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In-plan retirement income solutions: Fiduciary considerations for defined contribution plan sponsors

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In recent years, defined contribution (DC) plan sponsors have shown an increased desire to keep retired employees in their plans. Those that do often have a genuine concern for the well-being of their former employees and believe that these individuals would continue to benefit from their plans' lower investment fees, in contrast to the fees they would pay if they rolled over their savings to an IRA. Furthermore, keeping retirees—along with their typically higher account balances—in their plans may help the plans continue to qualify for lower-cost investments.

If their goal is to keep retirees in their plans, prudent fiduciaries of DC plans subject to the Employee Retirement Income Security Act (ERISA) should provide an effective mechanism for retirees to receive benefits throughout their retirement years. There are a number of questions fiduciaries may want to consider as they go about the process of adding retirement income solutions to their plans.

Choosing the *type* of retirement income solution

A plan sponsor wishing to add a post-retirement income solution to the DC plan's menu should engage in a deliberate process to determine the type of solution to be added. A good place to start is to collect information about the types of products available in the marketplace. This will help sponsors gain an understanding of how different products work and their features, benefits and tradeoffs.

LIFETIME INCOME PRODUCTS: SOME TRADEOFFS TO CONSIDER

More certain ← → More flexible

FIXED ANNUITY	VARIABLE ANNUITY	MANAGED PAYOUT/ DECUMULATION FUND

Less liquid ← → More liquid

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Because one of the responsibilities of a fiduciary is to act solely in the interest of the plan's participants and beneficiaries, fiduciaries should next consider what type of product would best align with retirees' needs, investment sophistication and interests, given the demographics of the workforce. This might prompt fiduciaries to ask themselves questions like:

- Do we want to provide our retired participants with *certainty* that their retirement benefits will never run out during their lifetimes?
- Do we want our retirees to have the *flexibility* to vary the amount of their periodic withdrawals as their needs change during their retirement years?
- Do we have a defined benefit plan that provides a level of guaranteed income for our retirees? If so, how might this affect our choice of an income solution for our DC plan?
- Do we want the lifetime income option to be a qualified default investment alternative (QDIA)?

Choosing the particular solution

Once plan fiduciaries have decided upon the type of income solution to be included in their plan, they should employ a fiduciary process akin to the one they would use to select any investment for their plan's menu. This typically involves engaging in an objective, thorough and analytical search to identify potential providers of the desired product. The process may include, among other things, seeking information to assess not only the reputation and experience of the provider but the product's performance and the reasonableness of its fees. However, because of the unique nature of lifetime income options, fiduciaries likely would want to consider some additional issues, including:

- If the product is or includes an annuity, how is the product designed, and what is the financial strength of the insurance company that provides the annuity? Fiduciaries may want to consider attempting to meet the conditions of the Department of Labor's safe harbor for the selection of annuity providers, which outlines a process they can follow to satisfy their ERISA fiduciary duties.[1]
- If the product has an investment component (for example, a managed payout/decumulation fund or variable annuity), what are the underlying investments? In addition:
  - Who manages the underlying investments?
  - Can these investments be changed? If so, under what circumstances?
  - What is the current asset allocation, and can it change? If so, what could trigger a change?
  - What role does each asset class play in the portfolio?
  - Are the overall risk-return characteristics of the product appropriate for retired participants?
- For managed payout/decumulation funds:
  - What is the fund's objective?
  - What benchmarks should be used to evaluate performance and assess whether the fund meets its objective?
  - How is the periodic withdrawal amount determined?
  - Can retirees withdraw more or less than the suggested periodic payment amount? If they do, are penalties applied, and how might this affect future withdrawal amounts?

[1]DOL Reg. Section 2550.404a-4(b). Also note that bipartisan bills have been introduced in Congress that would create a statutory fiduciary safe harbor for the selection of insurance companies to provide guaranteed lifetime income contracts for defined contribution plans. One such bill is the Retirement Enhancement and Savings Act, H.R. 1007.

- Is the product intended to be a QDIA? If so:
  - On what basis? For example, is it incorporated into a target date fund series?
  - Under what circumstances would participants be defaulted into the product, and how would any applicable participant notice requirements be satisfied?

Administrative considerations

It is important that fiduciaries consider several administrative issues as they think about adding a lifetime income solution to their plans. Plan sponsors may need to change provisions in their plan documents and/or modify some administrative processes to accommodate in-plan lifetime income. Some questions to consider:

- Does the plan document currently provide that retired participants must be cashed out when they reach normal retirement age, or can they keep their retirement savings in the plan?
- Does the plan document permit retirees to take periodic distributions, or does it limit them to lump sums?
- Are there any other restrictions in the plan document that might preclude the use of the product?
- Can the plan's recordkeeper administer the desired solution? If not, what would the recordkeeper need to do to be able to provide this service?
- Is there a mechanism for complying with the required minimum distribution rules?
- How will the product be explained to plan participants? Does the product provider have tools and other resources to support employee communications?
- If the product is or includes an annuity, does the plan sponsor have systems and procedures to comply with the joint and survivor annuity requirements? (These require, among other things, that the plan offer certain additional types of annuities and provide notices to participants.)

These are just some of the questions fiduciaries may want to get answers to as they go about the important process of adding post-retirement income solutions to their plans. Fiduciaries should consult their legal and financial advisors and, as with any fiduciary decision, document the decision-making process.

ADDING RETIREMENT INCOME SOLUTIONS: STEPS TO CONSIDER

1. **Collect information** about the types of products available in the marketplace to gain an understanding of how different products work and their features, benefits and tradeoffs.
2. **Consider what type of product** would best align with retirees' needs, investment sophistication and other interests, given the demographics of the workforce.
3. **Employ a fiduciary process** akin to the one used to select any investment for the plan's menu, but be mindful of the unique issues posed by retirement income products.
4. **Amend the plan document** as necessary to accommodate the selected retirement income solution.
5. **Develop a robust communication program** to help pre-retirees determine whether the solution is right for them.

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