encouraged to review Pratt's discussion. To summarize the key legal concern, plan sponsors, as fiduciaries, have been reluctant to include annuities or other forms of insured income in their plans for several reasons.[3] The three key rea-

1. This paper uses "401(k)" plans for the sake of simplicity, but that term is intended to apply to all types of defined-contribution plans.

2. In this paper, the term "annuities" is used to refer to the various types of such insurance products, including fixed rate, fixed index, variable, immediate, and deferred annuities, as well as other types of contracts, such as GMWBs, that provide an insured stream of income. In addition, the term refers to such contracts included in a plan for the accumulation of retirement savings and those issued at the time of distribution of a participant's benefit. Finally, references in this paper to annuities is not intended to exclude other types of insured retirement income products.

3. In this paper, the term "plan sponsor" is used to refer to the fiduciaries of an employer-sponsored defined contribution retirement plan, usually consisting of a committee appointed by the employer or officers of the entity.

sons that plan sponsors do not want to include annuities or other forms of insured income in their plans are as follows:

- First, there is a concern about providing information on how much retirement income an employee can anticipate receiving from their account at retirement. The concern is that, if the projected annual income is less than indicated, a participant might bring a claim against the plan sponsor alleging that the information it provided misled the participant.
- Second, there is a fear that, if an insured product is offered in the plan, the insurer could become insolvent, and therefore would be unable to pay the insured benefits before a participant retires. The concern is, if that were to happen, the participant could file a claim for breach of fiduciary duty for selecting and monitoring the insurer.
- The third issue relates to concerns about fiduciary liability where a plan sponsor switches plan providers and, as a result, the insured benefits are lost. If a plan offers an insured contract in which a participant invests, and the plan sponsor switches the plan to another recordkeeper that cannot administer the contract on its system, participants may lose the benefit of the insured guarantee, despite having paid fees for the guarantee; this issue is generally referred to as a lack of portability. Again, there is a concern over a potential claim by the participant for that loss.

Prior to adoption of the SECURE Act, the DoL adopted a regulation under the Employee Retirement Income Security Act (ERISA) intended to provide a fiduciary safe harbor for satisfying the fiduciary duties under ERISA's "prudent man standard of care" rule (Iekel 2018) in selecting an annuity provider and contract for participants in defined-contribution plans (DoL 2008). The perception by plan sponsors and others was that the regulation provided little actual relief because it specified only that they make an "objective, thorough and analytical search" to identify an insurer and "appropriately consider information sufficient to assess the ability of the annuity provider to make all future payments" (DoL 2015) without describing the information a fiduciary should consider in making the selection and what would be sufficient to make the assessment. As a result, it appeared to plan sponsors that they were obligated to make expert fiduciary decisions about insurance companies and insured products, which many believed was beyond their capabilities. Because of the lack of specificity of a defined and implementable process, many plan sponsors were unwilling to include insured retirement income products in their plans.

With regard to the possibility of loss of insured income where plans changed recordkeepers, some insurance companies and plan recordkeepers developed systems that would allow participants to maintain their insured benefits when recordkeepers were changed. However, those systems were not widely viewed as attractive options and, as a result, did not allay plan sponsor concerns.

With regard to projecting retirement income, neither Congress nor the DoL provided legal guidance or a safe harbor on the methods of projecting or otherwise providing retirement income illustrations to participants. This left plan sponsors and service providers without legal certainty about how projections or illustrations could be developed and provided to participants in a prudent manner, resulting in many plans not providing retirement income projections to participants. However, some plan sponsors and service providers did provide projections to participants, relying generally on reasonable approaches that were intended to comply with ERISA's prudent man standard of care.

The SECURE Act addressed the reasons described earlier for not including annuities in their plans:

- The act provides a safe harbor for retirement income illustrations. The DoL has issued an interim final regulation specifying the assumptions and disclosures that should be used in providing the illustration. The effective date is September 2021, and the annual illustrations must be provided within 12 months thereafter. The DoL is working on a final regulation that may modify the methodology for calculating the illustrations, as well as the disclosures, but the effective date will not change. In addition, the act mandates that participants be educated on the concept that their plan accounts are intended to provide an income stream in retirement.

- Second, the SECURE Act provides a portability solution for changes in service providers. In effect, plan sponsors will be able to allow participants to roll over their insured benefits into individual retirement accounts (IRAs) and annuities if those benefits would otherwise be lost. This distribution and rollover provision is available even if there is no other distributable event under a plan's provisions or the law.
- Finally, the act provides a fiduciary safe harbor for the selection of the insurer for an insured retirement income contract. For this purpose, the SECURE Act defines such a contract to include both annuities and other types of contracts that provide a similar benefit, such as a GMWB.[4] The safe harbor does not extend to selection of the contract itself, but the act does provide guidance on the issues to consider in selecting the contract.

