Is the SECURE Act Too Weak to Make a Difference?

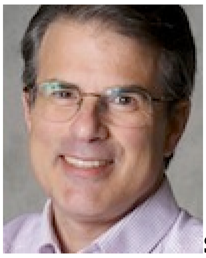
By Kerry Pechter *Thu, May 30, 2019*

Yes, there's a new 'safe harbor' for selecting an annuity provider for a 401(k) plan in legislation that appears headed for the president's signature. But there's no sign that many employers or employees want in-plan annuities, and the bill gives them no special reason to.

Life insurance and investment company trade groups are treating the expected passage of a retirement reform bill (based on the SECURE Act that recently passed in the House and the Retirement Enhancement and Savings Act awaiting a vote in the Senate) like the greatest thing since the repeal of Prohibition. Others don't think the legislation will change much.

It's true that the anticipated bill strikes at bottlenecks in the 401(k) system. The new legislation will make it less risky, legally, for plan sponsors to add annuities as plan options; it will promote savings adequacy by raising the limits of "auto-escalation"; and it will address the plan coverage gap among small firms by allowing them to join "open multiple-employer plans."

But the bills feel like a batch of random measures, not like a clear public policy directive.



They appear to reflect the interests of the sellers of retirement plan services more than the interests of the buyers of those services. Lawmakers don't appear to have haggled for measures that would spark demand for annuities—perhaps by giving in-plan annuities unique advantages.

The possibility also exists that the bills, like other deregulatory moves, won't be harmless. Like the Commodity Futures Modernization Act of 2000 (which deregulated derivatives), and the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (which denied relief of student loan burdens through bankruptcy), they might create loopholes that lead to adverse unintended consequences.

For instance, both bills allow plan sponsors to rely on state insurance commission filings and communications to satisfy their fiduciary duties when conducting due diligence on annuity providers. And, under the bills, a life insurer need be in existence for only seven years in order to qualify for consideration.

I asked two pension law experts about this. Neither one seemed to think that the bills would have much effect either way.

“One of the criticisms of SECURE is that some states are less rigorous in their oversight of insurance companies and, as a result, some weaker insurance companies will be able to qualify under the bill’s ‘checklist’ approach,” pension law expert Fred Reish at the law firm Drinker Biddle & Reath told *RIJ*.

“While that’s a possibility, I doubt that it will happen because the plan fiduciaries must still decide whether to include the annuities or GMWBs [guaranteed minimum withdrawal benefits] in their plans,” Reish said. “So far, at least, the 401(k) recordkeepers, who by and large, determine who is on their platforms, have only used large, financially strong insurance companies… usually the insurance company affiliated with the recordkeeper. I don’t see the recordkeepers allowing weak insurance companies on their platforms.”

Attorney Marcia Wagner of the Wagner Law Group agreed. She told *RIJ*, “[While] weaker insurers may make a pitch to small employers, they would still need to be sufficiently qualified to be considered under an RFP [request for proposal], and they may have difficulty in satisfying that hurdle.

“As with other service provider decisions, lowest cost is not the decisive factor, and even though [weaker insurers] may qualify, the likelihood is that the plan sponsor will feel more comfortable dealing with a more established insurer. As to whether the SECURE Act sets the bar too low, while insurance companies do fail, the proposal is dealing with an area in which there is a low level of risk.”

Employers will still have to behave like fiduciaries, and that’s still not going to be cheap. One 401(k) provider executive told *RIJ* that it’s still going to cost employers about $50,000 to hire a consultant to guide them through the annuity provider selection process, and that such an expense will be out of reach for most small firms.

Regarding the type of annuities that can be offered in 401(k) plans, the bills also appear to be intentionally open-ended. According to the text of the SECURE Act:

“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.”

Unlike a 2015 Department of Labor bulletin on this topic, the bills don’t point to immediate or deferred income annuities as the preferred types of annuities for plan participants. The bills don’t give employers any direction about choosing a type of income-generating annuity, even though vastly different products can call themselves “annuities.”

One employer might choose to offer only a deferred annuity with a guaranteed lifetime withdrawal benefit with full liquidity and little or no mortality pooling benefit, while another employer might choose a deferred income annuity that pays nothing until the participant dies or reaches age 80. But are they all in the best interest of the participant?

The retirement industry took the lead in shaping these bills; it has the strongest incentives to liberalize the in-plan annuity market, so taking the lead makes perfect sense. But the bills curiously lack stimulants for the demand side. Democratic lawmakers in particular could have insisted on concessions from life insurers or on legal changes that might make in-plan annuities much more appealing to workers. That might have disrupted the bipartisan appeal of the bill, but it might have made it more effective.

“It is unclear the extent to which there will be a take-up of annuities if this provision becomes law. First, an annuity form of distribution does not seem high on the priority list of benefits that 401(k) plan participants are requesting, nor is it the type of benefit that a plan participant could not create on its own,” Wagner told *RIJ*.

“For those plan sponsors for whom the risk of civil litigation for breach of fiduciary duty was holding them back from introducing lifetime income options, the SECURE Act would be an impetus to take action, but the number of plan sponsors in that category may not be large, and may not include many small employers.”

If these experts don’t think these bills will change the status quo much, why is the retirement industry so excited about them?