DCONVERSATIONS
A LIMRA-hosted retirement roundtable discussion

Income Solutions in Defined Contribution Plans:
A qualitative research project summary

Secure Retirement Institute® recently spoke with several industry thought leaders, representing various product, legal, and topical organizations in the industry, about the defined contribution (DC) retirement income landscape. This series of in-depth interviews explored the pre-SECURE Act state of income options and expectations about how the Act may impact this market.

As the wave of Boomers retiring continues to build, and more of them (and future retirees) doing so without the safety net of a traditional pension plan, the topic of how individuals use DC plans to generate the income they need in retirement gains increasing importance.

For decades, DC plans (which, in the private sector, were originally introduced only to be a supplemental savings benefit) have been introduced, enrolled, communicated, and positioned as investment vehicles. The options within plans are investment options rather than income-generating vehicles.

Issues such as dependable income sources for retirees and access to workplace retirement savings for more workers have risen to the forefront of national attention. Solutions that help individuals use their DC plans and investments to create an income stream are nothing new to the market; individuals have always had the opportunity to roll DC investments into income-generating annuities, for example. In-plan investment options with attached guaranteed income building features have been available for several years, but uptake has been slow.

The SECURE Act, passed in December 2019, contained provisions that were designed to help address what have been thought to be common challenges to adoption of in-plan guaranteed options at the plan level: Portability and Safe Harbor. SECURE Act also contained a provision requiring DC plans to illustrate the income stream that would be achieved from an existing DC account balance.

METHODOLOGY

Secure Retirement Institute staff conducted a series of interviews with industry experts and thought leaders, representing both solution manufacturers and industry organizations. This report summarizes the high-level points of those interviews. More detailed comments may be found in DConversations: Income Solutions in Defined Contribution Plans on LIMRA.com.

Secure Retirement INSTITUTE®

Participating Executives, Thought Leaders, and Organizations

- **Nevin Adams,** Chief Content Officer, American Retirement Association
- **Tamiko Toland,** Head of Annuity Research, CANNEX
- **Ben Norquist,** Principal, Convergent Retirement Solutions
- **Michael Kreps,** Principal, Groom Law
- **Robert Melia,** Executive Director, Insured Retirement Income Council
- **Ralph Ferraro,** Senior Vice President, Retirement Plan Services Product Solutions, Lincoln Financial
- **Matt Condos,** Vice President, Retirement Plan Services Product Development, Lincoln Financial
- **Roberta Rafaloff,** Vice President, Institutional Income Annuities, MetLife
- **Sri Reddy, CFA,** Senior Vice President, Individual Savings and Retirement Income, Principal
- **Doug McIntosh Jr.,**Vice President, Investments, Prudential

The Retirement Income Space:

Today's income space, within the environment of a defined contribution (DC) plan, consists of three main constructs (Figure 1):

- **"Best Effort" Strategies** — withdrawals from a DC account, which may or may not be advisor-aided. These can include managed payout funds or managed accounts with payout features, or be random (presumably "as needed") or part of a withdrawal strategy.
- **Hybrid Investment Options** — part of a plan's investment menu, a fund — usually a target date construct — with an income-building component, or guarantee, which begins to build after the participant reaches a certain age.
- **Payout** — at retirement, the participant converts all or a portion of the account balance to an annuity with a guaranteed fixed income stream.

Figure 1: Income Solutions

	"Best effort"/DIY		Hybrid	Fixed
Examples	▪ Managed accounts ▪ Managed payout funds	▪ Systematic withdrawals (SWIP) ▪ Spend-down strategies	▪ Guaranteed component on an investment option	▪ Payout annuity
Emphasis	▪ Accumulation	▪ Decumulation	▪ Accumulation/ Income	▪ Income
Guaranteed	▪ No	▪ No	▪ Yes, after a point	▪ Yes
Valuation	▪ Daily	▪ Daily	▪ Daily	▪ Benefit, not account value

In terms of solutions for *guaranteed income,* fixed payout options have been part of public sector DC plans for many years; recently the "hybrid" option has been introduced, primarily in the private sector, ERISA plans.

Adoption of this construct has been anemic; at the end of 2019, these options were available on only 4 percent of plans, available to 3 percent of participants, and held less than 2 percent of DC assets.[1]

Some panelists point out that the hybrid option was introduced as much to help build DC market share, particularly in smaller plans, as it was to gather assets and become a meaningful income-building vehicle for participants.

Another consideration lies in the notion — or necessity — of using a DC plan to generate meaningful retirement income. In the private sector, 401(k) plans were introduced as a supplemental benefit. It's only over time that they have overtaken DB pensions as the dominant workplace retirement vehicle.

Adoption Challenges

Challenges to adoption of guaranteed in-plan income vehicles are myriad, but many of them boil down to complexity for distribution, plan sponsors and plan participants.