The expectation of the retirement income illustrations is that the information will encourage participants to view their 401(k) retirement savings as a source of income to be drawn on during retirement, as opposed to viewing savings only as a lump sum of wealth.[5]

By providing a portability solution, the second change is designed to relieve plan sponsors of the concern that, if they include retirement income contracts in their plans and subsequently change recordkeepers (or even decide to eliminate the option or change providers), the insured benefits that participants had paid for could be lost.

Finally, the safe harbor for selecting an insurer encourages plan sponsors to offer insured retirement income contracts in their plans by eliminating fiduciary risk that might result from future financial difficulties at the insurer.

As a result of these changes, plan sponsors can consider the inclusion of insured income contracts in their plans without most of the concerns about potential fiduciary risk. For example, the availability of the fiduciary safe harbor for insurer selection and monitoring eliminates the concern over liability for future insolvency of the contract issuer.

Plan sponsors will still need to exercise care in selecting the particular contract to offer to their participants (ERISA §404(e)(1)(B)). However, by engaging in a prudent process of considering the features and costs of the contract and the experience of the insurer in issuing and managing such contracts, it should be possible to provide a guaranteed retirement income solution to participants. The steps that plan sponsors can take for adding these contracts to the plan lineup are addressed in more detail in section 4 of this paper and in appendix A.

1. THE NEED FOR RETIREMENT INCOME

Retirement savings plans—primarily 401(k) plans—are critical vehicles for providing the money that participants will need to live on in retirement. These plans are an important part of the retirement three-legged stool: Social Security retirement benefits, personal assets, and benefits from an employer-provided retirement plan.[6]

However, unlike a defined-benefit pension plan, which is designed to provide guaranteed periodic payments,[7] the disclosures historically given to participants in 401(k) plans create the impression that their accounts are lump sums of wealth to be withdrawn at retirement, rather than a source of retirement income that will need to last for the rest of their lives.[8] The lump sum perception, when combined with a lack of education about sustainable lifetime income (e.g., life expectan-

4. ERISA §404(e)(6)(B) defines a guaranteed retirement income contract as "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."

5. See, e.g., DoL (2020): "EBSA believes that illustrating a participant's account balance as a stream of estimated lifetime payments, in accordance with the IFR, will help workers in defined contribution plans to better understand how their account balance translates into monthly income in retirement and therefore to better prepare for retirement."

6. Traditionally, the third leg of the stool was an employer-defined benefit pension plan, but in light of the decline in the offering of such plans, this paper uses the term "third leg of the stool" to refer to any employer-sponsored plan. For a discussion of this point, see Fichtner (2021).

7. Increasingly, however, defined-benefit plans have permitted participants to take their retirement benefits in the form of a lump sum, though participants in such plans are provided information about what their periodic benefit would be at retirement.

8. Some service providers have sought to overcome this deficiency by voluntarily disclosing to participants how much retirement income they can expect to receive from their account and where they stand in reaching an income-replacement goal.

cies, inflation, withdrawal rates) makes it hard for most participants to understand and properly evaluate the retirement income that they need and how to generate retirement income that will be sustainable for their lifetimes. This is further complicated by the uncertainty of what a person's lifetime will be, and by the common practice of retirees underestimating their life expectancies (Morelli 2021). Added to this problem is that, as a general rule, participants do not understand the risks they face in handling their retirement savings. These risks include the following (see also ERISA Advisory Council 2020; and Hou 2020):

- Not understanding their (and their partner's) potential lifetime, such as how long they are likely to live, and, thus, how long their retirement savings needs to last.
- Not understanding how much they can withdraw each year so that the money will last for their anticipated lifetimes.
- Not knowing how to invest their money in retirement (i.e., during decumulation) to fund the withdrawals, while protecting against large losses.
- Not recognizing that their ability to manage their affairs will tend to diminish with age.

The first and second points in this list emphasize the risk that participants may spend their retirement savings too quickly by withdrawing too much in too short a period. The obvious concern is that they will not have resources, other than possibly Social Security retirement benefits and their non-plan assets, to pay their living and other expenses later in life.

An additional concern is the tendency of retirees to spend too little. By spending conservatively, retirees may live a less enjoyable retirement and may skimp on paying for necessary items. A recent paper by David Blanchett and Michael Finke addresses this issue, concluding in part that households with a steady fixed income (e.g., from an annuity) tend to spend more than those who rely on savings alone (Blanchett and Finke 2021). They conclude that this can provide retirees with a psychological benefit that they characterize as a license to spend—not frivolously, but in a way that is consistent with their available income.

These issues have led to an increasing awareness in legislative and regulatory circles, and within the service provider community, of the need for solutions to increase awareness and provide opportunities for 401(k) (and other defined-contribution) retirement savings to be converted to retirement income that will last for the lifetimes of retirees (and their spouses).

