Making it Last

Addressing five issues can help sponsors determine whether they should add longevity-planning options.

BY JUDY WARD

“A frequent question we get from sponsors is, ‘Is there anything in the law that requires me to consider adding a retirement-income option?’” says attorney William Charyk, a Washington, D.C.-based partner at law firm Arent Fox LLP. “I say, ‘No.’ Sometimes that is the end of the conversation. Other times, a sponsor asks, ‘But is there any reason I should?’”

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That depends how much it troubles a sponsor to see retiring participants struggle with the complexities of how to make their money last for the rest of their lives. To decide whether to add some type of longevity-planning option to their plan, “The first thing that a sponsor needs to do is recognize that there’s a problem, and that they need to do something to help,” says advisor John Pickett, a Dallas-based senior vice president at CAPTRUST Financial Advisors. “The participants are not going to do it themselves. Once they recognize that, then it makes sense for a sponsor to take the next step in turning the wealth-accumulation program into a true retirement program.” Depending on those participants’ needs, he adds, “It might be a managed payout fund, it might be advice on how to manage the drawdown, and it might be a guaranteed product.”

Today, many retiring participants just take a lump sum. “Clearly, it’s simpler for the employer,” says Martin Schmidt, a Chicago-based consultant and subject matter expert at advisory firm Tejera & Associates, LLC. “And there are still employers trying to decide: ‘Where does our responsibility to employees end?’”

Sources talked about the following five issues an advisor can help a sponsor think through to decide if it should seriously consider adding a longevity-planning option.

The Employer’s Philosophy

This evaluation process resembles a decision tree, Schmidt says. “The first question is, does the employer want to get involved in participants’ retirement-income issues?” he says. “That’s the philosophical question. Does the sponsor want to be looking out for participants’ best interests, not just when they are employed by the company, but in the longer term?”

These days, a lot of 401(k) plans don’t want to play a role in participants’ longevity planning, and their basic message to retiring employees is, “Where do you want us to send your lump sum?” says Steve Vernon, a consulting research scholar at the Stanford Center on Longevity in Palo Alto, Calif. What’s problematic about that? “It might be the most money they ever had in their life. What I see all too often is that older Americans start spending that money too quickly,” he says. At some point, they realize they’re running out of money, and they can’t do anything about it. “People need to set up a retirement-income generator that delivers a monthly paycheck for the rest of their lives, no matter how long they live,” Vernon says. Many people don’t know how to do that themselves, he adds.

A lot of the interest thus far in retirement-income products has come from 401(k) sponsors that have transitioned from defined benefit plans. “If they have had a DB plan and they terminated it or froze it, they’ve got two classes of [retiree] citizens out there: the haves and the have-nots. Some people have an annuity payment and some don’t,” Pickett says. “In those cases, it makes sense for the sponsor to take a long, hard look at some type of retirement-income product.”

The DB-to-DC transition “is kind of where the entry point is, where you can start the conversation” with a sponsor, Schmidt says. “Once you get beyond DB to DC, you get into, how does the plan sponsor view its responsibility?”

Employee Demographics and Savings Patterns

An employer should think about the appropriateness and likelihood of participants actually utilizing a longevity-planning option. Ben Yahr, a Philadelphia-based manager in the insurance and actuarial advisory services practice at Ernst & Young, suggests three factors to consider. “One is the age distribution of the group,” he says. “Are they mostly younger workers, older workers, or balanced? What’s the need?” A very young workforce likely won’t have much interest in or need for a longevity-planning option, a product or service to help a participant plan for living beyond life expectancy. Second, take into account whether the employer has a defined benefit plan. “If participants already have a substantial amount of guaranteed income from a pension plan, the need or desire for additional guaranteed income could be less," he says.

Third, Yahr suggests looking at the salary distribution. "If the workforce consists mostly of highly compensated professionals, many participants may have a relationship with an advisor who they would prefer to work with" on retirement-income issues, he says. On the other hand, he says, "If it is a group with a heavy concentration in very low-income jobs, you might expect that Social Security will generate a good portion of the participants' desired guaranteed income." The "sweet spot" is middle-income employees, who could get the "biggest bang for the buck" from in-plan retirement-income products and advice among different income groups, he says.

Availability and Portability Issues

"One of the biggest concerns for plan sponsors is implementation: Is the record keeper they are with able to accommodate an in-plan guaranteed solution?" says Ashley diMayorca, a senior consultant at investment consultant Portfolio Evaluations, Inc. (PEI) in Warren, N.J. PEI works primarily with mid-market corporate plans that have $100 million to $750 million in assets, and these plans mostly utilize the platforms of the largest mutual fund providers that do record keeping, says Jean Martone, PEI's director, retirement plans consulting group. While most of these record keepers currently are evaluating what they could offer on retirement income, she says, "for the most part, most aren't able to accommodate many in-plan solutions now."

"What we think participants need is steady retirement income," diMayorca says. "But in order for one of these products to have a guarantee, it has to be through an insurance provider — and that is where the challenge is."

Even if a plan does its record keeping with an insurance provider that offers guaranteed retirement-income products now, these investments lack portability, Martone says. That's a problem if a sponsor later wants to change providers. "From the plan sponsor standpoint," she says, "if you can't take it with you, is there enough of a demand for these products to add that level of complexity, to be married to your vendor?"

Waiting for a New Safe Harbor

Although some of the guaranteed products have been around for years, using them in-plan still seems too cutting edge for many sponsors. "The uptake has been gradual, so we are not in a situation where employers may feel like they have safety in numbers," Charyk says.

In-plan annuities probably won't gain a lot more sponsor acceptance until the federal government issues clearer and simpler guidelines in a safe harbor for fiduciaries selecting and monitoring these investments, Vernon says. "In theory, ERISA's 'prudent person' rule should give sponsors enough to move ahead," he says. "As a practical matter, a lot of plan sponsors would like more clear-cut guidance."

Sponsors need to decide if they want to hold out for a new safe harbor. Given the wide variations among guaranteed products, the U.S. Department of the Treasury "understandably is reluctant to issue a generic safe harbor," Charyk says. So some in the industry such as the Institutional Retirement Income Council (IRIC) are trying to identify five to 10 primary elements of in-plan guaranteed products, which they hope will set the Treasury in motion to issue a safe harbor for products that have those elements. The industry has to do something to encourage broader guidance, he says, "because otherwise, we're back in the private-letter phase," where employers feel like they have to rely on IRS private-letter rulings to get a firm sense of comfort as to what's allowable with an in-plan option. That effort likely won't come to fruition with a new safe harbor in the next year or two, he adds.

Guaranteed vs. Non-guaranteed Products

While annuities carry guarantees, Schmidt says, managed accounts and managed payout funds typically do not guarantee a benefit for life. They also may cost participants more than staying in mutual funds. But they do help participants with the drawdown phase, and from a sponsor perspective, these non-guaranteed products also involve somewhat simpler due diligence than annuities.

However, Schmidt has not seen many plan sponsors add managed payout funds yet. "A managed payout fund is truly a one-size-fits-all product," he says. "It's a pretty simplistic drawdown strategy, and ultimately, you run out of money." He says that sponsors looking for a non-guaranteed product have gravitated more toward managed accounts with a drawdown feature, such as Financial Engines, Inc.'s Income+, which offers participants personalized advice on a drawdown strategy and optional purchase of a longevity annuity.

Pickett also has seen some sponsors move toward managed accounts in part to help with retiring participants' decumulation needs. "A managed account is a little more personal," he says. "When people start getting closer to retirement, they want to have somebody to talk to. It might be a little bit more expensive, but I think it works better."

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