LIMRA research shows limited interest on the part of advisors, with just 9 percent in 2016 reporting that they had recommended an in-plan option to a DC client within the past 2 years.[2]

Panelists agree that these options are difficult to explain to sponsors and participants; there's an inherent difficulty in positioning the insurance aspect of the guarantee within what is, in effect, a plan investment option — and the additional cost (perception) — especially given uncertainty around portability of investments in these options. Still, and SRI research bears this out, participants are interested in the concept of guaranteed income. At the same time, participants themselves are not creating a groundswell of demand for in-plan income solutions.

The portability issue, combined with potential liability and fiduciary responsibilities for the selection of a guarantee provider for the option makes for a difficult pitch to plan sponsors, who may be hesitant to take what they perceive as risks for a plan design innovation that few adopt, and that participants are not asking for.

Behavioral Finance

Literally, every conversation mentioned behavioral finance in some measure (Figure 2). Overcoming participant inertia in the form of defaulting into a QDIA was a common theme. Participants also brought up how exploring income in the form of the mandated illustration might help individuals visualize the transition from an account value to an income stream — though there appear to be two schools of thought about whether such visualization might be empowering or disheartening. The need to reframe the income conversation — and how DC plans are positioned — from strictly accumulation focused to as means to build and establish income, from a perceived account value to an income stream — also resonated with interviewees.

Figure 2: Using Behavioral Finance to Improve Income

[1] *Guaranteed Income Investment Options in DC Plans*, August 2020, for assets in options, using Plan Sponsor's 2020 (representing year-end 2019 data) Recordkeeper Survey to scale market size.

[2] *Inserting Income (Options) Into Defined Contribution Plans*, Secure Retirement Institute, 2016.

Plan Sponsor Perspectives

DC plans are integral to benefits programs and key tools for employers to manage human resources. Still, there's a question as to whether including an income option helps further that objective, or simply adds unnecessary liability and complexity to a plan. Income is not a priority for many plan sponsors, and some have a perception that there is too much risk, and little reward, in offering income solutions.

The appeal of an in-plan income solution for plan sponsors is not universal. Sponsors that are interested in these options often share certain characteristics. For example, they may be eliminating or freezing a defined benefit (DB) or cash balance plan, they may be especially paternalistic, and/or think of themselves as benefits innovators and trendsetters (Figure 3).

Figure 3: Sponsor Interest in In-Plan Income

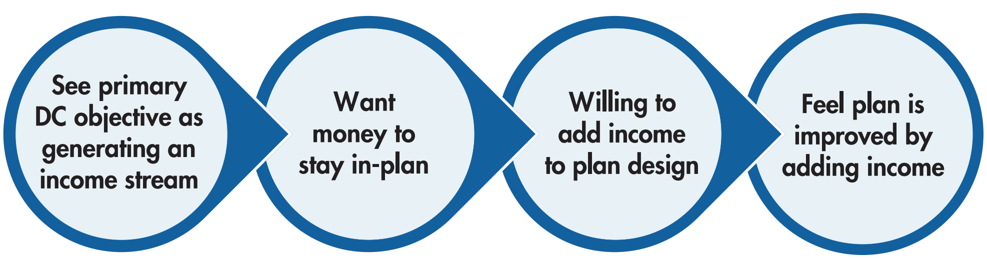
Paternalistic	• Obligation to take care of employees • Income a surrogate for traditional pension
Reducing Benefits	• Eliminating DB/desire replacement • Income a replacement for DB
Innovators	• Want to be on the leading edge of benefits • Think of themselves/their plans as trail blazers

Financial Wellness & Retirement Income

Is "retirement income" or "retirement readiness" integral to "financial wellness?" Recent events, especially, have highlighted the importance of financial wellness initiatives and programs for workers. Including an income option in a DC program may help support and round out a wellness offering.

Increasingly (and perhaps in reaction to SECURE), many plan sponsors' approaches to plan design are evolving to accommodate income generation (Figure 4).

Figure 4: Evolution in Sponsor Approaches to In-Plan Income



Whether to use a DC plan to plan for and facilitate retirement income is not a binary yes-or-no situation. Still, it's a logical and convenient starting place. Considering the options available within a plan is a starting place for a holistic approach to retirement income.

The SECURE Act

Provisions in the SECURE Act aim to smooth the path for the "hybrid" income-investment option by offering definition around portability and Safe Harbor protection for the selection of a guarantor. Mandated income illustrations were also included, in order to help individuals better understand the transition from investment to income (Figure 5). Whether or not the act will be a game-changer in pushing adoption of income options is subject to different interpretations among interviewees. Still, there is some consensus that SECURE is, at least, a "good start," but that it will take time for widespread adoption of retirement income options in DC plans.

