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Experts Assess the Latest on ‘QLACs’

By Kerry Pechter *Thu, Oct 30, 2014*

Mark Fortier, Prudential's Srinivas Reddy, ERISA lawyer Fred Reish, Steve Shepherd of Aon EnnisKnupp and Jody Strakosch shared their views with RIJ about recent statements by Treasury official Mark Iwry (above) on in-plan annuities in target date funds.

When Deputy Treasury Secretary J. Mark Iwry stood at the podium in Knight Theater in Charlotte, NC, last Friday, and broke the latest news about “QLACs” to a gathering of a hundred or so Retirement Income Industry Association members, he left no ambiguity on one point.

The government’s retirement security advocates clearly want to make 401(k) plan sponsors feel more legally secure about offering default annuity options to participants in defined contribution plans. And it has said it thinks a QLAC—a qualifying longevity annuity contract, or qualified deferred income annuity—would fill the bill.

To allay plan sponsors’ anxieties about putting annuities in their plans, the Treasury Department, IRS and Department of Labor all issued written or verbal communications last week saying that such an option could be added without necessarily creating new fiduciary liabilities and without violating federal rules (“nondiscrimination” rules) against plan designs that favor older, highly-paid workers.

The announcements were also evidently intended to relieve any concerns that the government wants to impose a mandate on plan sponsors to offer annuity options in DC plans. In his comments in Charlotte, Iwry, Treasury’s chief advisor on retirement and health care policy, assured the audience that market-based solutions, not government mandates, can best fill the retirement income vacuum left by the disappearance of pensions and the absence of income features in most defined contribution plans.

Those market-based solutions, Iwry told RIIA, could take any of several forms, including a deferred group annuity inside a target-date fund or a managed account. It could be either an immediate annuity whose income stream starts at retirement or a deferred income annuity (DIA) whose stream begins as late as age 85. It would be voluntary, not mandatory, for the plan sponsor and for each participant.

“It’s a strong message that lifetime income is an important outcome for plan design, and clearly says annuities can be part of a qualified default investment alternative, and specifically, part of a target date fund. It’s great news,” said Jodi Strakosch, a former

MetLife retirement executive who ran that firm's since-abandoned experiment with in-plan annuities, called SponsorMatch.

Others agree. "It's clear that the government is promoting retirement income in DC plans," said Steve Shepherd, partner, Institutional Annuities and Life Insurance Solutions at Hewitt EnnisKnupp, a part of Aon. "We're trying to help plan sponsors think through implementing the QLAC. When we saw the DOL letter and the IRS notice, we thought it was another step in the right direction."

Watershed, or feel-good

But any certainty arising from the carefully worded announcements ended there, according to institutional retirement income experts who spoke with RIJ this week. They aren't sure how broad or narrow the application of the government's statement. It's not clear if Iwry's announcement represented a watershed for in-plan annuities, or an incremental advance in a long campaign, or just a feel-good moment for the relatively small subculture of in-plan annuity advocates.

Mark Fortier, the former AllianceBernstein executive who led the design of an in-plan annuity, underwritten by three life insurers, in target date funds at United Technologies Corp. in 2011, had some questions.

"Everybody was waiting for Treasury and the DoL to tell the world that they advocate lifetime income in DC plans. This tells plan fiduciaries that they want that to happen. That's all positive," he told RIJ this week.

But, in reading Notice 2014-66 from the IRS and the letter about QLACs from Phyllis Borzi of the DoL, Fortier found that they didn't address many of the devilish details associated with putting an annuity in a plan, like liquidity options, or whether the pre-annuitized allocations will be held in an insurer's general account or in a separate account.

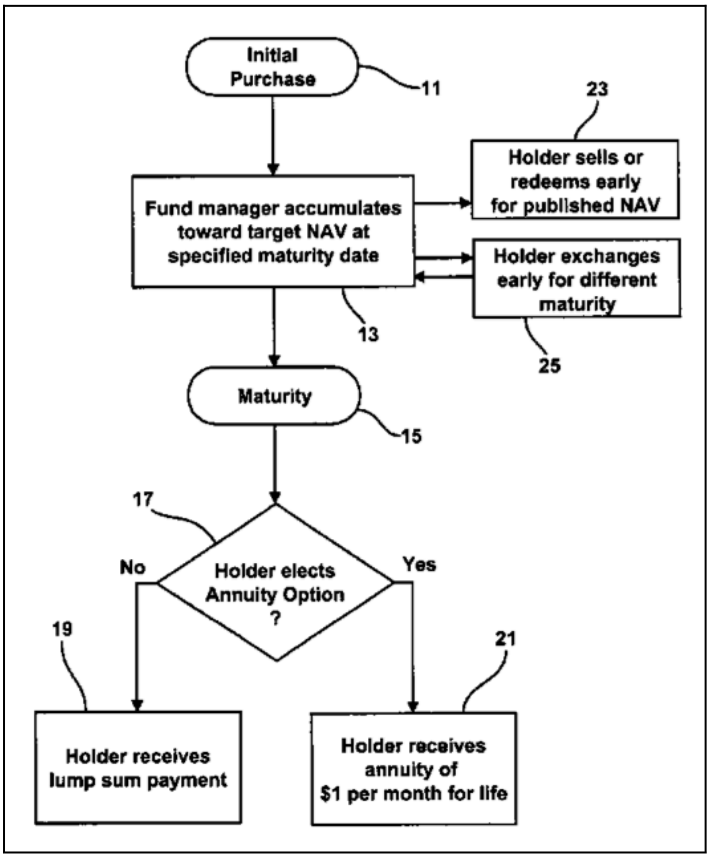
"Certain items in [the announcement] create ambiguity as much as they clarify ambiguity. But it's good news. My hope is that industry will help them fill in the missing pieces. They've opened the door of opportunity for some of those who've been sitting on the sidelines."