One alternative is to provide for insured retirement income in 401(k) plans.[9] While the need, and this solution, have been recognized for some time, there were barriers to including these products in plans.

Section 2 offers a discussion of the barriers that the SECURE Act sought to address.

2. BARRIERS TO PROVIDING GUARANTEED RETIREMENT INCOME

The impediments responsible for the slow adoption of guaranteed retirement income solutions in 401(k) plans have been at both the plan sponsor level (i.e., a reluctance tied to concerns about potential fiduciary liability) and the participant level (i.e., impediments that may arise from a lack of information and/or education). These are not the only factors, however. In the first three decades after 401(k) plans became the principal retirement plan vehicle in the United States, the primary focus was on accumulation—that is, getting employees to participate in and defer enough of their compensation into 401(k) plans for them to accumulate meaningful retirement savings. During this phase of the development of the 401(k) marketplace, service providers, plan advisors, and investment firms were slow to consider how participants would spend their savings in retirement in a sustainable manner, and thus were slow to consider offering guaranteed income products (Pratt 2020, sec. 1, p. 3).

The perception has begun to shift, but concerns by plan sponsors and the lack of engagement by participants remain. From a plan sponsor perspective, two of the primary fiduciary concerns relate to potential claims where the issuer of a guaranteed product is unable to fulfill its financial obligation when covered participants retire, and to participants' loss of their payments for an insured product if the product were no longer included

9. The term "insured retirement income," as used in this paper, refers to annuities and other insured contracts that provide for a specified amount payable by an insurance company for the life of the retiree or for a specified period.

in the plan and it was not portable in a manner that preserved the benefit acquired as a result of the participants' payments. (The portability concern is usually tied to the possibility that the product could not be maintained in the event of a change in recordkeeper by the plan sponsor.) From a participant perspective, the issue seemed to be largely a lack of understanding of the issues they face in retirement, such as life expectancies, withdrawals rates, and the risks involved in investing while in retirement, as well as a possible lack of knowledge about how annuities work and the benefits they provide.

2.1. LEGAL OBSTACLES

Pratt's paper provides a detailed exploration of the guidance that preceded the enactment of the SECURE Act. As he points out, legislative and regulatory guidance related to the purchase of annuities by defined-contribution plans began to evolve after the failure of Executive Life Insurance Company in 1991 (Pratt 2020, sec. 3, pp. 4–9). Unfortunately, these steps largely had the impact of heightening the concerns of plan sponsors about adding insured retirement income products to their defined-contributions plans. A DoL regulation emphasized their fiduciary duty to conduct an "objective, thorough and analytical search to identify providers from which to purchase annuities" (DoL 2008, 29 CFR §2550.404a-4). The DoL sought to address this concern by adopting a fiduciary safe harbor regulation (ibid.).[10] While the regulation was labeled as a safe harbor and while it identified certain items that sponsors needed to assess, it failed to provide guidance on what information a plan sponsor needed to obtain in order to make the required assessment.

Stated somewhat differently, plan sponsors understood that they had a fiduciary obligation to select a provider of insured retirement income (where the obligations for payments would be years in the future), but did not know what information should be considered in order to make that determination (and might not, in any event, have believed themselves to be competent enough to evaluate complex accounting information about the financial strength of insurers). This uncertainty led to plan sponsor concerns that they were exposed to potential liability if an insurer became insolvent at some point in the future, as occurred with Executive Life Insurance Company (National Organization of Life & Health Insurance Guaranty Associations [NOLHGA] n.d.a).

2.2. PRACTICAL OBSTACLES

The fiduciary concern about selecting and monitoring insurers and annuities or other insured retirement income products in 401(k) plans has been only one of the obstacles. Another concern has been about the portability of such a product offered to the participants—that is, whether participants will be able to retain their interest in the product in the event of a change in recordkeeper or if participants terminate employment.

For example, although insurers and recordkeepers have made strides in facilitating the transfer of guaranteed income contracts from one plan and one service provider platform to another, such a transfer has remained a portability obstacle due to the inability of recordkeepers, in many cases, to administer an insured retirement income product issued by a third-party insurer (Iwry et al. 2019, 15). It is common for providers of insured retirement income products to offer distribution portability products. In selecting a contract to include in their plans, plan sponsors should determine whether the product they are considering offers distribution portability and whether the solution is appropriate to preserve the benefits of participants who select the contract.

Another obstacle has been a lack of broad engagement by participants. Even when a plan does offer insured retirement income products, few participants have selected them (Iwry et al. 2019, 5).