Figure 5: SECURE Act Provisions Relative to Retirement Income

§109 Portability
- Participant "keeps" guarantee
- Recordkeeper change at plan level
- Separation from service

§204 Safe Harbor
- Sponsor protection
- Guidelines for selection/vetting of guarantee provider

§203 Disclosure
- Projects plan balances as monthly income
- Waiting for DOL assumptions/common guidelnes

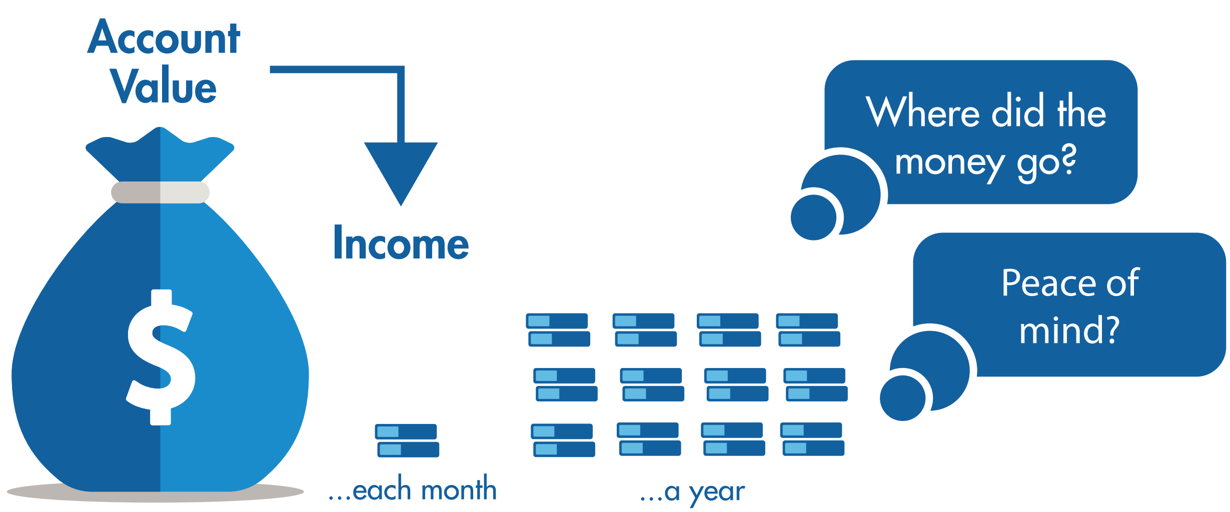
Income Illustrations

Like overall reactions to the SECURE Act, reactions are mixed about the impact of income illustrations. While they may help participants shift their thinking to income, will they create a groundswell demand from participants for help creating retirement income?

"Guardrail" parameters from the Department of Labor (DOL) may create a common starting point for illustrations, but many feel that they are limited and lack the true context of the DC experience (for example, of continuing contributions and growth over time).

Will participants be underwhelmed by the "size" of the income stream they may achieve from an existing account balance (Figure 6)? Several interviewees pointed out that such an illustration could backfire, especially if offered without clear education and prescriptive context.

Figure 6: Income Illustrations: Shifting the Conversation and Participant Perceptions



Portability and Safe Harbor

Portability and Safe Harbor were included in SECURE to address two common-wisdom sponsor obstacles to including income options in their DC plans. Several interviewees feel that these provisions go hand-in-hand, each magnifying the other's effects. Another mentioned that these provisions may now "turn the tables" and make including income the responsible design decision, from a fiduciary perspective, while another questioned whether sponsors will find new objections to income options.

From an administrative, or connectivity/back office perspective, there is some skepticism that SECURE's relief solves for the underlying technical challenges of portability. Similarly, while Safe Harbor offers guidance and protections for the selection of an issuer for the guaranteed portion of an investment, other technical aspects of operations around how lifetime income products are structured — age restrictions and spousal beneficiary rights — are not addressed.

Innovation… Looking Ahead

As more plan sponsors come to understand and accept income option solutions, and the legal community solidifies its view of product structures and arrangements, there is a school of thought that adoption will pick up — not immediately, but perhaps over the next 5 to 10 years. Income in DC also offers advisors a way — today, at any rate — to differentiate their own offerings and practices.

SECURE, with provisions that offer some protection and clarity, can open the door to innovation and the potential for new players in the market. Technology and FinTech may well play a role in next generation options.

Future congressional actions may also smooth the path and even require some sort of income solution within DC plans.

The full report, *DConversations: Income Solutions in Defined Contribution Plans*, can be accessed at LIMRA.com.

The Secure Retirement Institute® was established in 2013 with the goal of providing comprehensive, objective research and education to help improve retirement outcomes. Our research agenda covers all aspects of the industry and examines issues related to saving, investing, and generating retirement income.

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