Meanwhile, the director of the Defined Contribution Institutional Investment Association has sent out an email inviting members of DCIIA, a trade group of plan providers, to join a discussion about the announcement. "We are putting together a task force to review the guidance, share insights with our membership and provide feedback to Treasury," said Lew

Minsky, DCIIA's director.

The type of in-plan annuity that appeared to be blessed—or at least unshackled—by last week's announcement has been proposed and even launched in the past, but it hasn't gotten traction. Whether the latest clarifications will be sufficient to jump-start that product is impossible to predict, but they were widely believed to be necessary.

Besides the AllianceBernstein product, there has been SponsorMatch, a program from MetLife and Barclay Global Investors where participants could buy future income units, BlackRock's LifePath project, unveiled in 2013, and an initiative by Mutual of Omaha in 2010 for the micro-plan market. In 2004, Retirement Income Industry Association chairman Francois Gadenne and a colleague patented a related product called **Pension Shares**. (Gadenne's interest in their patents, which include the illustration below at right, has been in a blind trust, Gadenne said.) All of these efforts involved giving plan participants the option to buy discrete amounts of future income before retirement.



None of these has gotten as much traction as programs that offered a guaranteed minimum withdrawal benefit in a target date fund. Prudential's IncomeFlex and Great-West's SecureFoundation defined contribution annuities represent this type of product. Srinivas

Reddy, head of investments for Prudential Retirement, said that about 100,000 plan participants are using IncomeFlex—still only a fraction of what his company hopes the market will be.

What about GMWBs?

But this type of product was not directly addressed in last week’s announcements, leaving Reddy a bit perplexed. “When I look at a regulatory announcement, I want to know if the guidance adds clarity and if it’s broad enough to apply to multiple varieties of solutions and will foster innovation. But this applies only to a particular type of product,” he told *RIJ*.

“That product is the one that uses QLACs. But that design type has gotten no traction at all. If you look at [the GLWB] solutions, we know they resonate. So, while the announcement acknowledges that retirement income is important, it was very specific to one product type,” Reddy added. A Treasury spokesman said that any specifics in the announcement were meant to address specific legal concerns voiced by plan sponsors and providers, and not to be interpreted as excluding or restricting

But guidance on the living benefit design could be forthcoming, according to ERISA attorney Fred Reish of Drinker Biddle & Reath. “My sense is that Treasury is also working on GMWB guidance, which they feel presents different issues,” he said in an interview yesterday. “So, the fact that GMWB wasn’t included wasn’t a negative statement, just an indication that materially different products will have different pieces of guidance.”

Asked if participants are likely to embrace in-plan annuities, Reish pointed to TIAA-CREF’s defined contribution plans, where academics can allocate any part of their savings to a fixed income investment that turns into a life- and/or period certain annuity after retirement. “TIAA CREF has had relatively good uptake on annuities,” Reish said. “It is a role model for what can be done. For any type of guaranteed product, though, I think the key is for it to be accumulated or acquired over years of participation in a plan.”

Not a tsunami

The appeal of contributing to an annuity before retirement is based on the idea that guaranteed income costs less when you buy it in advance, and the earlier you buy a dollar of future income, the less it is likely to cost.

“If I went out at age 65 to buy an annuity with money from a regular TDF, it would cost me more than if I bought it with units from a TDF with an in-plan annuity option,” said

Strakosch. “Any time you buy income on a deferred basis, you allow the insurance company the gift of time. We don’t typically call it a discount. But there’s a price difference.”

In providing the guarantee, the insurer assumes the risk that the underlying assets won’t grow enough to cover the cost of making all the income payments before the participant dies. In last week’s government announcement, 55 was the suggested age at which participants would begin allocating money to the annuity option in the TDF. But, according to Treasury, that was not intended to mean that contributions to an annuity couldn’t begin earlier.

Aon’s Shepherd said his firm looks at this year’s government announcements about QLACs to be an incremental advance. “Our position is that this is an evolutionary type of development, not a watershed event,” he told RIJ.

“Plan sponsors are with more frequency looking to adopt these products over the next few years,” he said. The trends are directionally there. But we have told every industry leader that this won’t be a tsunamic event. Plan sponsors will have to approach this carefully and consciously.

“We don’t see this as a *product* evolution. We don’t think that plan sponsors will just drop in a product and feel that they have met the retirement income needs of the participants. Plan sponsors need to understand the demographics of their plans and the communication needs of their individual participants, and they may need to adopt multiple income options. They will need to figure the right approach for their plans, and that’s going to take time.”