Retirement Income
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How T. Rowe Price Approaches the ‘401(k) Income’ Market

By Kerry Pechter *Wed, Oct 2, 2024*

By bundling a deferred income annuity with a managed payout program, T. Rowe Price's optional 'out-of-plan' 401(k) income tool aims to boost participants' spending power in retirement by as much as 50%, relative to a managed payout program with no annuity.

Several of the major target-date fund (TDF) providers, in their quest to equip defined contribution (DC) plan participants with tools for “pension-izing” their savings (and to retain assets in the plan), have embedded deferred annuities into their popular funds-of-funds.

Their expectation is that plan sponsors will default auto-enrolled participants into the TDFs, that participants will automatically start contributing to the deferred annuity at about age 50, and that when participants retire, some will choose to switch on the annuity’s lifetime income rider.

1. Rowe Price is taking a different approach with its retirement business. The $1.61 trillion asset manager, which record-keeps more than 8,400 retirement plans and manages about $464 billion in TDFs across those plans, isn’t defaulting participants into anything. It believes plan sponsors prefer it that way.

The Baltimore-based asset manager decided several years ago to focus on non-guaranteed “managed payouts” as an optional income solution for auto-enrolled participants. Starting this year, it is offering an enhanced managed payout program called “Managed Lifetime Income.” It includes a deferred income annuity that guarantees payouts until the annuitant dies.

In the jargon of 401(k) income solutions, MLI offers an “out-of-plan” annuity (funded at or after retirement) rather than “in-plan” annuity (notionally funded before the participant retires). T. Rowe Price will offer MLI initially to the DC plans that it administers.

Multiple income solutions needed

Last September, T. Rowe Price’s senior global retirement strategist, Jessica Sclafani, explained her company’s initiatives to the **ERISA Advisory Council** (EAC), a 15-person panel representing various stakeholder-groups in the retirement industry and the public at large.

Jessica Sclafani

The panel was hearing witnesses and gathering testimony for the Department of Labor about Qualified Default Investment Alternatives, of which TDFs are one, and whether regulations governing QDIAs should be tweaked to reflect their use as vehicles for annuities in 401(k) plans.

"There are several solutions in the marketplace today where contributions are allocated to an annuity-like asset class that would allow for the future purchase of guaranteed income," Sclafani told *RIJ* in an interview after the EAC meeting.

Instead, she added, "We believe that ultimately retirement income will be implemented through an array of investment options. We don't think that one solution will meet the majority of participants' needs."

In 2017, T. Rowe Price started offering participants in its plans a mutual fund with a managed payout program that's offered to participants over age 59½ and retirees. In 2019, it introduced a collective investment trust (CIT) with the same feature. The target (but not guaranteed) payout rate was 5% of an amount based on the participant's final TDF balance, subject to a "smoothing" mechanism that makes the income stream less volatile. In an email to *RIJ*, Sclafani described the payout calculation:

> The total calendar-year distribution amount is determined each year by calculating 5% of the average net asset value (NAV) of the participant's fund or CIT over the trailing five years. The fund/trust automatically makes 12 equal monthly dividend payments to investors each calendar year. The amount to be paid each year is reset annually as a means to balance these competing goals and risks.
>
> The 5-year look-back serves to smooth potential volatility in the amount paid out. Also,

> the participant chooses how much to invest in the "Price Managed Payout Investment." They could allocate their entire balance or just a portion. In this way they can influence the amount of the payout, even though it is set at 5%.

"That solution is currently available only on our recordkeeping platform," Sclafani said. We're looking to work with a middleware provider to launch it on third-party recordkeeping platforms."

The company's new Managed Lifetime Income (MLI) program bundles a managed payout process with a type of deferred income annuity called a Qualified Longevity Annuity Contract (QLAC).

[Established in 2014 by the U.S. Treasury Department, QLACs are deferred income annuities with a twist. Savings in a QLAC aren't subject to the Required Minimum Distribution rules, which require withdrawals from IRAs, 401(k) and other qualified accounts starting at age 73.]

"We know that a certain cohort of participants will benefit from a QLAC, so we've paired QLAC and managed payouts," Sclafani said. "You choose either at retirement or in retirement how much to put into Managed Lifetime Income."

At retirement, participants who are invested in TDFs must decide whether to opt-into the MLI program or not. If they do, part of their money stays in a liquid managed payout account in the 401(k) plan. The rest is applied to irrevocable purchase of the QLAC.

