Not Yet Legal in the US: CRITs

By Mark Shemtob *Thu, May 20, 2021*

Collective Retirement Income Trusts resemble variable income annuities, but without explicit guarantees. These group arrangements could help retirees turn part of their 401(k) or IRA savings into rising income for life, writes this actuary and CFP.

The 401(k) will continue to be the primary employer-provided private sector retirement savings program for the foreseeable future. Unfortunately, 401(k) plans are not designed to provide retirees with the steady lifetime retirement income they need.

Many participants would like to see income options in their 401(k) plans. Though employer plans can fulfill this role, to date most employers have expressed a reluctance to do so. Individuals are thus required to assume this challenge on their own.

Retirement income can be generated through pre-planned structured withdrawals from an investment portfolio, but this approach requires some investment expertise. It may not provide sustainable lifetime income nor does it offer longevity risk pooling, which can increase retirement income substantially.

Though an individual retiree can pool longevity risk by purchasing a guaranteed lifetime income annuity from an insurance company, these annuities are not popular. Many people consider them expensive relative to their benefits, especially in a low interest rate environment. Certain variable insurance products provide guaranteed minimum levels of income for life, but their fees can be high and they don’t pool longevity risk.

Welcome to CRITs

Collective Retirement Income Trusts (CRITs), though not currently allowed in the US under ERISA qualified plans or Individual Retirement Accounts (IRAs), offer an alternative for creating reliable income. CRITs, should they become permitted by law, would be established, administered and managed by financial institutions and open to anyone with retirement savings.

CRITs would work as follows: At or after retirement, investors would irrevocably transfer a portion of the assets in their employer plans or IRAs into a CRIT. The CRIT would pay the retiree a monthly income for as long as the CRIT has collective assets. The amount of the payments would be actuarially determined and subject to adjustments (increases or decreases) based on the actual mortality and investment experience under the CRIT.

These adjustments make certain that the CRIT does not run short of money but at the same time pays out actuarial gains to all retirees on a fair basis. Individuals could choose payments for life or for "life with a period certain." (A 15-year period certain would likely result in a return of principal or more.) They could choose a single life contract or, to provide for another person, a joint-and-survivor contract.

The CRIT would invest in a collective professionally managed balanced portfolio similar to a defined benefit pension fund. The retiree's initial monthly benefit would be based on several factors: The amount of savings he or she transferred to the CRIT, an assumed investment rate of return based on the CRIT portfolio composition, the age of the retiree (and co-annuitant, if applicable), the assumed average life expectancy for the covered group (preferably gender-based), and the income option selected.

To allow the CRIT to pool longevity risk, CRIT participants may not withdraw money in a lump sum. Longevity risk pooling increases the benefits for all retirees. It anticipates the savings that will come as some participants die and forfeit their remaining savings to the fund. Retirees would not invest all their retirement savings in a CRIT. They would likely want to keep some funds for liquidity needs.

Unlike payments from traditional defined benefit plans and insured fixed income annuity contracts, the CRIT payments can fluctuate. The changes would reflect differences of the fund's investment performance from the assumed rate of return and of the group's actual mortality rate from its assumed mortality rate.

Additional changes to benefits might occur if it seems appropriate to adjust the future investment return or life expectancy assumption. A change in benefits might reflect changes in the investment environment or in the covered group's life expectancy.

Available abroad, but not in US

To prevent large swings in benefit amounts (either up or down), benefit adjustments may be spread over several years. Note that the use of more conservative investment and life expectancy assumptions would reduce the size of the initial benefit but raise the likelihood of future benefit increases. A CRIT provider might also offer different sets of underlying investment portfolios. Highly risk-averse investors might select a conservative option. Those with more risk appetite could choose an aggressive option.

In addition to longevity risk pooling, the CRIT can enhance retirement income in other ways. Professional investment managers may be able to achieve higher returns and lower expenses than individuals through access to investments not available to individuals. The CRIT might cost less to manufacture, administer, or distribute than an insurance product, and it would avoid the costs of the hedges that annuity issuers typically buy to protect themselves against adverse investment expense changes and mortality risk changes. In Canada, where such programs are newly being offered, studies show 25% higher payout rates from CRITs relative to insured fixed income annuities.

CRITs are not currently available in the US. For CRITs to be allowed, a change in US pension law would be required. If they were allowed, the Treasury and Labor Departments would likely regulate them. Regulators would monitor overall CRIT operating expenses, asset holdings, investment return and life expectancy assumptions, and the methods used for adjusting benefit levels. Annual independent audits of the CRITs may also be appropriate.

While CRITs might compete with individual fixed income annuities, life insurers could be among the larger providers of CRITs. Life insurers would profit from administering them and would have no financial risk to reserve capital against, since retirees absorb all benefit level risk. While CRITs don't guarantee investors against a drop in income, they are more likely than other risk-based income methods to produce steady income based on professional management in a collective diversified fund.

CRITs offer potential value to people who seek predictable lifetime income, who feel more comfortable letting professional institutions manage their retirement funds, who do not have access to unbiased outside expertise, and who do not participate in employer plans that offer retirement income options. Retirees in the Netherlands, Great Britain, Canada, and elsewhere are already benefiting from CRIT-type programs and plans, but Congress would have to amend US law before they could be offered to the public here.

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