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SECURE Act and Guaranteed Income (Part 2)

Article By:

Fred Reish

The introduction to my last post, SECURE Act Part 1, explained:

> *There are two parts of the SECURE Act that I believe will have the greatest impact on my clients: plan sponsors and plan service providers. The first includes the provisions on retirement income, including the safe harbor for selecting a guaranteed income provider, the ability to distribute guaranteed income investments if a plan no longer want to offer those products, and a new requirement to give participants projection of their retirement income. The second impactful part is the authorization of Open MEPs (Multiple Employer Plans), which the law calls "PEPs" (or Pooled Employer Plans). That change will allow financial institutions to sponsor plans that can be adopted by multiple (or even many) unrelated employers, transferring much of the fiduciary responsibility onto the financial institution.*

That post then discussed the fiduciary safe harbor for selecting an insurance company to provide the guaranteed retirement income products for defined contribution plans (*e.g.*, 401(k) plans).

This article talks about the types of guaranteed retirement income products currently found in 401(k) plans. Let me start by addressing two common areas of misunderstanding.

First, when some people hear about this new safe harbor, they assume it refers to individual annuities. While the safe harbor covers individual annuities because they are one form of guaranteed retirement income, they are not the most common guaranteed product found in 401(k) plans, as explained later in the article.

Second, for an investment or insurance product to be included in a 401(k) plan for participant selection, it needs to be on a recordkeeper's platform. In other words, the retirement income products are not "sold" to participants; instead, they are offered as a part of the menu of alternatives. And, possibly, the guarantees may be "wrapped" around target date funds (TDFs) and used as a plan's default option for participants who do not direct their investments.

With those preliminary thoughts, let's turn to the arrangement currently found in 401(k) plans. Far and away the most common arrangement is a GMWB (guaranteed minimum withdrawal benefit) attached to the plan's TDFs. The GMWBs typically guarantee a 5% withdrawal rate beginning at age 65, based on a participant's "high water mark" (that is, the participant's highest account value on a contract's valuation date). In that way, if the participant lives for a long time and/or if the market returns do not support a 5% withdrawal rate for the full retirement period, the insurance company will continue making payments after the account runs dry.

The cost of the guarantee is usually between 60 and 100 basis points, depending on the features of the GMWB contract. The GMWB can be terminated at any time without further cost.

When a participant retires, and if the plan permits, the plan can make the 5% payments from the participants' account. On the other hand, if a participant wanted to roll over, or if the plan didn't allow for periodic distributions, the account could be rolled over into an individual variable retirement annuity (*i.e.*, a form of IRA) and the high water amount (typically called the benefit base) would carry over from the plan, so that the participant could continue to have the full benefit of the GMWB.

Another approach is to accumulate interests in annuities along the way. These interests are similar to guaranteed investment contracts (GICs) with a stable principal value and with interest accruals. They may be included in asset allocation models as an allocation to fixed income. At retirement, the interests are convertible into annuities at the participant's election.

A third approach, which may be inside or outside of a plan, is an annuity platform, which offers a number of insurance companies and guaranteed products as distribution alternatives. While under this arrangement, participants would not accumulate units of annuities during participation and would not have the projection of a GMWB high water account balance, they could opt to use an individual retirement annuity for part or all of their distributions.

While the future is unpredictable, I think that it is likely, at least for the near future, that these will continue to be the primary approaches to offering guaranteed products to participants . . . partially because they are already designed to be on recordkeeping platforms.

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