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In-plan annuities: A viable option for DC plans?

As employers evaluate the ever-changing retirement plan landscape, many plan sponsors are beginning to place more emphasis on supporting retirees through a defined contribution (DC) plan.

Plan sponsors can support their retirees in many ways through various DC plan channels, including tools and resources, investment solutions and advice features. This paper will focus on standalone (i.e., not tied to an investment solution[1]) in-plan annuity solutions for DC plans, providing:

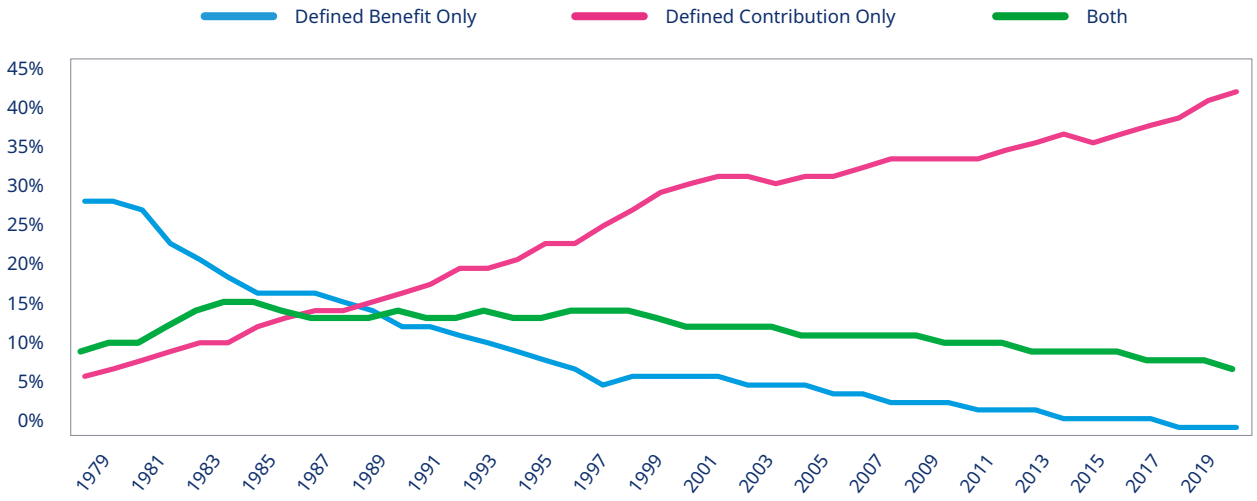
- Background on in-plan annuities
- Plan sponsor considerations when determining whether to implement in-plan annuities
- Fiduciary roles in overseeing in-plan annuities
- Appropriate steps for plan sponsors looking to add an in-plan annuity solution

[1] Mercer's Retirement Income Strategic Research Team has a separate framework in place to appropriately research investment solutions with a guaranteed income component. Please contact a Mercer team member for additional information.

An evolving retirement plan landscape

Retirees have historically relied on a guaranteed fixed income stream from a defined benefit (DB) pension plan to supplement their Social Security benefit. As the number of open DB plans continues to shrink, so will retirees' access to a guaranteed income stream that they have historically relied upon via a pension benefit. Figure 1 demonstrates the rise of DC and declining number of participants with access to a DB plan. With each generation, more retirees are left to their own discretion as to how they generate adequate income for retirement rather than being able to rely on a plan-sponsor supported DB plan, which generates a guaranteed income benefit on their behalf.

Figure 1. Percentage of private sector wage and salary workers participating in an employment-based retirement plan by plan type, 1979-2019



Source: U. S. Department of Labor Form 5500 Summaries through 1999. EBRI estimates 2000-2019using Bureau of Labor Statistics, Current Population Survey and U.S. Department of Labor data.

