



QUALIFIED
PLAN ADVISORS


GULF COAST
FINANCIAL ADVISORS
www.gulfcoastfa.com

White Paper Series

Answering the Call for Security: Lifetime Income Options on the Horizon

White Paper Series

Answering the Call for Security: Lifetime Income Options on the Horizon

Matthew J. Eickman, J.D., AIF®
National Retirement Practice Leader

qualifiedplanadvisors.com

© 2019 Matthew Eickman



Answering the Call for Security: Lifetime Income Options on the Horizon

I. Introduction: The Time Is Now

People crave security. They desire it now, tomorrow, and especially the days after that.

When one lacks the feeling of security, he or she experiences stress that impacts the ability to function, particularly at a high level. The stress causes distraction, sleeplessness, development of bad habits, and poor health. The cumulative effect of Americans' stress is far-reaching; it impacts all areas of our country's social and economic structure. The workplace is among those settings where the lack of security and resulting stress most manifest themselves.

In days gone by, employers played a significant role in providing American workers the fundamental sense of security. They did so in the short term through job security and support of a stable workforce. They did so in the long term through retirement plans (primarily defined benefit plans) that offered lifetime income upon an employee's retirement. Somewhere along the way, though, that sense of long-term security dissipated as employers shifted to defined contribution plans. In doing so, they took their eyes off their employees' need for consistent income in retirement. They lost sight of the confidence that accompanied employees' knowledge that such a benefit was available at the end of a career.

The time is right for a return to retirement plan offerings that provide what employees crave and need. The time is right for employees to have access to a retirement plan that is not merely a retirement *savings* plan, but is a retirement *income* plan. There is some time-sensitivity to this shift; every passing day increases the odds that more employees will run out of money long before they die. The time is now.

II. Retirement Crisis on the Horizon

America's retirement future is bleak. The causes are plentiful: the shift from defined benefit plans, less disciplined saving and spending habits, the exponentially rising cost of healthcare, and longer life expectancies. Some may argue regarding the degree to which those respective causes have created or contributed to the forthcoming retirement crisis. But those arguments are unlikely to produce winners; they merely delay the exploration and implementation of solutions, which merely creates more losers.

Policymakers have developed a bipartisan understanding that something must be done.

- Representative Richard Neal (R-MA), Ways & Means Committee Chair, observed: “The retirement crisis is real and will only worsen unless we strengthen Social Security, make saving easier, and do more to encourage employers to offer retirement plans.”ⁱ
- Recent Senator Heidi Heitkamp (D-ND) identified the impact on retirees, as well as the generations that must support those financially ill-equipped retirees: “We face a looming retirement crisis that will impact millions of elderly and soon-to-be elderly Americans, as well as our children and grandchildren who will have to bail out those generations.”ⁱⁱ
- Diane Oakley, Executive Director of the National Institute on Retirement Security, painted a sad picture for hard-working Americans: “[T]he American dream of a modest retirement after a lifetime of work now is a middle-class nightmare.”ⁱⁱⁱ
- Senator Susan Collins (D-ME), Special Committee on Aging Chair, emphasized the likelihood that Americans will outlive their financial resources: “As Americans live longer, the risk that they will outlive their savings only increases. For many, saving for retirement seems out of the question. We’re on the verge of a national crisis.”^{iv}

Those observations reflect the need for both retirement system input and output solutions. Since the adoption of the Pension Protection Act of 2006, Congress, the Department of Labor (DOL), and the Internal Revenue Service (IRS) have sought ways to encourage more employers to sponsor plans, more employees to participate in those plans, and employees to save more when they participate. Those efforts seek to grow the pot on which retirees will rely for their retirement needs.

More recent efforts have focused not only on the size of the pot, but also how to make it last longer. Employees have become concerned that they will run out of money. Employers have become concerned that this concern causes its employees to endure ongoing stress and the fear of an uncertain tomorrow.

III. Barriers to Retirement Income

An obvious response to those concerns would be for 401(k) and 403(b) plan sponsors to add lifetime income products and protections to their defined contribution plans. Yet many barriers have deterred employers from doing so. Before identifying those barriers, it is critical to acknowledge the context in which they have arisen.

A. Context: DB to DC

The country has shifted, rather quickly, from defined benefit plans to participant-directed defined contribution plans. One should not minimize the pace at which this occurred or the extreme to which it has occurred. Consider that in the early 1980s, roughly 60% of private sector workers’ only retirement account was a defined benefit pension; today that number has fallen to 4%.^v In 1998, 59% of Fortune 500 companies offered a traditional defined benefit plan to its new hires; that number fell to 16% by 2017.^{vi} This trend is expected to continue, with plan sponsors planning to soft freeze, hard freeze, or terminate plans in the next few years.^{vii}

This shift fits an increasingly transient workforce that is much less likely to remain with one company for an entire career. It also reflects companies' reactions to balance sheet volatility, which was exacerbated when the tech bubble burst and financial crisis caused extreme market shocks within a short period of time. Of course, the shift was accelerated when the ironically named Pension *Protection* Act of 2006 made defined benefit plan maintenance more difficult.

