Deferred Income Annuity Added to U. of California 403(b) Plan

By Editorial Staff *Thu, Dec 2, 2021*

Three firms are working with UC: State Street Global Advisors (SSgA) provides the custom target date funds, MetLife issues the QLAC annuity, and Fidelity Investments serves as the recordkeeper of UC's $34.6bn plan.

The University of California (UC) has begun offering participants in its 403(b) defined contribution plan an opportunity to apply part of their target date fund (TDF) savings to the purchase of a deferred income annuity at age 65 and, by doing so, reduce their risk of poverty in old age.

Three financial services companies are working with the university: State Street Global Advisors (SSgA) provides the TDF and serves as the plan fiduciary; SSgA chose MetLife as the annuity issuer for 2021. Fidelity Investments is the recordkeeper of the UC plan, which has more than 300,000 participants and $34.6 billion in assets.

SSgA's offering is called "IncomeWise." The annuity is a QLAC, or Qualified Longevity Annuity Contract, which, under IRS regulations, allows retirees to devote as much as 25% of their tax-deferred savings (capped at $135,000) to the purchase of an annuity that starts paying a monthly income (with a 2% annual cost-of-living adjustment) at age 80.

"It's a **Qualified Plan Distributed Annuity**," David Ireland, global head of defined contribution at SSgA, told *RIJ* this week. "There's a group life contract that the plan sponsor will sign, and at the point of distribution the participant will receive an individual certificate."

David Ireland

Since 2017, UC has had a TDF series custom-built by SSgA for their participants. Before buying the annuity at age 65 (or soon after) they can increase the annuitized portion of their assets by moving money into the pre-funding sleeve, up to 25% of their savings. They can leave their remaining 403(b) savings in the UC plan if they wish. They have full flexibility with the rest of their assets.

"Whether the participants decide to purchase the annuity or not, when they reach age 55 we'll begin to allocate a portion of their assets to the annuity pre-funding strategy. That will provide a fully liquid elongated fixed income exposure designed to look and feel like a fixed deferred annuity, with an LDI [liability-driven investing] strategy," Ireland said.

"As the participant moves from age 55 to age 65, the proportion in the pre-funding strategy grows to 25%," he added. "Age 80 is the default start date. [Annuitants] can bring the payment date forward at an age-adjusted payout rate, but by no more than five years. If they don't decide to buy the annuity at 65, they can still buy it at age, say, 68."

The plan's annuity contract is a single premium QLAC. It includes a cash refund if the policyholder dies before income starts and a return of unspent principal if the policyholder dies while receiving income. SSgA's regular TDF has a net annual expense ratio of 29 basis points (0.29%). Ireland said the UC version, with the QLAC, has an expense ratio that's higher "by single digits."

Along with the death benefit, there's a 2% COLA built into the payout rate. Every September there will be a one-month window where 65-year-old participants can purchase the annuity. The annuities are gender-neutral, and State Street expects them to be priced favorably relative to retail QLACs because there's no distribution cost. For 403(b) plans, participants do not need to get a spousal permission to buy a single-life annuity, but they would if it were an ERISA-governed 401(k) plan.

Various retirement companies and asset managers—Principal, Fidelity, BlackRock, and others—have been launching initiatives that will give retirement plan participants a chance to buy a lifetime income stream—typically a chance to buy a irrevocable SPIA (single premium immediate annuity) or a more flexible GLWB rider (guaranteed lifetime withdrawal benefit) on a deferred annuity.

State Street chose to offer a QLAC. Given the same purchase premium, the payout rate from a QLAC appears much more substantial than the payout from a SPIA, simply because the first QLAC payment is delayed by a decade or more. QLACs, which were created by the US

Treasury in 2014, make it possible for retirees to buy deferred income annuities with tax-deferred money; otherwise that money would be subject to annual taxable distributions starting at age 72.

"At some level, our thinking eventually pointed us to the QLAC. Individuals are averse to allocating a large portion of savings to annuities. It made sense for us to ask them to apply a smaller percentage of their savings to the annuity. If you look at the payout of a QLAC at age 80 versus a SPIA at age 65, you'll get three times as much money per month," Ireland told RIJ.

Although MetLife is the annuity provider for 2021, SSgA might pick a different insurer to issue the contract next year. It depends on who wins a bidding contest. "Each year SSgA will go out and, acting as the fiduciary, will vet the potential life insurers and come up with an approved slate of insurers. Then they will have an opportunity to bid on the annuitization," Ireland said.

The existence of the project has been known for some time, but SSgA didn't announce it until now, waiting until after the first annuity enrollment period last September. "UC hired us to be their custom TDF manager in 2017 with the end intention of moving toward an income oriented solution. Phase I was the custom TDF part, and then Phase II was the income part," Ireland said.

TDFs originated as a default investment for participants who weren't engaged enough in the savings process to choose their own funds. Ireland was asked if TDF investors and annuity purchasers—highly engaged, high-salary employees—might be two different groups. He said that high-salary employees increasingly use TDFs.

"We find that the vast majority of flows [of contributions] are going into TDFs, regardless of the participant's compensation level," he said. "TDFs have proven to be a solid default solution. We're seeing growth across all cohorts. As DC plans become the public's primary savings vehicle, I think we'll see balances grow. In the narrow segment of individuals with hundreds of thousands of dollars in the accounts, we're seeing savvy individuals move money out of the core funds and map them into the TDF."

At present, UC is the only SSgA TDF client to have the income option. Ireland expects more corporate clients to start asking for it. "We're approaching $150 billion in our TDF series, so the UC project represents less than 10% of our total," he said. "I view IncomeWise as the next generation of TDF. I see our entire TDF franchise extending into retirement income.

We’re already having conversations with existing TDF clients about it.”