THE OPPORTUNITY FOR LIFETIME INCOME

THE VALUABLE ROLE OF INSTITUTIONAL INCOME ANNUITIES IN DEFINED CONTRIBUTION PLANS

The role of retirement income has taken on an increased importance as Baby Boomers retire, many without the defined benefit (DB) pension income that previous generations of workers had received. With that comes a renewed look at income annuities and how they can be best used by defined contribution (DC) plans. MetLife, the leading provider of institutional income annuities, has been in this business for more than 40 years and has more than 10,000 group annuity contracts providing income benefits to more than one million people. The company was also the first to introduce a longevity insurance product, and the first to offer a fixed deferred income annuity inside a 401(k) plan. Tim Brown, Senior Vice President and Head of Life & Income Funding Solutions at MetLife, spoke with PLANSPONSOR about institutional income annuities and their expanding role in DC plans.

PS: How are plan sponsors' perceptions of defined contribution plans shifting, and how do you think plan sponsors should be viewing these plans?

Tim Brown: More and more plan sponsors are starting to look at their defined contribution (DC) plans as their primary retirement benefit program, and they're recognizing that their DC plans are incomplete without the ability for plan participants to access predictable and sustainable income for life. In the past, plan sponsors viewed their DC plans simply as supplemental savings plans but we are beginning to see more DB-like features added to DC plans as sponsors realize that retirement income should be the plan's outcome.

In addition, the shift from traditional DB plans to DC plans means that plan participants are exposed to more risk. These include market, investment, and longevity risks which, in a pension plan, were borne by the employer. These risks are now borne by the participant, so plan sponsors need to educate them about these issues and offer simple product solutions that address these risks to ensure successful outcomes.

In May, MetLife commissioned a survey of plan sponsors, the MetLife 2016 Lifetime Income Poll, which was just released. It showed that 85% of plan sponsors agree that the core purpose of their defined contribution plan should be to serve as a source of retirement income. We fielded a study back in 2012 and asked a similar question: just 9% of plan sponsors back then agreed that their DC plan should have retirement income as a core objective, as opposed to retirement savings.

The importance of retirement income will continue to grow—the Poll also found 82% of respondents expect the importance of plan sponsors making lifetime income options available to their DC plan participants would continue to increase. In a 2014 MetLife study, we found that 70% of DC plan-only sponsors have already taken some important preparatory steps for a future addition of an income annuity. There has been a real evolution in the thought process of plan sponsors.

PS: What are some of the key considerations that plan sponsors should keep in mind when selecting a retirement income approach for their DC plans?

Brown: There are a couple of things sponsors should keep in mind. First, they should begin to reframe their plan from a retirement *savings* plan to a retirement *income* plan, one that helps to ensure their financial security. One important way to expand how participants view their DC plan is with the addition of an income equivalent on DC plan benefits statements. The Department of Labor (DOL), with its Advanced Notice of Proposed Rulemaking issued in May 2013, is considering a rule that would require a lifetime income projection be provided in addition to the account balance for DC statements. According to our Lifetime Income Poll, 96% of the plan sponsors agree that this would be helpful for plan participants.

Sponsors should also keep solutions simple—to make it easy for participants to understand what their needs are and how to take action. In fact, the Poll also found that 90% of plan sponsors agree that it's in the best interests of plan participants to keep plan designs simple. To us, that means providing access to products like immediate income annuities at the point of retirement and, more recently, qualifying longevity annuity contracts, (QLACs), which are deferred income annuities also offered at retirement, that provide guaranteed income later in life (i.e., age 80 or 85) when other sources may be running low. In July 2014, the U.S. Treasury issued final regulations on QLACs and, as the only insurer to offer an institutional QLAC, we've been getting a lot of interest from plan sponsors about the product.

Simplicity enables participants to focus on the outcomes that they want and take the actions necessary to put themselves in the best possible position to achieve those outcomes.

Immediate income annuities and QLACs are simple in contrast to some of the other more complicated products being offered to—or considered for—DC plan participants, such as withdrawal solutions with minimum guarantees. It is surprising to us that plan sponsors would offer these products since 58% of plan sponsors say that products such as withdrawal solutions with minimum guarantees aren't that easy for the average participant to understand.

PS: Why is simplicity so important?

Brown: Simplicity enables participants to focus on the outcomes that they want and take the actions necessary to put themselves in the best possible position to achieve those outcomes. Action is one of the most important things needed to ensure a secure retirement, whether it's to begin saving early; understanding their future financial needs and expenses, versus their current needs; and/or determining how to convert their savings to income for retirement while maintaining some flexibility along the way. The main way that can be achieved for plan participants is with an income annuity that can be purchased with a portion of their DC savings.

PS: Can you talk about the importance of framing the conversation for participants about whether to annuitize some or all of their DC plan savings?

Brown: There's a growing body of research that suggests that most people look at a savings balance that's several times more than what they make each year and have an illusion of wealth. Think about a 30- to 40-year working life span and add up all the money that people make and save. If you have a several hundred thousand dollars in a bank account most people say, "Wow, I'm really doing pretty well." But when that has to last for a long period of time in retirement, it may not be enough. Participants need help understanding how their savings will translate to income during retirement and how solutions like income annuities can help ensure that they can't outlive their income.

One way to encourage greater annuity take-up rates is with partial annuitization—79% of plan sponsors think that allowing plan participants to take a partial lump sum *and* a partial annuity from a DC plan is preferable to a plan design where participants must take their entire account balance as *either* a lump sum *or* an annuity.

PS: So once a plan sponsor has decided to add an income annuity solution as a DC plan distribution option what steps should they take?

Brown: Adding an income annuity as a distribution option is similar to adding a new investment option to their DC plan lineup. From a plan document perspective, it can be added in a few steps. First, select a provider. Next, plan sponsors will need to amend the plan and notify plan participants and beneficiaries of the availability; modify the summary plan description and the election benefit form to show the new product; and establish the principles and procedures for the administration in the 5500 filing. Of course, there is more involved than the mechanics and product features. When selecting the provider, we believe that a workable safe harbor for annuity carrier selection will be needed by most plan sponsors. And, as I mentioned earlier, a robust education program can help drive understanding and awareness of these solutions among participants.

PS: What role does education play when you're adding that income option? How should plan sponsors educate participants?

Brown: Even prior to announcing the availability of an income annuity, retirement income education should include topics and tools that cover how to create retirement income, the pros and cons of taking lump sums, the effect of commencing Social Security benefits at different claiming ages, and issues related to longer life spans (longevity risks). Participants should also be knowledgeable about the risks being shifted onto them, including the risks of managing their investments to last a lifetime, through market fluctuations and volatility, so that they can live a dignified life. This education is important so that plan participants can understand the context in which they are considering selecting an income annuity. For the plan participant, the decision to select an income annuity shouldn't be an all-or-nothing proposition. It's more a matter of balancing their need for income with their need for some liquidity. That is, how can they ensure that they have access to some of their retirement savings, while also getting a layer of predictable income and insuring it? After all, an income annuity is simply insurance protection against outliving one's income. ■