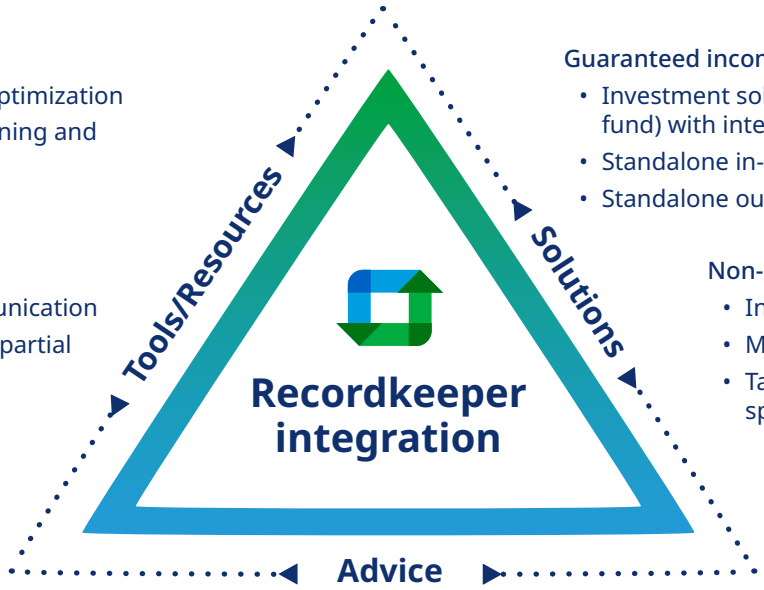
Retirement plan solutions, features and offerings are also evolving to meet the needs of participants without access to a DB plan benefit. The DC plan industry, one that has historically focused on savings and asset accumulation, is recognizing a need to shift more attention to the decumulation phase as an increasing number of DC plan participants consider retirement. According to the Pew Research Center, an estimated 10,000 baby boomers in the US turn 65 each day[2], a figure that led to 28.6 million baby boomers retiring in the first three quarters of 2020[3]. Many DC plan sponsors have responded to this population shift and increasing DC plan prominence by permitting terminated employees to remain in DC plans.

While there are numerous benefits to both active and terminated participants remaining in plan, this has further highlighted a need to provide better decumulation support. DC plan vendors, including investment managers, recordkeepers and insurers, have responded to the transition from DB to DC plans and the rise in the number of individuals approaching retirement, with a multitude of new and enhanced retirement income offerings. This marketplace shift in focus toward retirement income offerings, coupled with more terminated retirement-age participants staying in DC Plans, has put the onus on plan sponsors to appropriately educate themselves on the topic and understand the various ways they can assist plan participants as they go into retirement.

[2] Pew Research Center, February 25, 2019.
[3] Pew Research Center, November 9, 2020.

Below is a depiction of the DC retirement income landscape today, along with various offering categories:

Figure 2



Tools
- Social security optimization
- Retirement planning and projection tools

Resources
- Targeted communication
- Plan design (i.e. partial withdrawals)

Guaranteed income
- Investment solution (i.e. target date fund) with integrated guaranteed income
- Standalone in-plan annuities
- Standalone out-of-plan annuities

Non-Guaranteed income
- Income focused funds
- Managed payout funds
- Target date fund with spend down guidance

Managed Accounts Income Advice Services

Financial Coaching

The array of offerings is vast across Tools and Resources, Solutions and Advice; sorting through them can be an overwhelming exercise for plan sponsors. It is important to note that no single offering will be the perfect fit for every plan sponsor or participant base. Each category should be considered in concert with one another, not in competition, with a keen focus on how each offering integrates with the plan's recordkeeping platform and what the participant experience looks like.

While the retirement income marketplace is certainly expanding in each of the above categories, guaranteed income solutions, in particular, have seen further innovation and product evolution over the past couple of years. This is largely a result of the passing of the SECURE Act at the end of 2019, which provided investment managers and annuity providers the regulatory support they were seeking to enter, or enhance offerings to, the DC marketplace. As noted under Guaranteed Income in Figure 2, annuities can be offered to retirees in several ways, including as a standalone in-plan offering whereby a plan fiduciary selects and oversees the annuity provider(s), a standalone out-of-plan distribution feature whereby there is no fiduciary responsibility over the offering (i.e., annuity marketplace), or as an investment solution that incorporates guaranteed income.

