What’s Missing from SECURE 2.0

By Mark Shemtob *Thu, Dec 17, 2020*

As Congress prepares a follow-up to the SECURE Act, it should include a safe harbor for 401(k) plans that want to provide non-guaranteed withdrawals to retirees, and to allow the use of variable qualifying longevity annuity contracts, writes our guest columnist, an actuary and Certified Financial Planner.

In December 2019, the SECURE Act was signed into law, with one of the primary intents to improve the delivery of retirement income solutions through 401(k) plans. One provision provides fiduciary liability protection to employers who include annuity options in their plans. Another provision requires all defined contribution plans to disclose annually the value of each participant’s account balance as an annuity in retirement.

Fast-forward to 2021, when bipartisan legislation called SECURE 2.0 is likely to become law. Though SECURE 2.0 aims to improve retirement outcomes through expanded coverage and increased contribution levels, it lacks two provisions that I believe would improve it:

Non-insured retirement income options. The Department of Labor (DOL) should be required to provide fiduciary liability protection to employers who offer *non-insured* retirement income options under their 401k plans. Surveys indicate that, while many participants welcome plan-based retirement income options, many prefer to not purchase annuities.

Fearing potential fiduciary liability, few plan sponsors currently offer non-insured income options. The more options a plan offers (beyond those required by law) the greater the risk of lawsuits should the participant dislike the consequences of having elected that option. With protection from this liability, more employers might be amenable to adding non-insured options to their plans.

Those options might include distributions based on the 4% rule, on the required minimum distribution tables, or actuarially based on investment returns and life expectancy. The first two might incorporate minimum or maximum annual withdrawals. The latter option could include distribution patterns based on expected spending needs at various retirement stages. Employees could of course opt out or change at any time without penalty. The DOL might suggest additional options.

Variable QLACs. The Internal Revenue Service (IRS) should be required to allow the use of *variable* Qualifying Longevity Annuity Contracts (QLAC). Currently, QLACs must provide a fixed guaranteed income. As a result, insurers hold the premiums in their general accounts in low risk securities. In today’s low interest rate environment, this practice makes QLAC payouts unattractive on a price-to-benefit basis.

The lengthy accumulation period of these contracts (between premium payment and the first benefit payment) can be 15 or 20 years. Few retirees wish to lock in their future retirement funds for such a long period with an unattractive internal rate of return.

Allowing variable QLACs could potentially provide larger and more attractive future income. As an example, over a 15-year period the difference in the accumulation of funds between a 3% and a 5% rate of return would result in a 33% larger benefit. One approach might be to invest the premium at purchase date in a target date fund that converts to a fixed income annuity at payout date.

As Congress addresses the retirement income challenge faced by tens of millions of retirees who will rely on withdrawals from their defined contribution plan accounts for essential income, an increased focus on retiree preferences is critical.

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