Implications of the SECURE Act

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Today's Panel

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The SECURE Act

- SECURE Act signed into law December 2019
- Consists mostly of about 17 generally applicable and largely noncontroversial (with a few exceptions) changes to private pension and retirement saving provisions of tax code and ERISA
- Changes – developed at various times over the preceding 10 years or so – also include a few controversial and/or special interest provisions
- Provision most widely discussed is permission for unrelated employers to be grouped together in multiple employer plans (“open MEPs”), typically 401(k)s, in pursuit of lower costs through economies of scale
  - Might have incidental effect of providing larger platform for lifetime income in 401(k) plans, though not a necessary result
  - Likely to have considerable impact on industry, less on expanding coverage (some estimate 1% increase)

Lifetime Income Trio

In the long run, SECURE's other most important provisions may prove to be a trio of new lifetime income provisions (which some of us have worked on for over a decade)

- ERISA fiduciary safe harbor for selection of annuity providers
- Lifetime income estimate disclosure requirement for 401(k) and other DC plans
- Improved portability for annuities in 401(k) plans

401(k) ERISA Fiduciary Safe Harbor for Selection of Annuity Provider

- To encourage 401(k) and other DC plans to include annuity options, ERISA is amended to provide a safe harbor for plan sponsors from fiduciary liability for selecting an annuity provider to offer annuities in their plan
- Intended to respond to employer concerns about liability exposure if the selected insurance company proves unable, years later, to meet its obligations under the annuity contracts it issued to participants
- Conditioned on insurance company representing that it is in good standing with its state regulators and has been in business for at least 7 years
- No requirement of high ratings for solvency or claims paying ability or other high quality standards

401(k) ERISA Fiduciary Safe Harbor for Selection of Annuity Provider (cont'd)

- Plan sponsor not protected from ERISA fiduciary liability for imprudence with respect to price paid for annuity contracts or other terms of contracts
- Safe harbor not limited to fixed income annuities; extends to other types (variable, indexed)
- Effective 2020 PYs, would help mitigate one important impediment to inclusion of annuities in DC plans, but lack of insurer financial strength standards might mean employers will still need to purchase consultants' advice on selection of annuity provider(s)
- Bidding or quotation platforms or services might expand

Disclosure of retirement income equivalent of account balances

- To encourage reframing of DC plan benefits from account balances/ lump sums to regular retirement income, DC plan benefit statements will be required to include at least annually an estimate of lifetime retirement income payable at retirement age based on participant's current account balance
- Plans that comply will be protected from liability for estimating
- Labor Dept. interim final rules include standard calculation assumptions and model language. Plans must comply starting in 2022.

Disclosure of retirement income equivalent of account balances (cont'd)

- But unclear whether further rules will require plans to—or protect them if they choose to—provide a second estimate projecting current account balance forward to retirement age using participant's current contribution rate before converting balance to income stream at retirement age.
- Concern that participants should be told about how much monthly income their projected retirement-age account balance would buy, not merely how much their current account balance would buy if retirement is still many years away
  - Younger, smaller-balance participants might be discouraged from continuing to save by projections of retirement income based on current account balances
- And will plan sponsors be exposed to risk of liability for existing estimates of retirement income that don't comply with standards in interim final regulation?

Portability of annuity contracts in plans that stop offering them

- One of the other concerns raised about in-plan annuities is that a plan containing annuity contracts might need to stop offering them if the plan or its recordkeeper and its platform was no longer able or willing to continue offering them—preventing further accumulation and possibly triggering higher fees
- In this case, active employees who have been accumulating deferred annuity units through the gradual investment of contributions will be unable to roll them out to an IRA offered by the same insurer to continue accumulating annuity units there, because cessation of offering of the annuities would not be an event permitting distribution from the plan
- SECURE Act amended the tax code to prevent 401(k) withdrawal restrictions from stranding frozen annuities in plans and instead allow withdrawal of frozen annuities for rollover to IRAs where participants can maintain and grow them

More SECURE?