What are standalone in-plan annuity features?

Standalone in-plan annuities offer a way for DC plan participants to convert a portion or all their plan savings into a guaranteed stream of income payments in retirement. Plan sponsors electing to offer participants annuities within the DC plan have two implementation methods to consider:

Direct
Plan sponsor engages directly with an annuity provider (i.e., insurer). Under this arrangement, the plan sponsor maintains fiduciary responsibility in selecting and monitoring an insurer, the annuity type(s) to be offered to plan participants and combination of annuity features it wishes to offer participants.

Platform
Plan sponsor utilizes the recordkeeper's in-plan annuity platform. Under this arrangement, the plan sponsor maintains fiduciary responsibility to select one or more insurers from the recordkeeper's platform of annuity providers (unless the recordkeeper has indicated they intend to take on this fiduciary responsibility). The plan sponsor is limited by the recordkeeper's offering in regard to the insurers, annuity type(s) and features made available to plan participants.

In the following section, we will explore considerations for plan sponsors implementing in-plan annuities through both methods.

What can we learn from the plan sponsor and participant experience with in-plan annuities historically?

Plan sponsor perspective

While in-plan annuity features are not necessarily a new concept within the DC landscape, there are certain aspects to historic offerings that have characteristically led to low plan sponsor adoption, including availability of DC annuity providers and fiduciary responsibilities.

Limited availability of DC annuity providers
There are a limited number of annuity providers currently offering institutionally priced annuities for inclusion in DC plans. Plan sponsors may feel they cannot perform a sufficient comparative analysis given the narrow universe of insurers available. Similarly, retirees are limited to the annuity types made available by a single annuity provider, which can make it difficult for retirees to compare proposed income rates to market rates (i.e., poor price discovery). Going forward, we expect new entrants into the DC market, particularly through arrangements between annuity providers and recordkeeping platforms, which may allow plan sponsors the ability to offer more than one insurer, which will also provide greater income rate flexibility for participants.

Fiduciary responsibilities
Prior to the passing of the SECURE Act in December 2019, plan sponsors were left unclear by the previous safe harbor issued by the Department of Labor (DOL) in 2008, which required that plan fiduciaries make judgment about the long-term financial stability of an insurer by concluding that the issuer would be able to make all future payments under an annuity contract. Plan fiduciaries were generally not willing to meet that onerous requirement, leading to less than 10% of DC plan sponsors offering an in-plan annuity feature at the time of the passing of the SECURE Act in 2019[4]. We delve into the SECURE Act provisions, the support it provides plan sponsors and why we think it further opens the door to annuities in the following section.

[4]2019 PSCA Survey of 401(k) Plans

Participant perspective

Similar to the plan sponsor experience, those who have included in-plan annuities as part of their DC plan have seen low participant utilization of annuity features. Key drivers of this trend include the lack of participant engagement with DC plans, barriers to integrating the participant experience within the plan's recordkeeping platform and the complexities that come with annuities.

Participant engagement
DC plans typically see low ongoing participant engagement, given most participants don't have the time or knowledge to appropriately understand their plan's various benefits, plan design features or investment options. Without plan engagement, a participant nearing retirement may not be aware of the distribution features of the plan. Ensuring that plan participants are aware of the plan's various offerings has historically been a challenge for distribution features like annuities. Plan sponsors should consider targeted participant communication campaigns and recordkeeper resources to engage participants early and often. One avenue that many plan sponsors have seen elevated success in engaging participants is through managed accounts, which can often provide additional support to those looking for decumulation services and advice, including advice around annuities.