3. CURRENT LEGAL SOLUTIONS

The discussion that follows addresses the legal solutions provided by the SECURE Act that help to address

10 . The regulation required that a fiduciary "appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract [and] appropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract" (DoL 2008, 29 CFR §2550.404a-4). The regulation does not, however, indicate how that assessment is to be made or what information is sufficient for these purposes.

the obstacles discussed in section 2: the fiduciary safe harbor for selecting and monitoring the insurer, issues related to selecting the contract, the portability solution, and the lifetime income disclosure requirement of the new law. The paper then addresses the question of including lifetime income in a plan's qualified default income alternative (QDIA).

The discussion in this section of legal solutions is followed in section 4 by a description of steps that plan sponsors should take in light of the discussions in this paper.

3.1. ADVENT OF THE SECURE ACT

The SECURE Act contains three provisions designed to address both the participant and plan sponsor issues about including and investing in insured retirement income contracts in 401(k) and other participant-funded plans: the fiduciary safe harbor for the selection and monitoring of the insurer (sec. 3.2), the addition of a new in-service distribution option to address the portability issue (sec. 3.4), and a new requirement to provide participants with an illustration of the income their 401(k) account will provide them in retirement (sec. 3.5).

The first of these three provisions is designed to address fiduciary concerns about adding an annuity or other insured income contract to the plan. The second is intended to eliminate concerns about portability. The third is designed to provide illustrations and education to participants to show their account balances as retirement income.

These new provisions are discussed in the following section of this paper.

3.2. THE FIDUCIARY SAFE HARBOR FOR SELECTING AND MONITORING THE INSURER

New ERISA section 404(e), which was added by the SECURE Act, provides for fiduciary protection for the selection of an insurer that underwrites a "guaranteed retirement income contract" (ERISA §404(e)((6)(B)).[11] The safe harbor protection applies to the selection of the insurer for such a contract, but not to the contract itself. Pratt's paper provides a detailed description of the new section (Pratt 2020, sec. 3.6, sec. 3.7, pp. 6–7), but below is a brief summary.

Plan sponsors, as fiduciaries, are relieved of liability for losses sustained by a participant due to an insurer's inability to pay the benefits under the guaranteed retirement income contract (ERISA §404(e)(5)). The protection is afforded to plan sponsors when they appropriately consider the financial capability of the insurer at the time of selection of the contract (ERISA §§404(e)(1)(B)(i) and 404(e)(1)(C)(i), respectively). This fiduciary safe harbor was provided by Congress to encourage plan sponsors to include insured retirement income in plans. The goal was to allay plan sponsors' concerns about the possible insolvency of the insurer; this is true even though there are few incidents of the loss of annuity benefits due to insolvency and there are state guarantee funds that provide protection in the case of insurer insolvency.[12] Congress's adoption of a formulaic approach has simplified satisfaction of the obligation to consider the insurer's financial capability, as well as the monitoring obligation thereafter. In effect, the fiduciary responsibility has been reduced to a checklist approach, and plan sponsors are required only to obtain written representations from an insurer with respect to whether the following is true:

1. The insurer is licensed to offer guaranteed retirement income contracts.
2. The insurer, at the time of selection and for the immediately preceding seven years,
   a. operates under a current certificate of authority in its domiciliary state,
   b. has filed audited financial statements in accordance with law,
   c. maintains required regulatory reserves, and
   d. is not operating under an order of supervision, rehabilitation, or liquidation.

11. The provision defines such a contract as "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" (ERISA §404(e)((6)(B)).

12. See, e.g., NOLHGA (n.d.b) for information about state insurance guaranty funds.

3. The insurer undergoes a financial examination by the insurance commissioner of its domiciliary state at least every five years.
4. The insurer agrees to notify the fiduciary of any change of circumstances that precludes making these representations (ERISA §404(e)(2)).

If plan sponsors obtain that information from an insurer, they have a fiduciary safe harbor from liability if an insurer is unable to pay the guaranteed benefits, as long as they have "no other information which would cause the fiduciary to question the representations provided" (ERISA §404(e)(2)(B)). Considering that the purpose of the safe harbor is to facilitate the availability of insured retirement income products in retirement plans, and the lack of any requirement to investigate for that other information, the provision should be read literally. That is, if a plan sponsor acting in its fiduciary capacity (e.g., the plan committee) does not actually have any information that would cause it to question the insurer's representations, there is a fiduciary safe harbor provided where the plan sponsor obtains the required information from the insurance company.

ERISA requires fiduciaries to act with "care, skill, prudence and diligence" (ERISA §404(a)(1)(B)) in both the initial selection of an investment or service provider and in the decision to retain that investment or provider; the latter (the decision to retain) is referred to as the "duty to monitor."[13] The SECURE Act recognizes this monitoring obligation by requiring a periodic review of the continuing appropriateness of the plan sponsor's selection of the insurer and the contract. For the selection of the insurer, this review is accomplished by obtaining an updated set of representations from the insurer on an annual basis. In other words, the ongoing monitoring of the insurer (but not the contract) requires that the plan sponsor obtain the same information as it did for the initial selection process and, if that information is obtained and the plan sponsor does not have any other information that would cause it to question the representations by the insurer, the monitoring decision to retain the insurer as the provider of the guarantee is covered by the safe harbor (ERISA §404(e)(4)(A)(ii) and (B)).