For example, a 65-year-old might decide to receive a managed payout for 15 years, until age 80.

At that point, income from the QLAC would begin and would last for as long as the retiree lives. (If retirees die before receiving all of their QLAC income, their beneficiaries receive the unpaid balance.)

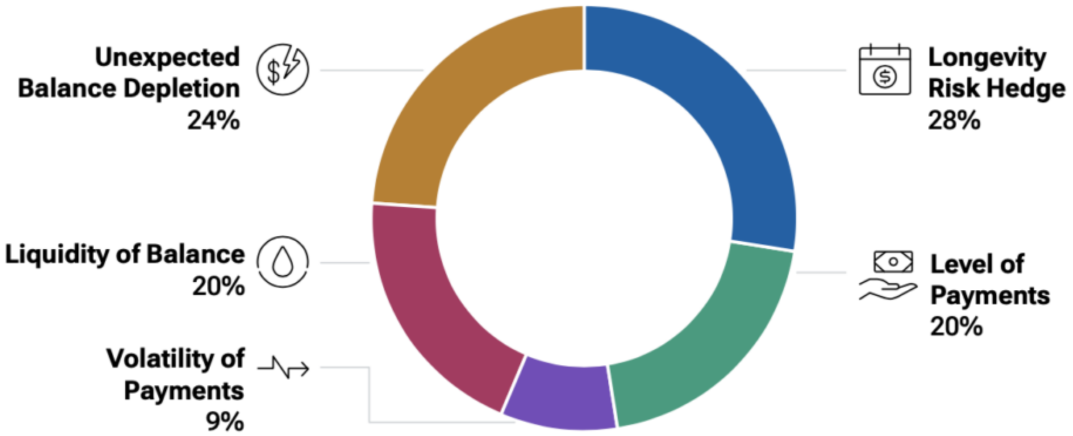
Significantly, the QLAC could boost a retiree's income by 50% a year relative to the annuity-less managed payout program, T. Rowe Price estimates. "There's a roughly 7.5% payout of the managed payout portion over 15 years. The QLAC is sized to offer the same payment that the retiree had been receiving before."

Although the money used to buy the QLACs would move over to the general account of the annuity provider from the retired participants' 401(k)s, the present value of the annuity would still be visible on the retirees’ account statements.

“We made sure that participants would still have a holistic view into MLI as a solution,” she said. “Participants have worked hard to achieve a desired balance. It shouldn’t look like they’re giving up a chunk of it when they buy the annuity.” [T. Rowe Price has not yet identified the life insurer providing its QLAC.]

Retirement income preferences among DC plan participants

(Fig. 4) Relative importance scores for preference attributes



Data do not add to 100% because of rounding.
Source: T. Rowe Price, 2024 Exploring Individuals’ Retirement Income Needs and Preferences.
See Appendix and Additional Disclosure for more information.

From “A Five-Dimensional Framework for Retirement Income Needs and Solutions,” T. Rowe Price. May, 2024.

The future of 401(k)s and annuities

Large plan sponsors now actively ask for information about income-generating tools rather than simply listen to pitches about it, Sclafani said. “More DC plan sponsors are taking meetings proactively. We’ve moved from the 10,000-foot level to the implementation stage.” A slight language barrier still impedes communication, however. “As an industry we lack a standard taxonomy for discussing retirement income,” she said. “That’s a barrier to future implementation.”

No one should expect the 401(k) income market, still in its infancy, to reach instant maturity, she said. “If you think you’ll see 20% of eligible participants use the solution, that’s a recipe for disappointment. We see 5% to 10% adoption rates among participants,” Sclafani told *RIJ*. Among T. Rowe Price’s 8,400 plans, the managed payout solution is offered to about 400. Of those, 60 currently use the managed payout solution.

1. T. Rowe Price research foresees defined contribution plans offering not one but multiple income tools to their participants. “Our research suggests that it’s a fallacy that you should offer one [income] solution,” Sclafani said. “Participants have diverse needs, so you need more than one solution. We would like to see participants opt into a retirement solution, and then streamline the process by limiting the number of decisions they have to make.”

The solutions don’t have to be embedded in QDIAs. “Adding a retirement income solution to a DC plan is already a complex decision,” she added. “We’re not doing ourselves any favors by attaching it to a QDIA. The industry is conflating two decision points that are already monumental by themselves. That’s just making it harder for plan sponsors.”