Retirement Income
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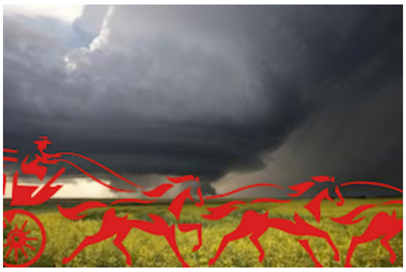
Wells Fargo’s New Annuity Wagon

By Kerry Pechter *Fri, Jul 24, 2020*

Wells Fargo Asset Management's new target-date series of CITs comes with a built-in, optional retirement income strategy: systematic withdrawals plus an annuity starting at age 85.



Imagine that you’re a 65-year-old participant in a 401(k) plan, preparing to retire. You’ve got $500,000 invested in a 2020 collective investment trust (CIT), which is similar to a 2020 target date fund. The manager of the CIT offers you this prepackaged retirement income strategy:

You’ll split your $500,000 into two parts. You’ll leave $425,000 in the 401(k) plan, and spend about $22,500 of it per year. With the other $75,000, you’ll buy a deferred income annuity that will start paying you about $18,000 a year if and when you reach age 85.

Meet the Wells Fargo Retirement Income Solution, which the brand-bruised, $2 trillion bank and asset management firm launched this spring. The firm is eager to grow its $12 billion target-date CIT business, and it believes that an income option will add cachet as well as new functionality.

“We did survey work at the participant and sponsor levels, and we heard a lot about the need for ‘liquidity’ and ‘flexibility,’” Nate Miles, head of retirement at Wells Fargo Asset Management, told *RIJ* in an interview. Participants need liquidity; and plan sponsors need the flexibility to change annuity providers if for any reason they need or decide to.

Many investment companies have tried, are trying, and will try to retrofit the tail end of a 401(k) plan to produce lifetime income for participants. They have to, or they risk losing access to trillions in tax-deferred money as baby-boomers age out of the “accumulation” stage and into the retirement spending (or “decumulation”) stage.

DCIO (Defined Contribution Investment Only) specialists like Wells Fargo are arguably not positioned as well as full-service retirement plan providers to control their own destinies. On the other hand, they offer “unbundled” a la carte solutions that some plan sponsors are said to prefer.

Nate Miles

With luck, elements of the 2018 SECURE Act will make plan sponsors more receptive to incorporating income solutions into plans. But the process is complicated—for many reasons. And, except in isolated areas, such as the academic market, neither plan participants nor plan sponsors are clamoring for this service.

Wells Fargo isn't the mostly likely pioneer in the decumulation business. The company is still recovering from a multi-year "cross-selling" **scandal** that cost billions of dollars in refunds, fines and settlements, as well as a chunk of the firm's reputation. As of 2019, it has a new president and CEO, Charles Scharf. Last year, Wells Fargo Bank sold its retirement plan business to Principal Financial for $1.2 billion. Now, boldly, it's tackling the age-old "annuity puzzle."

The DNA comes from SSgA

Wells Fargo Retirement Income Solution has its own particular nuances, but the company is not developing it entirely from scratch. For the two years ending in August 2016, Miles was head of U.S. Defined Contribution Investment Strategy at State Street Global Advisors (SSgA), where he worked on a similar target-date/deferred income annuity program.

As noted above, the actual design of the Wells Fargo Retirement Income Solution is pretty simple. (In fact, it resembles a **strategy** published by Jason S. Scott at Financial Engines over a decade ago.) Plan participants would be defaulted into an age-appropriate Wells Fargo target date CITs. As they approach retirement, they would learn about a packaged solution for their future income needs, combining a systematic withdrawal plan with an annuity.

A small portion (15%) of their **CIT** balance would be applied to the purchase of a **QLAC** or qualified longevity annuity contract. These are fixed deferred income annuities for qualified money, whose monthly payouts can be postponed until age 85. QLACs were created by the U.S. Treasury Department in 2014 to help retirees delay their annuity payments without running afoul of the requirement for minimum distributions (RMDs) from retirement accounts starting at age 72.

The remaining 85% of the retiree’s plan assets would remain in the Wells Fargo CIT. Wells Fargo would distribute it at the non-guaranteed rate of 5% a year. “We envision fees of 18 to 21 basis points on the money that stays in the plan,” Miles said. The recordkeeper will add an as-yet undetermined charge for running the systematic withdrawal plan. The cost of the annuity will be built into its payout rate.

Engaging the disengaged

Wells Fargo hopes to use the participants’ own inertia to carry them into the solution. People who have been invested for years in target date funds are characteristically passive. Wells Fargo is betting that when they reach age 65 and Wells Fargo offers them a packaged solution to their retirement income dilemma, a significant number of them will accept it.

“Our guess is that the auto-enrolled, auto-escalated participants are not engaged enough in the process to feel confident about choosing among many different retirement income options and strategies. We went back and forth on how much choice to offer,” Miles told *RIJ*. “We think that offering less choice, not more, is right for participants [who have consistently been passive investors].”

“From a marketing perspective, we would hope that our participants would be aware of the program from the beginning,” he said. “We would increase communications starting at age 60, and then have multiple points of communication as they approach age 65. We aren’t licensed to sell insurance, so the participants ages 65-plus would work with a representative of the insurance carrier [that issues the annuity].”

Still seeking partners

Wells Fargo Retirement Income Solutions is just getting started. It hasn’t formally engaged any life insurers who sell QLACs. Retail sales of all deferred income annuities in 2019, including QLACs, were $2.5 billion, or about one percent of total annuity sales. The “opt-in” aspect of the Wells Fargo plan also presents a potential pricing problem for annuity issuers.

Since participants aren’t defaulted into the annuity purchase, there’s a risk of “adverse selection.” That’s the risk, prevalent in the retail annuity space, that only the healthiest people—with above-average life expectancies—will opt-in. Insurers have to raise prices to compensate for that effect, which lowers the annuity payout rate and makes it less attractive.

In pitching the solution to plan sponsors, Wells Fargo stands to benefit from a provision in the 2018 SECURE Act that reduced the risk that plan sponsors might be sued for choosing an annuity provider that fails someday. “While assets leave the plan when annuity purchases occur, the money is still inside the plan when we’re asking the participant to choose the solution. So the plan sponsor could still benefit from the protections of the SECURE Act,” he said.

Miles also assures liability-conscious plan sponsors that Wells Fargo has a process for vetting and contracting life insurers. His firm will be acting as a fiduciary—a so-called “**3(38)**” fiduciary—in choosing the life insurer. “We’ll be taking responsibility for the selection of the insurance carrier,” he said. The selection process will be done by Wells Fargo’s Insurance Credit Analysis Group, which also evaluates annuity providers with products for sale via Wells Fargo Advisors’ 13,500 financial advisors.

Given his experience at SSgA, Miles appears to have few illusions about the difficulty of what he’s trying to accomplish—convincing multiple parties with dissimilar financial needs and imperatives to swim in the same direction.

“There are three or four sales here,” he told *RIJ*. “There’s the participant, the plan sponsor, the insurance carrier, and the recordkeeping platform. Each one of them requires time and thoughtful product development.”