B. Barriers

Unfortunately – but somewhat understandably – employers did not salvage the best aspect of defined benefit plans when they shifted away from those plans. An intimidating list of barriers caused employers to neglect the need for lifetime income from their defined contribution plans:

Fiduciary risk.

Plan fiduciaries bear the fiduciary responsibility for selecting and monitoring any sort of lifetime income options made available to participants. Sponsors' biggest reason for not offering an annuity-type option is that they are uncomfortable with or unclear about fiduciary implications.^{viii}

Product stagnation.

Fiduciaries' concerns slowed demand, which stunted product development. This prevented the development of products better suited to satisfy modern day workers' needs.

Proprietary bias.

Most available options are closely tied to the plan's recordkeeper. Proprietary products are a challenging fit in this fiduciary era, particularly when they cannot be selected on their merits from a pool that also includes non-proprietary products.

Limited flexibility.

Reliance upon a proprietary lifetime income solution also ties a plan fiduciary's hands when it comes time to consider a move to a new recordkeeper.^{ix}

They're expensive.

The lack of product innovation and the lack of competition from non-proprietary solutions means that the vendors have held the pricing leverage.

It's hard.

If nothing else, adding additional investment and distribution options can create an administrative burden – particularly if it involves shopping for and vetting something that involves “life insurance”, “annuity”, or “guarantee” terminology.

IV. Desire for Solutions

These barriers exist against a broader backdrop of employees wanting solutions. It is an understatement to note that they do not feel good about the present or the future. Only one-third of them have a positive perception of their current financial well-being.^x Half feel stressed by preparing for retirement.^{xi} More than half of employees are most concerned about running out of money during retirement.^{xii} This causes them to work longer and to feel less confident that they can retire on time. Only slightly more than one-third are confident they can retire when they want^{xiii}; four out of five expect to be working in

retirement.^{xiv} Between 1977 and 2007, the number of workers over the age of retirement increased by 101% and the number of workers age 75 and older increased by 172%.^{xv}

Employees crave security in the short-term. They want to know they can cover expected expenses and emergencies. They also crave security and stability in the long-term; nearly three-fourths of workers believe income stability is the most important financial priority in retirement.^{xvi} The same portion expresses interest in guaranteed lifetime income from their retirement accounts, whether that be an in-plan investment option or a separate product purchased at the time of retirement.^{xvii} In fact, those with protected lifetime income are far more confident that their retirement savings and income will last the rest of their lives.^{xviii} A strong majority (around 88%) of those who own an annuity with guaranteed lifetime income say it positively affects their feeling of confidence about being able to be financially secure throughout retirement.^{xix}

V. Help Is on the Way

A 2014 DOL Information Letter reflected the DOL's desire to stimulate lifetime income product innovation.^{xx} It included the DOL's blessing of a suite of target date funds that would offer lifetime income protection in the form of unallocated annuities. The DOL – and the IRS, with complementary guidance – were practically screaming to the retirement industry: “Develop and implement solutions!”

Members of both houses of Congress have followed with bill after bill that would include an updated “annuity selection safe harbor” intended to alleviate plan sponsors’ concerns about fiduciary risk implicated by lifetime income offerings. They have done so in response to the national crisis concerns discussed earlier in this Paper. Policymakers recognize that employers need a nudge.

This collection of support and encouragement is lifting the fog that has obscured innovation. Product innovation is upon us. Consider the barriers to adoption addressed above and look for product innovation that will present retirement income solutions that demonstrate the following common attributes:

- (1) **Fiduciary-friendly:** New age solutions will be designed to satisfy existing and forthcoming safe harbor guidance, which will help plan fiduciaries and their consultants to feel comfortable;
- (2) **Non-Proprietary:** Progressive options will not be proprietary offerings limited to one insurer's options, which will allow for better open market competition against available solutions;
- (3) **Less Expensive:** Competition breeds price reductions, which should drive down prices below the current 1.5-2.0% fee level in the current marketplace;
- (4) **Better Diversified:** Performance and safety should increase as new offerings consist of a multi-manager collection of underlying investment options and insurance;
- (5) **Portable:** They will permit movement among recordkeepers, which removes current vendors’ leverage and increases plan sponsor fiduciary protection and flexibility; and
- (6) **Simple:** There will be a premium on product design that a participant can understand; complexity is unlikely to add to a participant's sense of security.

VI. Closing Thoughts

The need for retirement income is rapidly increasing. As Baby Boomers have entered retirement, we have been fortunate to experience a decade of strong market returns and the longest economic expansion in the country's history. But as more retirees intend to enter retirement over the next decade, what happens if the economic expansion slows or stops, U.S. markets turn sideways or backwards, and retirees do not have a career pension to fall back on?