3.3. SELECTING AND MONITORING THE CONTRACT

While the safe harbor covers the selection of the insurer, plan sponsors are still obligated to 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" and to conclude that "the relative cost of the selected guaranteed retirement income contract... is reasonable" (ERISA §§404(e)(1)(B)(ii); ERISA §§404(e)(1)(C)(ii)).

As with any investment alternative chosen by plan sponsors to be offered to the participants, an insured retirement income contract must be selected and monitored using a prudent process. This process requires plan sponsors to (1) obtain information that is relevant to the selection (or monitoring), (2) assess the information, and (3) make an informed and reasoned decision based on the assessment of that information.

This is sometimes referred to as a prudent process leading to an informed and reasoned decision (see *Fink v. National Savings & Trust Co.*). This same process applies to the monitoring of the contract to determine whether the selection continues to be prudent.

Though the SECURE Act does not provide a simplified process for assessing the cost of a contract—as it does for selection of the insurer—it does spell what information (i.e., relevant information) should be obtained for purposes of assessing the cost: (1) the benefits provided under the contract, (2) the features of the contract, and (3) the administrative services provided by the insurer under the contract.

While cost of the contract must be considered, section 404(e) of ERISA says that there is no obligation to select the lowest-cost contract. That section goes on to say that a plan sponsor "may consider" additional information about the value of the contract and "attributes of the insurer (including, without limitation, the insurer's financial strength)" (ERISA §404(e)), but the act does not require consideration of that information.

13. See, e.g., *Tibble v. Edison International*: "ERISA's fiduciary duty is 'derived from the common law of trusts,' Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc., 472 U. S. 559, 570, which provides that a trustee has a continuing duty—separate and apart from the duty to exercise prudence in selecting investments at the outset—to monitor, and remove imprudent, trust investments."

The reference to the insurer's financial strength may raise a concern that this language undercuts the safe harbor, which requires only obtaining the insurer's representations. That should not be a concern—first, because the provision does not mandate that a fiduciary consider additional information, only that it "*may* consider" (emphasis added; ERISA §404(e)) such information; and second, because section 404(e) is clear that the only requirements about the financial strength of the insurer is for plan sponsors to obtain the representations and not be in possession of contrary information.

In considering which product to select, the first step would be to determine the desired type of benefit (e.g., an annuity or GMWB) and to compare it to other competitive products in that category, primarily in terms of cost, benefits, and administrative experience of the insurer. Neither ERISA nor the SECURE Act requires plan sponsors to select the "perfect" product for their plans; indeed, it is likely there are a number of insured contracts in each category that could be prudent choices for a plan. For the selection of a particular insured retirement income contract, the law requires only that plan sponsors engage in a prudent process to reach an informed and reasoned decision that balances cost, the needs of participants, and the terms of the available products. To the extent that the competing products of several insurers pass that test, any of those products could prudently be selected for a plan.

Steps that plan sponsors should consider taking to fulfill the contract selection process are further discussed in section 4 of this paper.

3.4. THE PORTABILITY SOLUTION

In order to satisfy any legal and/or administrative concerns regarding the portability of insured retirement income contracts, the SECURE Act added a new in-service distribution event to defined-contribution plans and provided conforming changes for distributions from 401(k), 403(b), and 457 governmental plans (though not nongovernmental 457 plans). The new provision applies when a lifetime income investment (which is, essentially, the same as an insured retirement income contract) is no longer authorized to be held in a plan[14] (Internal Revenue Code [IRS], §401(a)(38)). This would occur, for example, if a plan sponsor determines that the lifetime income investment should no longer be made available in the plan or if the plan sponsor decides to change recordkeepers and the new service provider is unable to administer the contract on its platform.

New section 401(a)(38) of the Internal Revenue Code, which was enacted as part of the SECURE Act, permits a distribution "on or after the date that is 90 days prior to the date on which such lifetime income investment is no longer authorized to be held as an investment option under the plan" (IRS n.d.). (For a more detailed discussion, see Pratt 2020, sec. 4.)