- Upcoming retirement legislation likely to include more noncontroversial provisions drawn from two Neal bills (Automatic Retirement Plan Act, H.R. 4523, and Retirement Plan Simplification and Enhancement Act, H.R. 4524) and Portman-Cardin bill (S. 1431, 2019)
- Most recently, "SECURE 2.0" bill (H.R. 8696) introduced by Ways and Means Committee Chairman Neal and senior Republican Rep. Brady reflecting bipartisan consensus on additional odds and ends in retirement proposals
- SECURE 2.0 includes several significant required minimum distribution (RMD) proposals relating to lifetime income and annuities

Next Up:

- Eventual potential centerpiece: After a half-century of relatively stagnant coverage, upcoming legislation may include most dramatic breakthrough ever in U.S. retirement coverage by combining workplace payroll deduct saving, auto enrollment, and private-sector individual retirement savings accounts (automatic IRAs)
- These are the payroll deduction workplace IRAs using automatic enrollment that are being, in effect, piloted and acquiring proof of concept in California, Oregon, Illinois, and soon in other states
- Ultimately has potential to be a major platform for annuities/lifetime retirement income

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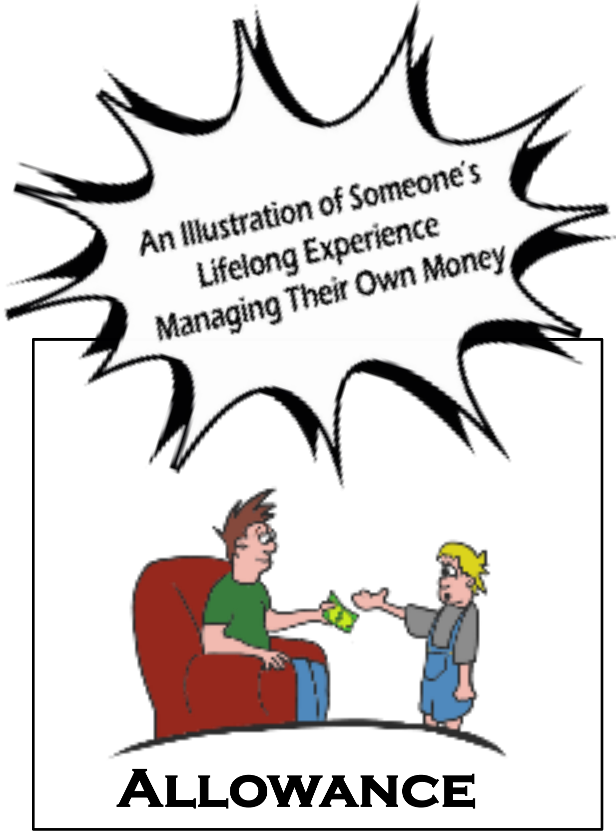
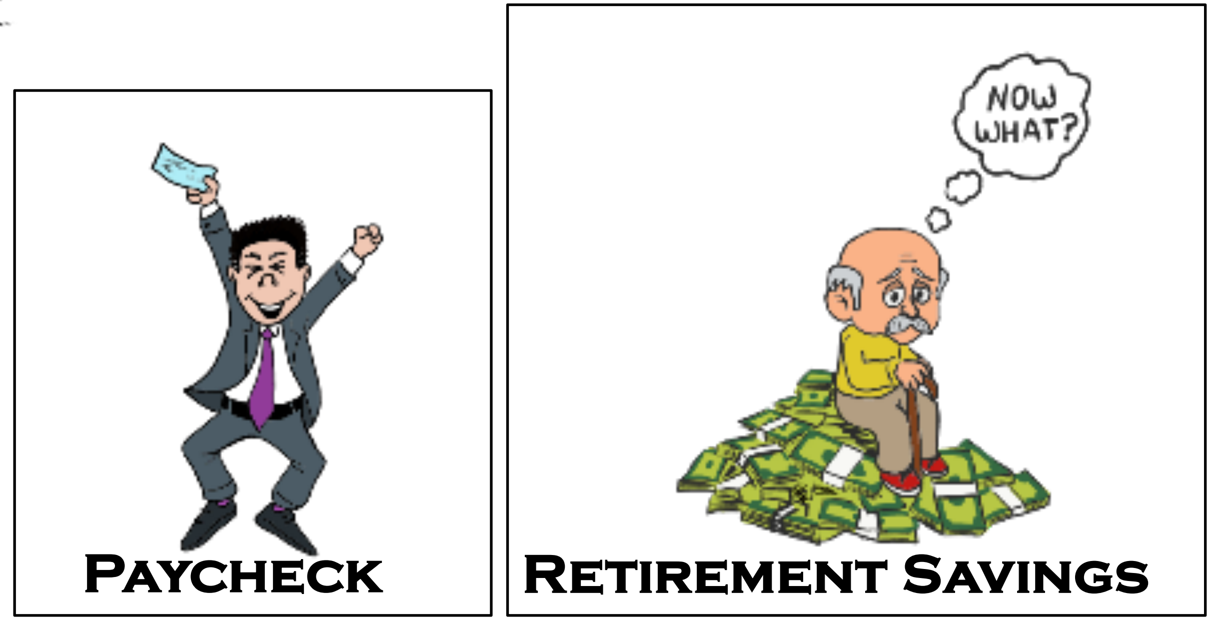
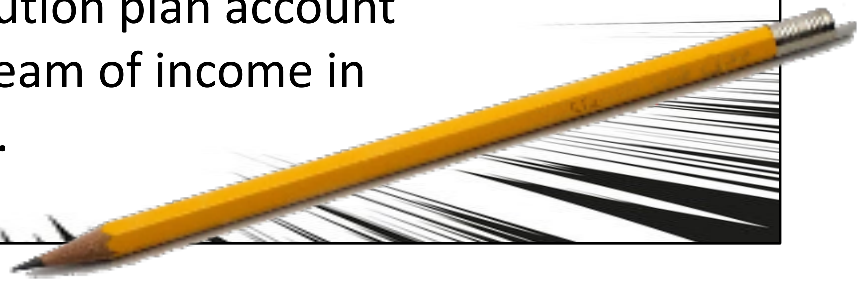