The awareness of that possibility has caused the demand for retirement income to accelerate even more quickly. A vast majority of employees want some level of guaranteed retirement income.^{xxi} More than half of employers believe defined contribution plans should be vehicles for retirement income generation.^{xxii} More than half of plan sponsors believe they have a level of *responsibility* to offer retirement income solutions to participants.^{xxiii}

It is this sense of responsibility that is most likely to drive employers to give their employees what they want and need. Call it strong business policy or merely an old-fashioned American responsibility. In either event, American employers are answering the call for retirement income and beginning to sour the marketplace for new solutions. They recognize that they possess the power and influence to provide their employees the security they crave. They also demonstrate a sense of urgency. The time is now.

Questions? Contact the author.

Matthew J. Eickman, J.D., AIF®

National Retirement Practice Leader
meickman@qualifiedplanadvisors.com
402.507.5085



- ⁱ Forbes, "Comprehensive Bill Aiding Retirement Security Likely to Pass House This Year, Says Ways & Means Chair", February 6, 2019.
- ⁱⁱ ASPPA, "Invest Now to Head off 'Looming Retirement Crisis,' Says Heitkamp", February 25, 2019.
- ⁱⁱⁱ Business Wire, "Retirement in America: Out of Reach for Working Americans?", September 17, 2018.
- ^{iv} National Association of Plan Advisors, "Senate Committee Looks at Answers to 'Looming Crisis'", February 7, 2019.
- ^v Bureau of Labor and Statistics, "National Compensation Survey: Employee Benefits in the United States", March 2018; CNN Money "Ultimate Guide to Retirement", 2018.
- ^{vi} Yahoo Finance, "14 Companies That Still Offer Pensions", June 6, 2019.
- ^{vii} See, e.g., SHRM, "Corporate Pension Plans Hit Hard in 2018", January 1, 2019 (reflecting that plan sponsors plan to close their plan to new participants and freeze accruals for existing participants); CFO/Mercer, "Pension Management: Creating a Roadmap to Success", 2019 Risk Survey (finding that 71% of plan sponsors were considering terminating their DB plans over the next 10 years, up from 59% in 2017 and 47% in 2015); CFO/Mercer, 2019 Risk Survey (finding that 63% of defined benefit plan sponsors are planning to terminate their plans in the next five years, up significantly from 38% in 2015); Metlife, "Pension Risk Transfer Poll", 2019 (finding that 76 percent of defined benefit sponsors with de-risking goals plan to completely divest all of their company's pension plan liabilities at some point in the future, including 10 percent of plan sponsors that will completely divest their plans within the next two years).
- ^{viii} Callan, "Defined Contribution Trends Survey", January 2019.
- ^{ix} Georgetown University/Willis Towers Watson, "Generating and Protecting Retirement Income in Defined Contribution Plans", 2019 ("Plan sponsors should not feel beholden to one recordkeeper for fear that the value of lifetime income solution they have adopted will be lost if they change providers for service-, fee-, or business-related reasons," the policy specialists write "Without a purely open-architecture approach to DC plan administration, portability continues to be an issue that hinders the broader adoption of guaranteed income solutions.").
- ^x Alight Solutions, "Health and Financial Wellbeing Mindset Study", 2019.
- ^{xi} Employee Benefit Research Institute, "Retirement Confidence Survey: Summary Report", April 23, 2019 (hereinafter "EBRI 2019 Retirement Confidence Survey").
- ^{xii} PwC, "8th Annual Employee Financial Wellness Survey", 2019 (hereinafter "PwC 2019 Employee Financial Wellness Survey").
- ^{xiii} PwC 2019 Employee Financial Wellness Survey.
- ^{xiv} EBRI 2019 Retirement Confidence Survey.
- ^{xv} Forbes, "Comprehensive Bill Aiding Retirement Security Likely to Pass House This Year, Says Ways & Means Chair", February 6, 2019.
- ^{xvi} EBRI 2019 Retirement Confidence Survey.
- ^{xvii} *Id.*
- ^{xviii} Alliance for Lifetime Income, "Tens of Millions of Americans Lack Protected Lifetime Income for Retirement; New Research Reveals Looming Retirement Income Crisis", October 4, 2018.
- ^{xix} TIAA, "Lifetime Income Survey", 2019.
- ^{xx} United States Department of Labor, Information Letter, October 23, 2014.
- ^{xxi} AON, "Living the Dream? DC and Financial Wellbeing Employee Survey", 2018.
- ^{xxii} JPMorgan, "DC Plan Sponsor Survey: The Power of Being Proactive", July 2019.
- ^{xxiii} *Id.*



855.401.5378 | qualifiedplanadvisors.com

Advisory services offered through Prime Capital Investment Advisors, LLC. ("PCIA"), a Registered Investment Adviser. PCIA: 6201 College Blvd., 7th Floor, Overland Park, KS 66211. PCIA doing business as Qualified Plan Advisors ("QPA") and Prime Capital Wealth Management ("PCWM").

© 2019 Matthew Eickman