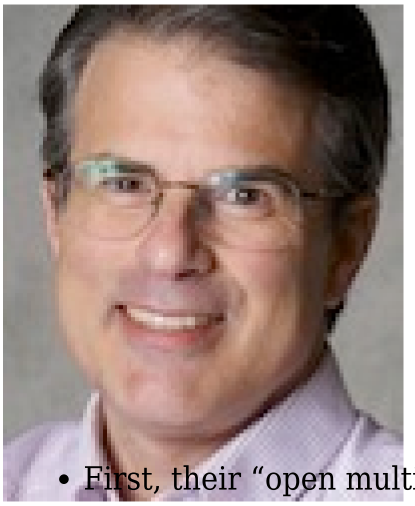
Deregulating Retirement

By Kerry Pechter *Thu, May 16, 2019*

Retirement bills close to passage in the House and Senate remove barriers to commerce in the 401(k) business but could also weaken safeguards that have been in place for many years.



Legislators in the House and Senate are inching toward the passage of two similar pieces of retirement legislation. These bills, the SECURE Act (**H.R.1994**) in the House and RESA (**S.972**) in the Senate, would tweak many aspects of existing pension law.

More specifically, they would loosen current rules for retirement plans in at least three ways that could impact the 401(k) business:

- First, their "open multiple employer plan" provision would allow small company employers to join big, provider-sponsored, multi-employer 401(k) plans rather than sponsoring their own plans.
- Second, the bills don't limit the types of annuities that could be offered in 401(k) plans to plain-vanilla immediate or deferred income annuities, as previous Department of Labor (DOL) policy preferred.
- Third, the bills allow plan sponsors to rely on state insurance commissions to verify the financial strength of the life insurers that offer in-plan annuities, even though 401(k) plans are regulated by the federal government. There's no requirement that the insurer be A-rated by the ratings agencies.

These provisions could, by reducing the administrative or legal burden of plan sponsorship on employers, encourage more small employers to offer 401(k) plans—and even to offer annuities in plans. That's why the retirement industry has lobbied for them.

If they did stimulate more plans, it could help close the "coverage gap" that leaves up to half of all private sector workers in the US without a retirement savings program at work. That's part of the public policy rationale for the bills. By removing barriers to commerce, however, they have the potential to affect long-standing safeguards for workers' savings in unpredictable ways.

'Challenges in the System'

On Tuesday, in a meeting entitled “Challenges in the Retirement System,” members of the Senate Finance Committee interviewed four witnesses with stakes in retirement reform: Joni Tibbetts of Principal Financial, Joan Ruff of AARP, Lynn Dudley of the American Benefits Council and Tobias Read, state treasurer of Oregon, which has pioneered a workplace-based Roth IRA program called OregonSaves.

Principal’s presence at the meeting made sense. Principal provides retirement plan services to tens of thousands of small and mid-sized plans in the US. In addition, Principal already has an in-plan annuity option, the Pension Builder, which allows participants to make incremental contributions toward a life-with-10 year’s certain deferred fixed income annuity. So the Des Moines-based plan provider could be a major beneficiary of both the open MEP provision and the in-plan annuity elements of RESA and SECURE. “We like open MEPs,” Tibbetts told the senators.

Sri Reddy, the chief of Principal’s Retirement and Income Solutions business, told *RIJ* in an email this week, “We believe the specific annuity provisions of SECURE/RESA will encourage more employers to make in-plan annuities available to their employees and we are confident that over time, with appropriate education, participants will see great benefit in electing to convert portions of the accumulated balances into a guaranteed income stream.”

Open MEPs and a ‘safe harbor’

But the hearing didn’t touch on parts of the bill that, I think, merit more discussion. The “open MEP” and annuity “safe harbor” provisions of the bill sound fairly innocuous but they could remake the retirement industry.

For instance, the “open MEP” provision would, on the face of it, allow small firms to “band together” to buy retirement plan services at economies of scale.

But informed observers agree that the impact will be very different. The law will allow—it’s still not clear exactly how—plan service providers to sponsor large plans and invite many small employers to join it. That would turn the current employer-driven 401(k) world on its head.

There are two other provisions in the RESA and SECURE bills that sound purely technical but could have far-reaching consequences. One provision appears to allow plan sponsors, when choosing an annuity to incorporate into their plan, to rely on state insurance commissions for information about the financial strength of an annuity provider.

But retirement plan sponsors have hitherto had to meet Department of Labor standards for due diligence when choosing an annuity. In 2008 and in 2015, the DOL reframed the steps required of an employer when choosing an annuity. But annuity issuers have pressed for further relaxation of the regulations, and have succeeded in shifting from federal to state standards for annuity strength.

Significantly, the new bills also appear to allow almost any annuity product as a plan option. In the past (in Field Assistance Bulletin 2015-02), the DOL used only immediate and deferred income annuities in its illustrations—implying that only those annuities should be offered in retirement plans. But here's how the new bills define an annuity for the purpose of inclusion in a 401(k) plan:

> "The term 'guaranteed retirement income contract' means an annuity contract for a fixed term or a contract (or provision or feature thereof) which provides guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant or the joint lives of the participant and the participant's designated beneficiary as part of an individual account plan."

The words, "or provision or feature thereof," means that the chosen annuity need only have a rider or a clause that allows conversion of the contract to an income annuity. In fact, every annuity contract—including every deferred indexed and variable annuity contracts—contains such provisions. That's what makes a contract an "annuity." It's why only life insurers can issue annuities, and why deferred annuities receive favorable tax treatment.

These two provisions are a potential boon to the annuity industry generally. They represent the kind of deregulatory spirit that arrived in Washington with the Trump administration. The Obama DOL's Employee Benefit Security Administration, headed by Phyllis Borzi, would almost certainly have questioned them.

Indeed, Borzi told *RIJ* in an email this week, "We did intend the safe harbor to be limited to what I would call 'plain vanilla' lifetime income products like immediate and deferred annuities and not sweep as broadly as the current legislation does. That doesn't mean that the other investment products offered by insurers (e.g., variable annuities and fixed indexed annuities) are prohibited from being used in 401(k) plans. It simply means that they are not eligible for safe harbor treatment."

Regarding the reliance on state insurance commissions, she said, "That is a huge weakness (if not an enormous loophole) in the pending legislation. [It] does appear to turn this important component of the DOL's fiduciary interpretive, administrative and enforcement powers over to the states.

"Deferring to the states for standard-setting for ERISA plans is a very unusual and odd result… In my 40 plus years of ERISA practice, plan sponsors have always strenuously opposed such an approach."

Bottom line: the RESA and SECURE bills contain provisions that could potentially drive enormous changes in the retirement industry. These provisions have largely been written behind closed doors, with strong industry influence. For some, the implications of the language in the bills is worrisome. Others hope that the bills, if passed, will remove long-standing barriers to innovation.