For good reason, the new distribution option does not address the other portability issue—that is, how the insured retirement income contract is preserved by a participant when the participant retires or otherwise terminates their employment. There are two reasons for not addressing the other portability issue. First, termination of employment is itself a distribution event, so a participant may elect to take a distribution and roll over into an insured IRA that protects the retirement income guarantee. Second, and as a practical matter, the insurance companies that provide insured retirement income contracts have rollover solutions to this aspect of the portability issue. For example, if the benefit is a GMWB, the insurance company typically has an individual variable annuity with a GMWB that preserves the insured income that the participant has paid for. Similarly, if the benefit is in the form of an annuity, it can be distributed as an individual retirement annuity, which is another form of IRA. Thus, plan sponsors should consider whether the particular provider has a rollover product that allows participants to continue the protected benefits they paid for and accumulated. While there is no explicit fiduciary requirement that plan sponsors examine a rollover product, they may want to determine that the costs and benefits are comparable to what they were in the plan or, alternatively, that any increases in cost are reasonable.

A plan sponsor will need to amend its plan to provide for these SECURE Act in-service distribution provisions.

14. See §§401(a)(38)(B)(ii) and §§401(a)(38)(B)(iii) for relevant definitions.

3.5. LIFETIME INCOME DISCLOSURE

The SECURE Act added a requirement to ERISA that individual account plans issue lifetime income disclosures to participants at least once a year (ERISA §105(a)(2)). It also required the DoL to issue guidance specifying the assumptions to be used for calculating the retirement income illustrations, as well as safe harbor disclosures and explanations. The DoL released the guidance in 2020 in the form of an interim final regulation, which became effective on September 18, 2021 (Federal Register 2020, p. 59132).[15]

Without repeating the details set out in Pratt's paper, the interim final regulation specifies that the notice must provide participants with an illustration of a lifetime income stream based on a participant's current account balance (Pratt 2020, sec. 5.2). While this will be useful for participants who are approaching retirement age, the information's usefulness for younger participants with small account balances is questionable. The DoL's interim final regulation requires that the illustrations assume that a participant is age 67; for example, if the December 31, 2021, account balance is used for a 35-year-old participant, that participant is assumed to be 67 years old on that date. That said, the expectation is that, by giving participants annual notices describing the stream of income that their account will provide, they will be encouraged to view their accounts as a source of income, rather than only as a lump sum of retirement wealth. If the SECURE Act is successful in that regard, it should generate interest in insured retirement income contracts and investment strategies for retirement income.

3.6. LIFETIME INCOME AS A QDIA

If participants in 401(k) plans fail to direct their investments, plan sponsors have a fiduciary responsibility to invest those defaulted accounts.[16] To ease concerns about making this fiduciary decision, ERISA provides a fiduciary safe harbor for the selection of a QDIA (ERISA §404(c)(5)). While a plan sponsor is required to engage in a prudent process to select the QDIA investments offered in its plan, it is not liable for any losses that a participant may suffer as a result of the investment of their account in a QDIA (ERISA Reg. §2550.404c-5(b)).

A regulation adopted by the DoL in 2007 lays out the requirements for this safe harbor, including required notices and the types of investment vehicles that qualify as QDIAs (ERISA Reg. §2550.404c-5(b), §§ (c), (d), (e)). These include target date funds, balanced accounts, and managed accounts. The regulation does not address whether it is permissible to include an insured retirement income element in a QDIA. However, the DoL has provided informal guidance on this issue, indicating that the inclusion of such a feature would not cause the investment vehicle to fail to qualify as a QDIA (Borzi 2014).

Since defaulting participants face the same risks in retirement as those who exercise control over their accounts, plan sponsors may conclude that inclusion of an insured income contract in their QDIA is appropriate. One reason for considering inclusion of an insured income contract in their plan's QDIA is that participants are prone to inertia—that is, they tend not to elect to move their retirement savings to other investment alternatives offered by their plan (Blanchett, Finke, and Liu 2020). Plan sponsors will need to take the same steps as discussed in the next section of this paper to make the selection, but both the insurer selection safe harbor and the QDIA safe harbor will provide them with considerable fiduciary protection.

4. STEPS THAT PLAN SPONSORS SHOULD TAKE

As discussed in section 3, the SECURE Act provides a fiduciary safe harbor for the selection of an insurance carrier that issues a retirement income product. The act does not include a safe harbor for selection of the contract issued by the carrier. This means that a plan sponsor must engage in a prudent process in making that selection. While that process is akin to the prudent process for selecting any investment alternative for a plan, there are additional factors that need to be considered. The purpose of this section is to outline the steps that plan sponsors can take when adding a retirement income solution to their plan and, in particular, in selecting a retirement income contract to offer to participants.

15 . At the time of writing of this paper, the DoL is working on a final regulation that may modify some of the provisions of the interim final regulation.

16. See, e.g., ERISA Reg. §2550.404a-5(a). For a fuller discussion of this issue, see Pratt (2020, sec. 6).

4.1. THE SIX-STEP PROCESS

There is no legal mandate under ERISA for plan sponsors to include insured retirement income contracts (or, for that matter, other retirement income strategies) in their 401(k) plans. Nevertheless, plan sponsors may want to consider including that benefit, given the participant's need and the enhanced fiduciary protections for the selection and monitoring of insurers. The following is the six-step process to help plan sponsors in adding guaranteed retirement income contracts to their plans (see appendix A).

