Lifetime Income: A Deeper Dive

We've introduced you to lifetime income in retirement plans, but it's time to revisit and dig a little deeper. It's becoming clear that lifetime income isn't something you can ignore. You may not think it belongs in your retirement plan today, but it should at least be evaluated as an option.

Here's What You Really Need to Know:

- Lifetime income is not a single solution. There are several types of solutions to meet the needs of the plan and its participants including SPIAs, DIAs, GLWBs, and QLACs (don't worry, we will define all these terms below).
- Before the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), plan fiduciaries feared fiduciary liability associated with the risk of an insurer defaulting. The SECURE Act provided a safe harbor for plan fiduciaries to help address this risk.
- Plan fiduciaries still need to follow a prudent process even with SECURE Act's safe harbor protection.

Let's Dive In...

Now, Let's Dive into the Details, Starting with Vocabulary:

There are a wide variety of lifetime income solutions. Here are four of the most common:

Single Premium Immediate Annuity (SPIA): designed to create a steady stream of income that a retiree cannot outlive. Based on the owner's life expectancy, this type of contract is usually funded with a lump sum, starts paying income as soon as the policy is initiated and continues for as long as the owner is alive. Immediate annuities are popular with retirees who are entering or close to retirement and who are concerned about outliving their savings.

Deferred Income Annuity (DIA): allows the contract holder to put off receiving regular income annuity payments until sometime in the future, often years later. Deferred annuities sometimes offer a death benefit, whereby if the account owner dies while the annuity is in the accumulation phase, their heirs may receive some or all the account's value.

Guaranteed Lifetime Withdrawal Benefit (GLWB): before it is converted to a stream of income, this feature can be added to a variable or indexed annuity that guarantees some level of retirement income during the accumulation phase (and by accumulation phase, this means the time when someone is still in the saving phase). The amount of the GLWB allowed is a percentage of the total value of the annuity and may increase as the underlying investments in the variable annuity rise in value. The GLWB rider (rider meaning additional part of a contract) is often optional but comes with additional benefits and associated fees.

Qualified Longevity Annuity Contract (QLAC): a deferred annuity offered within a qualified retirement plan such as a 401(k) or IRA. As of January 1, 2021, an individual can use up to $135,000 or 25% of the account balance of qualified plan savings to purchase a QLAC (note: these limits adjust over time). Aside from tax-deferred growth and guaranteed payments, the main benefit of a QLAC is that its value is not included in required minimum distribution (RMD) calculations (which start at age 72), thus extending tax deferral on QLAC amounts until age 85, when payments must begin.

Evolution + Evaluation

Product manufacturers, including insurance companies, investment managers, and technology middleware, are quickly evolving the solutions described above to work inside plans. However, fiduciaries must wade through confusing solutions complicated by the fact that some of these solutions are advertised before they are ready for the market. Keeping up with the ever changing environment and practicing due diligence is critical when selecting a lifetime income solution. The retirement plan industry is also working to simplify lifetime income due diligence (check out the Broadridge Fi360 Consortium).

The SECURE Act lifted one of the big impediments to lifetime income, which was the fear of fiduciary liability for an insurance carrier that defaulted. Under the SECURE Act, plan fiduciaries reduce the liability by following steps consistent with the statutory safe harbor:

1. The plan fiduciary follows an objective, thorough and analytical search process for the purpose of identifying providers of annuity contracts
2. The plan fiduciary considers both the insurer's capacity to meet its ***financial obligations*** and the annuity's all-in costs relative to features, benefits and administrative services provided
3. The plan fiduciary determines that the insurer can meet its ***financial obligations*** and the relative cost of the contract is reasonable. Notably, a plan fiduciary is deemed to have considered the financial capability of the insurer if the insurer puts in writing that it complies with specific regulatory requirements

The insurer meets the financial obligation requirement discussed in numbers 2 and 3 above by attesting to the following:

- the insurer is licensed to offer guaranteed retirement income contracts
- the insurer, at the time of selection and for each of the immediately preceding 7 plan years:
  - operates under a certificate of authority from the insurance commissioner of its domiciliary state that has not been revoked or suspended
  - has filed audited financial statements in accordance with the laws of its domiciliary state
  - maintains and has maintained reserves that satisfy all the statutory requirements of all states in which the insurer does business
  - is not operating under an order of suspension, rehabilitation, or liquidation
- the insurer undergoes, at least every 5 years, a financial examination by the insurance commissioner of its domiciliary state
- the insurer will notify the fiduciary of any change in circumstances after providing the above representations which would preclude the insurer from making such representations at the time of issuance of the contract

The plan fiduciary should periodically review the attestations above to make sure there aren't any changes *(and, keep in mind this is a boring checklist; each needs to be met, but the insurer should have this information readily available for your review.)*

If the above are satisfied, then one part of the due diligence is complete as it relates to selection of the lifetime income solution. Once complete, plan fiduciaries should also use a prudent process to evaluate other features of the lifetime income solution and its all-in costs relative to features, benefits and administrative services provided (don't forget the prudent process: determine framework, gather information, objectively compare information, make a decision, and document that decision). The evaluation of lifetime income solutions may include a comparison of the following features including but not limited to fees, guarantee benefit, spousal benefits, portability, liquidity, participant education and resources.

Action Items for Plan Sponsors

1. Shift the mindset to think of lifetime income as an in-plan option
2. Learn the vocabulary
3. Evaluate the needs of the plan and its participants
4. Formulate the due diligence framework to review in-plan options
5. Commence a review of available in-plan solutions

Let's Discuss

To learn more about fiduciary governance in lifetime income and beyond, see us in action at an upcoming event, or book one-on-one time to discuss.