Complexity
Given the general lack of engagement with their plan benefits, participants nearing retirement are typically not aware of their option to annuitize their DC plan balance, let alone how much of their balance to annuitize or how to appropriately select an annuity type or its features. For most participants, an annuity purchase can be an overwhelming concept on top of an already complex topic in retirement planning. For some, a negative connotation that accompanies the word "annuity," along with the general lack of transparency around annuity fees, are also driving factors that can cause participants to avoid an annuity purchase. Plan sponsors should collaborate with their recordkeeper to determine how best to provide participants with the appropriate retirement planning tools and annuity educational resources. Simplifying a traditionally complex topic is no easy feat but will be required to engage participants with the features of the plan.

Participant experience
Historically, participants looking to purchase an annuity with DC plan assets are redirected to the annuity provider's interface, which is outside of the plan's recordkeeping platform. Solutions that require participants to engage with a third-party website typically do not see substantial utilization given the lack of integration with the recordkeeping experience. The more integrated a plan offering is with the recordkeeper's technology, the more likely participants are to access and utilize it.

What considerations should plan sponsors keep in mind when assessing in-plan annuity offerings?

If the main goal of an in-plan annuity offering is to ensure participant engagement and utilization, then plan sponsors should focus on the following characteristics when assessing an offering:

Simplicity
Have the annuity type(s) and features been pre-selected on participants' behalf? Is the offering easy for participants to access and use?

Cost
How are vendors paid once a participant purchases an annuity?

Flexibility
Does your plan design allow participants flexibility regarding the amount of their account balance they would like to annuitize?

Integration
Is the offering, along with its features and tools, accessible via the plan's recordkeeping platform?

Support
Do participants have access to the necessary educational resources to assist in determining whether to purchase an annuity and, if so, how much of their account balance may they consider annuitizing?

Plan sponsors may want to consider the following questions when determining whether to implement an in-plan annuity feature:

Do the plan's participant demographics warrant the addition of a standalone in-plan annuity feature?	How long are retirees keeping their asset in the plan currently? What percentage of inactive participant assets stay in the plan for a prolonged period? What distribution methods are inactive participants using today?
Do annuity features align with the plan's objectives? If so, how does this type of offering fit with other retirement income options offered in the plan?	Does the plan sponsor wish to continue assisting plan participants in retirement? If so, how does transitioning assets out of the plan via an annuity align with those objectives?
Does the offering properly integrate with the plan's recordkeeping platform?	Is the plan sponsor willing and able to effectively communicate and educate its participant base regarding distribution features, such as an annuity?
Does the plan sponsor feel that the types of annuity options and their accompanying features are sufficient for the plan population?	Are various survivor benefits available, such as joint and survivor, period certain and cash refund?
Is the plan's governing body (i.e., Plan Investment Committee) willing to take fiduciary responsibility to oversee and monitor the offering and its accompanying vendors?	Should the governing body utilize a third party to analyze the annuity providers and assist in meeting their fiduciary responsibilities?

The fiduciary role of a plan sponsor and the SECURE Act

The passing of the SECURE Act at the end of 2019 was a welcome regulatory change for plans interested in offering guaranteed income to their DC plan participants. The SECURE Act took the vague, yet onerous requirements of the existing regulatory safe harbor and clarified several key points surrounding guaranteed income options in DC plans, in regard to the following three key points:

1. A fiduciary safe harbor provides for a targeted limit of liability for plan fiduciaries for their selection of insurance provider(s). The SECURE Act provides steps a plan fiduciary must follow to obtain safe harbor protection for the inclusion of guaranteed income in a DC plan:

   - engage in an objective, thorough and analytical search for the purpose of identifying insurers from which to purchase such contracts;
   - consider the financial capability of the insurer to satisfy its obligations under the contract, with this condition deemed satisfied if the fiduciary obtains certain written representation from the insurer; and
   - consider the cost (including fees and commissions) of the contract in relation to the benefits and product features as well as administrative services to be provided under the contract (a subsection says this need not be the lowest cost, but it cannot exceed a reasonable cost)

   Assuming a prudent process has been followed (as outlined in the steps above), the SECURE Act provides safe harbor in that plan fiduciaries will not be liable for any losses that may result for the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the contract. The fiduciary continues to be liable for claims of losses for other reasons, relating to, for example, the cost of the annuities made available.