STEP 1: DECIDE TO ADD RETIREMENT INCOME.

The first step is to decide whether retirement income strategies should be added to a plan. If not, there would be no need to investigate the options available for insured retirement income.[17]

STEP 2: CONSIDER PLAN MODIFICATIONS.

Assuming a plan sponsor decides to include a retirement income solution in its plans, it should then assess several other issues:

a. Whether to offer the insured benefit as an exit strategy only; an example would be an annuity to be purchased at retirement or as an in-plan investment alternative. If the insured benefit is offered as an in-plan alternative, the plan sponsor will also need to decide whether to include the annuity in the plan's QDIA.

b. Whether the plan should be amended to mandate inclusion of an insured retirement income contract.

c. Whether the plan should be amended to permit periodic distributions.

d. Whether to amend the plan to mandate inclusion of an insured retirement income contract.

As an aside, it should be noted that the decision to mandate inclusion and to permit periodic distributions would be considered settlor decisions—that is, a business decision made by the plan sponsor, rather than a fiduciary decision. Once those settlor decisions are made, their implementation is a fiduciary function. ERISA requires fiduciaries to follow the terms of the plan unless it would be imprudent for them to do so (ERISA §404(a)(1)(D)), so the settlor decision to include an insured retirement income feature in the plan would need to be implemented, unless the fiduciaries determine that it would be imprudent to comply with the plan provision. Realistically, it is unlikely that it would be imprudent to offer retirement income solutions to participants. Absent that determination, though, the fiduciaries (e.g., a plan committee) would be obligated to follow the plan provision. Even there, though, the process of selecting a particular contract would continue to be a fiduciary responsibility.

STEP 3. REVIEW PRODUCTS AND SELECT THE TYPE OF INSURED VEHICLE.

The plan sponsor will need to assess the available alternatives and choose the particular form of insured retirement income vehicle to select. As the SECURE Act safe harbor recognizes, a "guaranteed retirement income contract" can come in several forms (ERISA §404(e)(6)(B)). For example, these forms include traditional annuities and products referred to as guaranteed minimum withdrawal benefits (GMWB) contracts.

STEP 4. IDENTIFY INSURERS THAT OFFER THE VEHICLE.

After deciding on the type of product, a plan sponsor should identify insurers with a history of issuing and administrating insured retirement income contracts of the type selected, with a focus on those with experience in working with retirement plans.

STEP 5. GATHER AND ASSESS INFORMATION ON THE PRODUCTS.

In this step, a plan sponsor will need to gather and assess information to compare the terms, features, and costs of the contracts issued by the identified sampling of insurers who issue the particular type of insured product that the plan will be offering. This step is discussed in further detail in section 4.2.

STEP 6. OBTAIN INSURER SAFE HARBOR REPRESENTATIONS.

A plan sponsor will need to obtain the representations required by the SECURE Act safe harbor from the

17. For a discussion of the participant demand for such an option, see Finke and Fichtner (2021).

insurer that issues the contract selected in step 5 and affirm that the plan sponsor does not have any contradictory information.

Once the insurer and contract have been selected and added to the plan's investment alternatives, the plan sponsor will need to begin a process of notifying and educating participants on the need for and advantages of selecting the contract for their accounts.

Because of the SECURE Act safe harbor, the selection of the insurer is straightforward and, in a manner of speaking, is a check-the-box approach. Though selecting the contract requires a fiduciary process, the SECURE Act identifies the issues to be considered. The insurance companies that are experienced in providing insured retirement income products to retirement plans can provide assistance with the information that needs to be considered.

4.2. GATHERING AND ASSESSING INFORMATION ON THE PRODUCTS: SELECTING THE CONTRACT

Subsection 4.1 briefly summarizes the process for selecting the issuer of an insured retirement income contract. That process includes selecting the type of contract to be included in the plan and then selecting the specific contract to be offered to participants. As outlined in step 5, selecting the specific contract entails gathering information about the alternatives under consideration, and comparing the terms, features, and costs of the contracts. This subsection describes steps that plan sponsors may take that, if followed, should constitute a prudent process for selection of a contract. Note that this is not an exclusive list and, in a given case, additional factors may need to be considered.

First, consider the terms of the contract in relation to the needs of the participants. In selecting the contract, there is no obligation to select a "perfect" retirement income contract or even to select the very best product, if that were even possible. Instead, the fiduciary responsibility of plan sponsors is to make a reasonable and prudent choice that balances the needs of the participants with the terms of the contract, its cost, and the ability of the insurer to administer the product. Since the marketplace for insured retirement income products is robust, it is likely that a number of competing products would satisfy those requirements and would thus be prudent choices.

