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A fiduciary's guide to offering lifetime income

With companies, employees and policymakers all thinking more about "retirement readiness," the question of how to generate sustainable and reliable lifetime income is growing in importance. For retirement plan fiduciaries, this focus can give their participants a sense of security and can be a tool to attract and retain employees. Per a recent Employee Benefit Research Institute survey, three out of four employees say they prefer income stability over principal preservation, and 78% express interest in a guaranteed lifetime income product at retirement. The 2019 SECURE Act made it easier for plan sponsors to offer workplace annuities, by providing a safe harbor protection as long as employers follow some simple steps. So what do plan fiduciaries need to know?

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KEY TAKEAWAYS

- Plan sponsors now have the ability to offer employees guaranteed lifetime income as part of their retirement plans.
- The SECURE Act provided specific steps for selecting a guaranteed income provider within a retirement plan that plan fiduciaries must follow to qualify for the safe harbor.
- TIAA and Nuveen can help 401(k) plan sponsors evolve their retirement plans, just as we have serviced our 403(b) clients and helped them provide guaranteed lifetime retirement income for their participants for more than 100 years.

EMPLOYEES NEED, WANT AND DESERVE A STREAM OF GUARANTEED INCOME

The 401(k) plan was designed back in the 1980s to allow employees to save pretax money for retirement, supplementing the steady, guaranteed retirement income stream provided by defined benefit plans. With defined benefit plans now largely phased out, however, employees are on their own to turn their 401(k) savings into retirement income at a time when market investments alone are proving to be inadequate.

As a result, Cerulli reports that 71% of employees say they are concerned about losing their savings, while 72% worry about outliving retirement savings. And retirees must navigate complex questions such as: How should I manage my assets in retirement? How much can I safely take out of my account each year? What happens if the markets decline and the value of my nest egg significantly declines? How long will my assets last?

These employees are looking to their employers for help. Our own research shows that more than half believe that employers have a responsibility to provide their workers with the means of securing lifetime income after retirement. Now, thanks to the SECURE Act, employers can make 401(k) plans look more like traditional pension plans. This has the dual benefit of helping employees achieve the retirement they deserve, while also providing employers a way to attract and retain talent.

This is a major step forward. Outside of pensions and Social Security, only annuities can guarantee lifetime retirement income. As life expectancy increases and health care costs continue to rise, annuities have become an important way for retirees to literally "insure" they won't run out of money in retirement.

EMPLOYERS HAVE OPTIONS TO OFFER LIFETIME INCOME WITHIN THEIR PLANS

Retirement income can be provided to participants in a number of ways (Figure 1). Systematic withdrawals and managed payouts emphasize preserving liquidity, while various forms of annuities focus on reducing longevity risk (the risk of running out of money in retirement). The various strategies and tradeoffs can be complicated (especially when it comes to annuities), and we encourage plan sponsors to work with experienced retirement providers to help determine which approach might be most appropriate for their individual plans.

Figure 1: Lifetime income solutions offer varied benefits

	Emphasize liquidity		Emphasize longevity risk protection		
Attribute	**Systematic withdrawals**	**Managed payouts**	**Guaranteed lifetime withdrawal benefit (GLWB)**	**Fixed annuity**	**Qualified longevity annuity contract (QLAC)**
Description	Participant determines amount and frequency of withdrawals from their retirement account until it's empty	Managed account investment manager determines the regularly scheduled payouts, adjusted for market fluctuations, with the goal of helping to ensure funds last through retirement	Contributions are invested into an insurance separate account and paid out to the retiree as steady withdrawals in retirement, regardless of market fluctuations	Predetermined interest rate is earned during the participants' working years. Participant can exchange the fixed annuity for a guaranteed monthly income amount throughout retirement.	Portion of retirement assets are used to purchase guaranteed lifetime income that does not start to payout until a later age; typically 85 or older.
Principal protection	No	No	No	Yes	N/A
Payment guaranteed for life	No	No	Yes	Yes	Yes, but payments do not start until later in retirement
Income protected from market downturns	No	No	Yes	Yes	Yes
Ability to withdraw before payments have begun	Yes	Yes	Yes, but may impact guaranteed payment amount	Yes	No
Ability to withdraw after income has begun	Yes	Yes	Yes, but may impact guaranteed payment amount	No	No

Data sources: Employee Benefit Research Institute (EBRI), Cerulli and TIAA/Nuveen. This comparison represents only a sample of features typically included in the product types when used in the institutional retirement plan market and does not attempt to articulate all options that may be available. Insurance product guarantees are backed by the claims-paying ability of the issuer.

CHOOSING THE RIGHT PARTNER WITHIN SAFE HARBOR SPECIFICATIONS

In addition to the complexities involved with structuring income options within a 401(k) plan, plan sponsors also need to follow specific rules to protect themselves from liability. The SECURE Act created a new fiduciary safe harbor that helps plans offer annuities by protecting plan sponsors from these liabilities should the annuity provider become insolvent or otherwise unable to pay. The act provided specific steps, outlined below, that plan fiduciaries must follow to qualify for the safe harbor:

Identify the insurers. Conduct and document an evaluation of several insurance companies that provide competitive annuity products. Include the available products, pricing, participant communications and potential client experience, as well as any restrictions.