Retirement Savings vs. Retirement Income



RETIREMENT INCOME:

Converting a defined contribution plan account balance into an ongoing stream of income in retirement.



Employees Like the Concept of Guaranteed Income

Employees recognize the need for income in retirement, and employers can help fill that need

80% of employees want some form of **guaranteed income in retirement**

1 in 10 put assistance with **spending savings during retirement** as a top 3 area for employer support

Source: Aon's DC and Financial Wellbeing Employee Survey, 2018 (U.S.)

Employers see retirement income as important, but also cite many barriers keeping them from doing more

Employer interest is strong

4 out of **5** **employers**

say they need to **focus on retirement income solutions** to help manage their workforce

Almost **70%** believe that DC plans should include **lifetime income options**

Despite **less than 10%** of employers offering in-plan lifetime income solutions today

Barriers considered a major concern

- **1** in **3** — Fiduciary Concerns
- **1** in **4** — Cost of the Investment
- **1** in **4** — Complexity of Structure
- **1** in **5** — Usage by Plan Participants

Source: U.S. results from Aon's Defined Contribution Survey 2020

SECURE Helps Break Down Barriers

Fiduciary Concerns

Fiduciary Safe Harbor for Selection of Lifetime Income Provider

- *Optional* safe harbor for selection of an insurer
- Similar to guidance previously provided by Department of Labor

Complexity of Structure

Portability of Lifetime Income Options

- Direct transfer of lifetime income options to other qualified plans or IRAs

Disclosure Regarding Lifetime Income

- Show monthly income available from account
- Include J&S options

Coming in 2021!

SECURE Act: https://www.congress.gov/bill/116th-congress/house-bill/1994/text

Fiduciary Safe Harbor Protection

The selection of an annuity provider for benefit distributions from an individual account plan satisfies the requirements of section 404(a)(1)(B) of ERISA if the fiduciary complies with the following criteria

Criteria for selection process[1]

1. Engage in objective, thorough, analytical search
2. Consider insurers future claim-paying abilities
3. Consider fees relative to benefits provided to participants
4. Conclude counterparty is financially viable at time of selection and costs are reasonable
5. Consult with expert(s) to assist with assessment as necessary

Requirements to Determine Financial Capability of the Insurer[2]

The fiduciary obtains written representations from the insurer that:

1. The insurer is licensed to offer guaranteed retirement income contracts
2. The insurer complies with statutory requirements in the states that it operates within
3. The insurer undergoes, at least every 5 years, a financial examination by the state insurance commissioner
4. The insurer will notify the fiduciary of any change in circumstances occurring after selection

[1]**Source:** United States Department of Labor Field Assistance Bulletin No. 2015-02
[2]**Source:** SECURE Act https://www.congress.gov/bill/116th-congress/house-bill/1994/text

New Solutions Continue to Come to Market

Leading Innovation

Innovative plan sponsors have begun implementing custom solutions for their employees including options spanning across the following spectrums:

Retirement Income Trade-Offs

In-Plan ⟷ Out-of-Plan

Guaranteed ⟷ Liquid Access to Capital

Stand-Alone ⟷ Component of Asset Allocation

Ongoing Income Purchases ⟷ Income Purchased at Retirement

	Type of Option	In-Plan	Out-of-Plan	Guarantee	Liquid	Stand-Alone	Part of Asset Allocation
Scheduled Payout	Managed Payout—Existing Funds	✓			✓		✓
	Managed Payout—New Fund	✓			✓	✓	
	Deferred Guaranteed Withdrawal Benefit	✓		✓	✓	✓	✓
Ongoing Guaranteed Income Purchase	Deferred Guaranteed Income Benefit	✓		✓	✓	✓	✓
	Deferred Fixed Annuity	✓		✓	✓[1]	✓	✓
Lump Sum Annuity Purchase	Traditional Annuity—End of Plan	✓	✓	✓		✓	
	Annuity Platform		✓	✓		✓	
Longevity Insurance	Longevity Insurance	✓	✓	✓		✓	✓

Individual classes or products should not be viewed as "one size fits all"

[1]Deferred fixed annuities typically have liquidity before going into income

Sample Tiered Investment Menu with Income Choices

Objective

- Asset Allocation
- Capital Preservation
- Income
- Growth
- Retirement Income

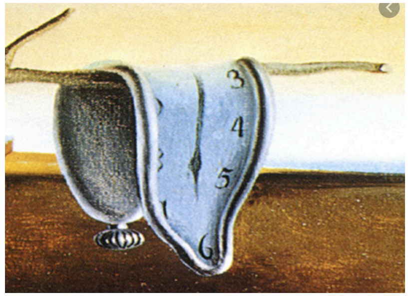
Phase	1 Seeking Professional Managed	2 Wanting Low Cost Access	3 Looking to Outperform
Savings Phase	Target Date Funds	Fixed Income Index	Capital Preservation
	Managed Accounts	U.S. Equity Indices	Income
	QDIA options can straddle savings and payout phases by including retirement income solutions or managed payout capabilities	Non-U.S. Equity Index	U.S. Equity
			Non-U.S. Equity
			REITs
Spending Phase	Target Date Funds Built-In Retirement Income	Multi-Asset Real Return (Inflation Protection)	Longevity Insurance[1]
	Managed Accounts Managed Payout—Existing Funds		Annuity Purchase Window (Out of Plan Distribution)
	Annuity[1]		
	Systematic Withdrawal		

Plan Features
(Not Investment Choices)

[1]Solution can be offered either as in-plan or out-of-plan option.
For illustrative purposes only.

Kerry Pechter, Editor and Publisher

Retirement Income Journal



Finally time to put DB into DC?

"A method of issuing and managing investment instruments called 'Pension Shares' which preferably take the form of securities that represents a claim against and is secured by an investment fund. A Pension Share entitles its holder to receive, at a specified maturity date, either a lump sum payment amount or, at the option of said holder, to receive a sequence of annuity payments." U.S. Patent No. 7249077B2L, 2004

"The whole [401(k)] industry spent years helping people save. We have done a poor job, until now, of turning that into income." — president, major retirement plan provider.

"The SECURE Act … represents a giant step forward to reduce some of the barriers that have discouraged the use of lifetime income products by defined contribution plans, and to encourage participants to think about their savings in terms of a lifetime income stream." — Groom Law Group

"Between the fiduciary safe harbor and the increased portability of LTI options, Congress has made clear that defined contribution plans represent an important and viable market for annuities." — Ropes & Gray Benefits Alert, Jan. 10, 2020.

