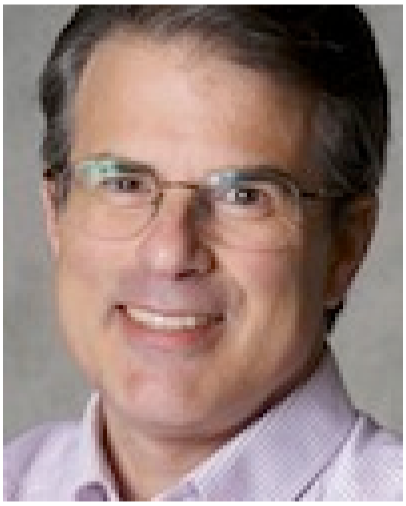
How Much Retooling Does the 401(k) Need?

By Kerry Pechter *Thu, Jun 21, 2018*

At the ERISA Advisory Council's meeting this week and at an EBRI webinar, proposals to inject lifetime income elements into 401(k) plans were debated and evaluated.



This was a talkative week in Washington, D.C. for folks who want the Department of Labor to tweak (or refrain from tweaking) the 401(k) system to reflect its emergence as American's primary source of private retirement savings in a post-defined benefit pension world.

On Tuesday, Kelli Hueler of IncomeSolutions, the online annuity platform for plan participants and others, and Jack Towarnicky, director of the Plan Sponsor Council of America (now part of the American Retirement Association), both testified at a meeting of the DOL's ERISA Advisory Council.

On Wednesday, the Employee Benefit Research Institute held a broadcast webinar on the findings of its Retirement Security Projection Model. Jack VanDerhei presented and Brett Hammond, the American Funds research chief and former TIAA executive, moderated.

Lots of issues are in the air: some new, some evergreen. Up to half of private-sector workers don't have a tax-deferred retirement savings plan at work. The cost and quality of plans varies widely, depending on employer size and profitability. Too many workers still reach retirement without enough savings. Few plans teach workers how to convert 401(k) accounts into personal pensions.

The wild card factor for 401(k) plans has been the emergence of the rollover IRA. Trillions of dollars accumulate in 401(k) accounts, but when workers change jobs or retire, they move their account assets into rollover IRAs. As a result, individual brokers and financial advisors are replacing 401(k) sponsors as the proximate provider of income counseling. Reasonable people disagree on whether that's a positive development.

'Change IB-96'

Kelli Hueler

Hueler would like to see sponsors play a bigger role in income counseling. An entrepreneur who runs a respected stable-value data business, she has also barnstormed the nation for over a decade, enlisting support from jumbo plan sponsors like IBM, GM and Boeing for her IncomeSolutions web platform, where recently-separated plan participants can roll part of their savings into an immediate or deferred income annuity.

Hueler wants to change the 401(k) rules that currently discourage the conversion of savings to income. She urges the DOL to revise the language about participant education in a 22-year-old directive, Interpretive Bulletin 96-1, to “specifically address the decumulation phase” and highlight, among other things:

“The attributes of partial withdrawals in order to encourage plans to offer partial distributions, so participants may retain a portion of their savings in the plan as well as take advantage of institutionally structured and priced lifetime income alternatives and purchasing strategies.”

‘No new mandates’

Towarnicky presented testimony on behalf of the PSCA, which, until fairly recently, was called the Profit-Sharing Council of America. Members of the PSCA have no great desire to retool their plans to make them more defined benefit-like, nor, they say, are participants demanding such a change. He acknowledged a need to make it easier for retirees to draw regular income from plan accounts, but otherwise he thinks the status quo is working.

Jack Towarnicky

“Many plan sponsors use decumulation processes other than annuities to accommodate diverse participant demographics,” he said. “Because lump sum/installment payouts offer greater flexibility with less complexity and cost, they offer value to many more participants. Adding in-plan retirement income features are typically not top priorities as participants can customize retirement income by using the more than adequate decumulation/ retirement income products/options available in the IRA marketplace.”

Above all, plan sponsors don’t want government mandates and they want to avoid any activities—adopting in-plan annuities, recommending annuities, illustrating lifetime income—that might get them sued by participants down the road.

EBRI’s super modeling tool

In its webinar yesterday, EBRI, which compiles data on defined contribution plans, rolled out the latest findings of its Retirement Security Project Model. EBRI uses this tool to assess retirement policy proposals. Recently, EBRI assessed America’s retirement readiness and evaluated the following potential initiatives:

- Auto IRA programs, such as the one proposed under President Obama’s 2015 Budget
- Programs expanding access to defined contribution plans, such as the Automatic Retirement Plan Act of 2017 (ARPA) proposal
- A universal defined-contribution scenario
- Auto-portability proposals
- Proposed reductions in the 402(g) and/or 415(c) limits

Evaluations of these proposals from the RSPM analysis included:

- An automatic Individual Retirement Account (IRA with a three percent deferral would reduce EBRI’s estimated $4.3 trillion aggregate national retirement savings shortfall

by $268 billion if there were no employee opt-outs but only by $202 billion if there was a 25% employee opt-out rate.
- The Automatic Retirement Plan Act of 2017 would reduce the shortfall by $645 billion if there were no employee opt-outs but only by $495 billion if there was a 25% employee opt-out rate.
- A universal defined-contribution system would decrease the shortfall by $802 billion if employers who do not currently sponsor a retirement plan would adopt a plan similar to those currently offered by plan sponsors with a similar number of employees (assuming empirically observed opt-out and contribution rates).
- Auto-portability would reduce retirement shortages for those currently ages 35-39 by between 17% and 23%, depending on the number of future years of eligibility to participate in a defined contribution plan.