Research insurer financial strength. Obtain written representation that each licensed insurance company satisfies the following (currently and for the preceding seven years):

- Operates under a valid certificate of authority
- Files compliant audited financial statements
- Maintains adequate statutory reserves
- Does not operate under an order of supervision, rehabilitation or liquidation
- Undergoes financial examinations by its state insurance commissioner at least every five years

The onus of this criteria is on the insurer, not the plan sponsor. The plan fiduciary is not required to evaluate the information, but rather only ensure that the insurer's written attestation statements align with the statute's requirements. That creates a fiduciary safe harbor for selecting the insurance company.

Consider fees and costs. Weigh the cost (including fees and commissions) of the guaranteed retirement contract in relation to the product features, benefits, record-keeper portability and administrative services. Do the fees seem reasonable and competitive given the product features and benefits being provided? Are they in-line with the plan objectives and what the plan sponsor wants to provide their employees?

Evaluate the product features. Plan fiduciaries should look at more than past performance and fees when considering lifetime income options. They should also consider when lifetime income should be included in the qualified default investment alternative (QDIA). Is there a benefit to adding lifetime income for younger participants and what are the consequences/costs? What are the tradeoffs? How does lifetime income impact the portfolio allocation?

When including a lifetime income feature within a plan's QDIA, plan sponsors should consider:

- Impact on savings, particularly around the time of retirement
- Income received in retirement (guaranteed and not guaranteed)
- Savings available for emergencies or to bequeath to a beneficiary
- Portfolio characteristics (expected returns, downside capture, etc.)
- Risk measures: market risk, inflation risk, longevity risk, cognitive risk, liquidity risk

Plan sponsors should also conduct a cost/benefit analysis of retirement income solutions to help determine the best retirement option for participants. Documenting this evaluation will help sponsors support the rationale for the final selection.

Assess contract features and pricing. Fiduciaries should fully understand all contract features, benefits and restrictions. Are the fees explicit or implicit (e.g., do they reduce the crediting/interest rates)? Do participants have full liquidity? If participants do not annuitize/take guaranteed income, what happens to the premiums paid during the working years? Can participants defer taking the retirement income? Does that impact their future guaranteed income?

Can participants access their assets in retirement? Can their retirement income increase/decrease in retirement?

Determine plan portability. Because of the frequency of job changes, workers must have the ability to easily move retirement savings so they don't leave money on the table, especially if these investments contain a lifetime income option. Previous legislation dictated that annuities must be liquidated when participants leave the plan or if the sponsor no longer offers it, but participants should be able to roll over a lifetime income investment to another employer-sponsored retirement plan or IRA without penalty or fees. Plan fiduciaries should confirm the participant portability options and process.

NEXT STEPS AND IMPORTANT CONSIDERATIONS

Plan consultants and advisors can help. Many different products are available with varying features, benefits and restrictions, and it can be difficult to keep up with the latest rules. In fact, SECURE 2.0 and the Lifetime Income for Employees Act are already making their way through the legislative process, looking to further change retirement plan provisions.

But the good news is that consultants and advisors can help plan fiduciaries comply with their responsibilities within the rules, while keeping them informed about the latest changes in products and regulations. They evaluate the various lifetime income products and can guide plan fiduciaries in determining the right solution for their plan.

According to Cerulli Associates, "The SECURE Act will provide a greater opportunity for target-date providers to incorporate annuities and other guaranteed income options into their products and find amenable sponsors, although sponsor adoption will take some time. In one survey, 34% of DC asset managers said it was highly likely that the next generation of target-date funds would incorporate an annuity component..."

Building confidence around retirement income. The SECURE Act will ultimately require plan sponsors to show employees how their retirement account balances translate into guaranteed monthly income, regardless of whether the plan has a lifetime retirement income solution. Participants may think they've saved enough, but demonstrating how their savings convert into a monthly income stream may show otherwise. A final effective date for this change awaits guidance from the Department of Labor.

WORKING WITH TIAA AND NUVEEN

TIAA has a 100-year legacy of providing secure retirements and outcome-focused investment solutions to millions of people and thousands of institutions. In fact, we paid more than $3.6 billion to retired clients in 2020 and more than $505 billion since 1918.

Nuveen's target date investment team is among the longest tenured in the industry, and we serve as the fifth largest manager of defined contribution assets.

Just as we have been supporting the retirement of our 403(b) clients, our robust research agenda includes applying our experience to the changes in the defined contribution market. TIAA and Nuveen can lead the shift of 401(k) plan design to include guaranteed income for essential living expenses in retirement. We encourage plan sponsors to contact us to learn more about the multiple solutions that we are working to put in place.

For more information, please visit us at nuveen.com.

Endnotes

Sources

EBRI Retirement Confidence Survey, 2020.

Cerulli: U.S. Retirement End-Investor 2019 and "Annuities coming to target-date funds, but not right away," from Pensions & Investments, 28 Dec 2020.

TIAA Lifetime Income Survey, 2021.

Benefits since 1918 as of December 31, 2020. Other benefits from TIAA include: surrender benefits and other withdrawals, death benefits, health insurance and disability insurance benefits, and all other policy proceeds paid.

Defined contribution asset rank from Pensions & Investments, 31 May 2021. Rankings based on institutional tax-exempt assets under management as of 31 Dec 2020 reported by each responding asset manager.

A word on risk

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