2. Increased portability of lifetime income: Regulation enables participants to roll over any purchased annuity features to another DC plan or IRA.

3. Lifetime income disclosures: Provides participants with another tool to understand how much their current plan savings would generate in monthly income in retirement.

The SECURE Act provides relief to plan fiduciaries interested in offering in-plan annuities within their DC plan but does not relinquish fiduciaries of their duties. It is important to note that the decision to add an annuity distribution to a plan is not a fiduciary decision in and of itself, but the actual selection and monitoring of annuity providers are fiduciary responsibilities.

Appropriate steps for plans sponsors looking to add in-plan annuities

Mercer recommends plan sponsors follow these steps when considering the implementation of an in-plan annuity solution:

Determine whether the plan's recordkeeper has a proprietary in-plan annuity platform. If so, the plan sponsor has two options for implementing the solution:

Path A:
Recordkeeping platform offering

Understand
Understand the recordkeeper's offering, including annuity providers, and determine whether it meets the objectives of the plan.

Evaluate
If interested in pursuing the recordkeeper's offering, Mercer recommends working with a third-party vendor to evaluate annuity providers in order to meet the fiduciary standards laid out in the section titled, "The fiduciary role of a plan sponsor and the SECURE Act." A third-party vendor can provide plan sponsors with a detailed review of the available annuity providers to ensure a thorough and prudent process is being followed when selecting a provider(s).

Select
Based on the detailed review, select one or more annuity providers from the recordkeeper's platform to include for plan participants' access.

Monitor
Monitor recordkeeper offering and annuity provider(s) made available on the platform on an ongoing basis.

Path B:
Direct relationship with insurer

Understand
Assess annuity provider marketplace to determine availability of institutional offerings made available to defined contribution plans.

Evaluate
To meet the fiduciary standards laid out in the section titled, "The fiduciary role of a plan sponsor and the SECURE Act," a third-party vendor can provide plan sponsors with assistance in reviewing the available annuity providers within the DC marketplace to ensure a thorough and prudent process is being followed when selecting a provider.

Select
Select an annuity provider that has an active institutional annuity product set for the defined contribution marketplace.

Monitor
Monitor offering and annuity provider on an ongoing basis.

Conclusion

Guaranteed income provides the peace of mind and longevity risk protection that many participants seek in retirement. According to EBRI's 2021 Retirement Confidence Survey, 78% of participants indicated they would be interested in putting some or all their retirement plan savings into an option offering guaranteed income. While participants have clearly indicated their interest in receiving guaranteed income in retirement, historically, participant utilization of in-plan annuity features has been very low for plans offering it.

Experience also shows that participants require simplicity and transparency, along with clear communication and education tools, for an in-plan annuity offering to see substantial utilization. As offerings become more integrated with recordkeeping platforms and more user-friendly, and with the support of the provisions laid out in the SECURE Act, the DC marketplace is poised to see a rise in both in-plan annuity offerings and potentially participant utilization of those offerings.

Since the passing of the SECURE Act, we have noted a rise in plan sponsor interest in the topic of retirement income, and guaranteed income specifically. In response, Mercer continues to build on its internal resources to support DC plan sponsors interested in exploring the topic of retirement income.

For more information

For plan sponsors interested in exploring annuity features further, Mercer has the capability to assist plan sponsors in meeting their fiduciary duties in assessing in-plan annuity offerings as part of the selection and monitoring of insurers. Contact your consultant for further information.

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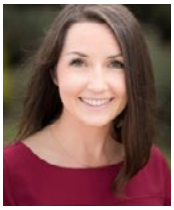

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