Momentum Building for Retirement Income in Defined Contribution Plans

Many 401(k) and other defined contribution (DC) plans have evolved to resemble defined benefit (DB) plans in a few important ways, except for one—the ability to receive a stream of income from the plan over one’s retirement years. But that is changing as more retirement income products are being developed and plan sponsors are becoming more receptive to incorporating them into their plans. Participants like the idea: According to our 2021 participant research, 85% of participants said they would stay in their plans after retiring if there was an in-plan retirement income option. Congress is doing its part to promote retirement income by enacting or proposing measures to encourage plan sponsors to add these solutions to their DC plans.

DC plans are evolving to resemble DB plans

Think about how DB plans typically work. Employees don’t have to sign up for the plan; they automatically become participants after working for their employer for a period of time, often one year. The amount they will receive at retirement usually increases the longer they work for the company. And they don’t need to make decisions about the investments that support their retirement benefits.

Over the past two decades, there has been a definite trend of DC plans incorporating features that resemble those of DB plans – call it the “DB-ization” of DC plans. For example, many plan sponsors automatically enroll participants and automatically escalate their contribution percentages each year up to a specified percentage. Most will default participants into target date funds, thereby relieving them of the difficult job of determining how to invest their retirement savings.

This evolution of DC plans was spurred in large part by legislative and regulatory changes. The Pension Protection Act of 2006 (PPA), for example, eliminated obstacles to automatic enrollment by clarifying that federal law preempted state laws that prevented an employer from deducting amounts from employees’ paychecks without their consent. The PPA also created a fiduciary safe harbor that protects plan sponsors when they invest the contributions of participants who fail to make an investment decision in a qualified default investment alternative, such as a target date fund.

Legislative efforts to encourage retirement income

Just as Congress amended the law to promote auto features in DC plans, it has enacted measures and proposed other changes that could encourage retirement income in plans or at least eliminate some of the obstacles standing in the way. Some of these changes or proposals are significant, others more subtle. Here are some examples:

**SECURE Act.** The Setting Every Community Up for Retirement Enhancement (SECURE) Act, which passed at the end of 2019, contains three provisions related to retirement income:2

- A requirement that DC plan participant statements include a disclosure of the monthly amount a participant could receive as a single or joint life annuity, based on the current balance. The hope is that this will cause participants to focus not just on their account balances but on the amount of monthly income those balances might produce. Most plans must start making these disclosures no later than the June 30, 2022, quarterly statement.

- A safe harbor that would protect plan fiduciaries that select insurers to provide guaranteed retirement income contracts in the event that the insurer is unable to meet its obligations under the contract. This could eliminate one of the concerns plan sponsors have about making annuity options available to plan participants.

- The ability of participants to transfer retirement income investments to another plan or IRA if the plan sponsor eliminates the investment as an option under the plan. This could occur, for example, if the plan sponsor changes recordkeepers to one that is not set up to administer the option.

**SECURE 2.0.** A bipartisan effort in the House of Representatives and the Senate, often referred to as SECURE 2.0, could make certain retirement income products more attractive.3 (See our 3Q 2021 Legislative and Regulatory Bulletin for a description of key provisions of these bills.) The changes would include:

- An increase in the amount that participants could invest in a qualified longevity annuity contract (QLAC). A QLAC is a type of deferred annuity in which payments can start as late as age 85. QLACs enjoy an exception to the required minimum distribution rules, which generally require distributions to start at age 72.

- More flexibility in the types of annuities that plans could offer. For example, the bills would permit plans to offer annuities that would increase the annual payments to the retiree by an amount that is less than 5% annually.

**A possible retirement income mandate?**

During its consideration of the sweeping Build Back Better Act—the substantial social spending bill that may affect many areas of American life, including health care, education and energy—the Ways and Means Committee of the House of Representatives approved a measure that would have required nearly every U.S employer to maintain a retirement plan. However, that provision was dropped from the bill. If the provision had passed, DC plans adopted after the date of enactment would have had to give participants with account balances in excess of $200,000 the option to elect a guaranteed retirement income stream for at least 50% of their accounts’ value.

Will a legislative mandate to include retirement income options in DC plans resurface in the future? That’s far from certain. But what seems clear is that the trend of adding retirement income options to DC plans will continue and that Congress will keep considering measures to help move that trend along.

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2 Setting Every Community Up for Retirement Enhancement Act (H.R. 1865) Sections 203, 204 and 109.
3 Securing a Strong Retirement Act (H.R. 2954) Sections 201 and 202; Retirement Security and Savings Act (S. 1770) Sections 201 and 202.
4 Joint Committee on Taxation, Description of Subtitle B—Retirement of Budget Reconciliation Legislative Recommendations (JCX-35-21), September 7, 2021.
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