SECURE Act Provisions: Necessary But Insufficient

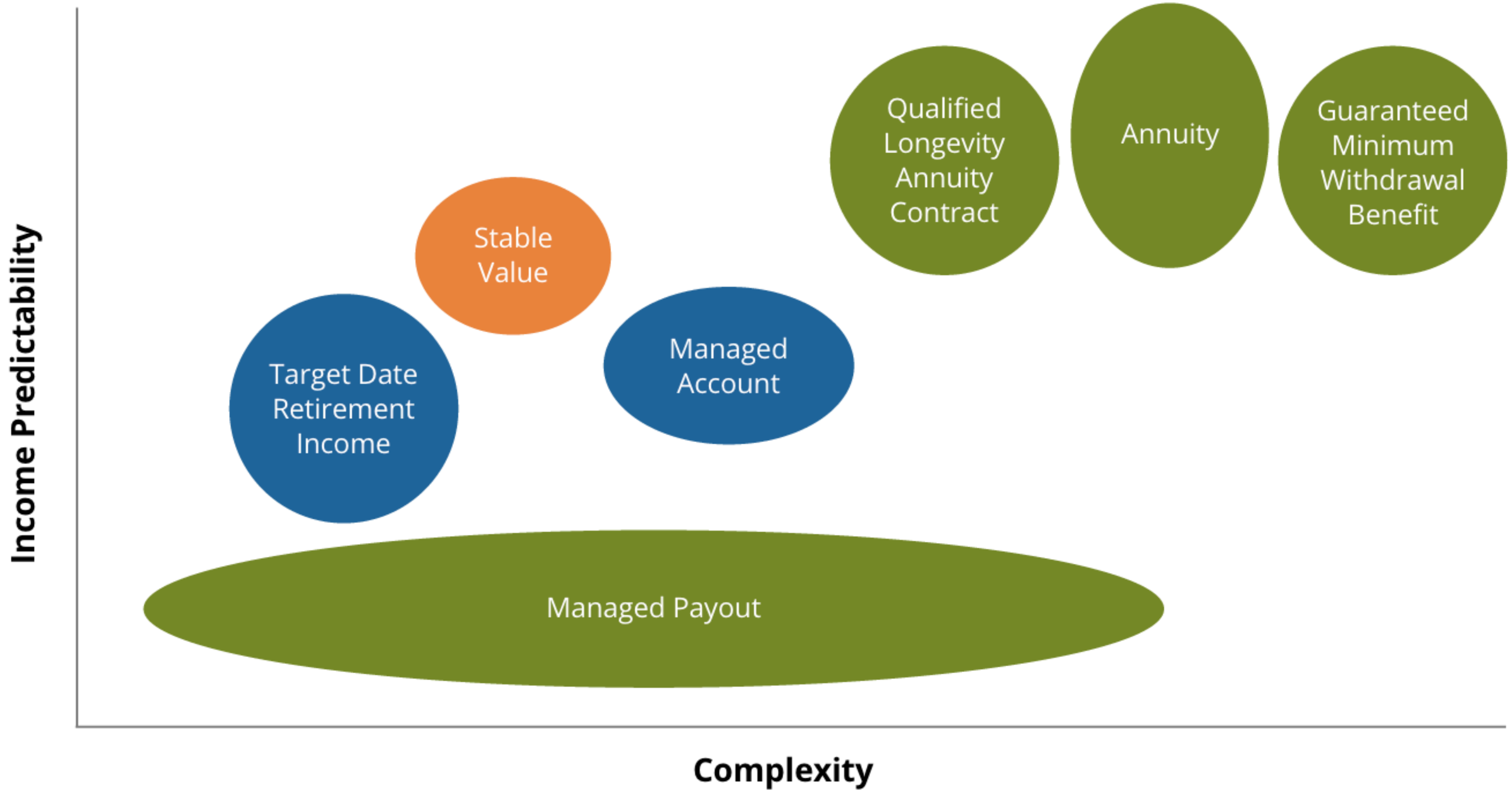
- New safe harbor … a game-changer, or not
- Portability technology … ready, or not
- Lifetime income calculator … 'B' for effort

Who wants/needs annuities in retirement plans?

- Life/annuity cos (more if linked to recordkeepers)
- “DCIO” target-date fund providers that want to stem the rollover tide
- Big plan sponsors that want to manage an aging workforce better and maintain economies of scale in their plans
- Sophisticated, high-balance plan participants

Let 100 Annuities Bloom

- Deferred income annuities inside managed accounts (QDIA)
- TDFs with lifetime income riders (QDIA)
- In-plan annuities
- On-the-way out-of-plan or out-of-plan annuities
- Individual or group annuity
- Fixed indexed annuities with lifetime income riders
- Fixed income annuity
- Qualified Longevity Annuity Contract (QLAC)
- Annuities that eliminate all or most of the distribution costs



Source: "DC Plans Have Helped Participants Save. Now They Need to Help Them Spend," Callan, August 2018.