Second, consider the cost of the contract. The standard under ERISA is to determine whether the cost is reasonable in comparison to other similar products in the market and in relation to the benefits provided by the contract. In other words, the determination of reasonableness of cost is based primarily on a comparison of similar products in the market. This means that plan sponsors should identify similar products with similar features and determine whether the contract they are considering is competitively priced.

Third, consider the administrative services to be provided by the insurer. This could include services provided both before retirement and after retirement, as well as an assessment of the insurer's experience in administering the particular type of contract, and other guaranteed products. A significant history of administering a large number of such contracts suggests both the requisite experience and a commitment to provide insured retirement income products.

Finally, plan sponsors may decide to consider attributes of the insurer, including its financial strength. This is a factor that a plan sponsor may consider, but is not one of the required elements. For example, a plan sponsor could look at the insurer's reputation, history, and financial strength ratings by the ratings agencies. In addition, plan sponsors may want to consider whether guaranteed income is a major part of the insurer's business. If it is, that suggests a long-term commitment to the business.

CONCLUSION

Many participants in 401(k) plans would benefit from guaranteed retirement income to protect them from risk factors, such as underestimating how long they will live, overestimating the rate at which they can spend their retirement savings without the risk of running out of funds, investment risks, cognitive impairment risks, and inflation, as well as the seemingly contradictory risk of being too frugal with their retirement savings. Prior to the SECURE Act, perceived fiduciary liability and practical constraints were barriers to the inclusion of guaranteed retirement income contracts in 401(k) plans.

The enactment of the SECURE Act, with its fiduciary safe harbor, its expanded distribution option to address portability, and the requirement to educate participants on the retirement income their accounts will provide, has been a significant step in removing those barriers.

Plan sponsors will still need to take steps to prudently select retirement income contracts. However, that process should be reasonably familiar to plan sponsors and their advisors, since they already engage in a similar process to select the investments offered in their plan. The difference is the information to be evaluated. Fortunately, the SECURE Act specified the information to be reviewed for that purpose, easing the burden on plan sponsors.

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APPENDIX A: *Checklist for Selecting Retirement Income Contracts*

STEP	ACTION REQUIRED	STATUS
1. Decide to add retirement income.	The first step is to decide whether retirement income strategies should be added to a plan. A plan sponsor should consider the information outlined in the remainder of this checklist.	
2. Consider plan modifications.	A plan sponsor that decides to offer a retirement income strategy should assess several other issues: a. Whether to offer the insured benefit as an exit strategy only; an example would be an annuity to be purchased at retirement. b. Whether to offer as an in-plan investment alternative and, if offered as an in-plan alternative, whether to include the annuity in the plan's QDIA. c. Whether to amend the plan to permit periodic distributions. d. Whether to amend the plan to mandate inclusion of an insured retirement income contract. Note: The decision to mandate inclusion and to permit periodic distributions would be considered "settlor" decisions, but once settlor decisions are made, implementation is a fiduciary function.	
3. Review products and select the type of insured vehicle.	Assess available alternatives and choose the particular form of insured retirement income vehicle to select (Note: Guaranteed retirement income contracts come in several forms, such as traditional annuities and GMWB contracts.	
4. Identify insurers that offer the vehicle.	Identify insurers with a history of issuing and administrating insured retirement income contracts of the type selected, with a focus on those with experience in working with retirement plans.	
5. Gather and assess information on the products.	Compare the terms, features, and costs of the contracts offered by the identified insurers: a. Consider the terms of the contract in relation to the needs of the participants. **Note:** A number of competing products may satisfy this requirement and thus may be considered to be prudent for this purpose. b. Consider the cost of the contract to determine whether it is reasonable in comparison to other similar products and in relation to the benefits. Note: This means that plan sponsors should identify similar products with similar features and determine whether the contract they are considering is competitively priced. c. Consider the administrative services to be provided by the insurer, including before and after retirement. d. Assess the insurer's experience in administering the particular type of contract, as well as other guaranteed products.	
6. Obtain insurer safe harbor representations.	Obtain the following representations regarding the insurer as required by the SECURE Act safe harbor and confirm the plan sponsor does not have any contradictory information. a. The insurer is licensed to offer guaranteed retirement income contracts. b. The insurer, at the time of selection and for the immediately preceding seven years, • operates under a current certificate of authority in its domiciliary state, • has filed audited financial statements in accordance with law, • maintains required regulatory reserves, and • is not operating under an order of supervision, rehabilitation, or liquidation. c. The insurer undergoes a financial examination by the insurance commissioner of its domiciliary state at least every five years. d. The insurer agrees to notify the fiduciary of any change of circumstances that precludes making these representations.	