First-Wave Products

- **Company A.** Top-ten multi-line insurer offers a fixed indexed annuity (FIA) for safe accumulation as the first of five institutional annuities.
- **Company B.** Global asset manager creates bundle: its own TDF, two life insurers and a record keeper.
- **Company C.** A TDF/GLWB product with cost of 90 basis points per year and a 4.5% payout at age 65 for a married couple.
- **Company D.** A deferred income annuity (DIA/QLAC rider available through 'certain group annuity contracts.' Income can't begin until separation.
- **Company E.** Wirehouse offers SWP w/ DIA: Example: With $500k, leave $425k in plan, spend $22.5k/yr in retirement. With $75k, buy DIA paying $18k/yr at age 85.

United Technologies Corp., AllianceBernstein and Three Life Insurers

- Started a decade ago
- AllianceBernstein provides the TDFs
- Three large life/annuity companies
- Insurers bid each month to wrap GLWB around participant contributions
- Low bidder takes majority of contributions; others split the remainder
- Sui generis, more or less?

The in-plan/out-of-plan dichotomy

In-plan annuity

- Takes advantage of QDIA
- Allows individual or group annuities
- Gender-free pricing
- Potential for pooling benefits

Out-of-plan

- Entails individual products
- Involves rollover IRA
- Who gives advice?
- How do platforms work

No shortage of questions for life insurers:

- Can we sell the product that we want to sell?
- What risks will we face: longevity, market, selection?
- What's our risk capacity/appetite?
- How do we estimate, incorporate lapse rates?
- Will we have a lot of tiny contracts?
- What about gender-based pricing?
- What companies have a cohort/pipeline of veteran, highly-compensated employees?
- After stripping out distribution costs/CDSC schedules, where else can we economize?
- What are the risks of guaranteeing a minimum GLWB 'benefit base'?
- How do I enrich the payout rate at age 65?
- Will we sell individual or group annuities?

Q for life insurers, con't.

- Will there be a mortality risk-pooling product?
- What's the adverse selection potential?
- Can we compete in the first wave?
- Are we a recordkeeper (or do we have close ties with one)?
- Can I partner with a target-date fund provider to offer a QDIA?
- Do I know much about ERISA?
- Could I sell other products to these companies?
- Who will I deal with?
- How do I support this product with education, marketing?
- As interest rates rise, will all participants benefit?

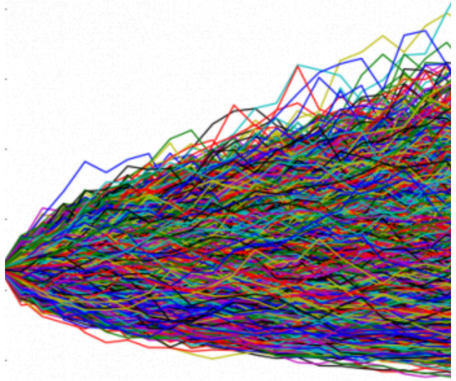
Issues for Actuaries

- Individual or group annuity pricing
- Plan demographics
- Gender-free pricing or not
- Prevalence of J&S contracts
- Adverse selection
- Lapse rates
- Withdrawal patterns
- Hedging
- Contract owner behavior over long-term
- Changing interest rates
- Longevity risk
- Distribution cost
- Fee compression
- Your firm's business model, requirements

Headwinds

- ZIRP
- Product complexity
- Product costs
- Life/annuity industry currently in turmoil
- Coverage gap, saving inadequacy and leakage persist
- Financial illiteracy
- “Institutional pricing” undefined
- Former leaders are out of the game
- TDFs are not proven path to adequate savings
- Competition from Social Security

How will this play out?



- Slowly … life insurers move slowly (then all at once)
- Can we count on low rates by 2023?
- Emerge first within large recordkeeper's or administrator's plans
- Patchwork of annuities could emerge
- Participant demand for annuities remains unknown, uneven
- QDIA attachment will be crucial but controversial
- Will annuities be commoditized? (Price-setting)
- Will presence of annuity option raise expectations of savings adequacy?
- Wealth inequality manifested in 401(k)s

If I were 'king of the hill'

- If I were 'king of the hill'
- Flexible-premium, like 'Sponsor Match'
- Variable income annuities w/floor
- No default into annuities
- Annuities in MEPs, PEPs
- Pilot programs, best practices, standard-setting
- Participant-driven
- Mandatory employer match
- Multiple annuity options in every plan
- Education on combining annuity with Social Security
- 'iTDFs' (smoothing)

Q & A?