

Regulators Pave the Road to Retirement Income

We've witnessed a flurry of new guidance and regulations from both the Department of Treasury and Department of Labor related to retirement income. The growing retirement crisis has employees, employers and the government recognizing that this shared concern needs shared solutions. Washington has shown its focus on removing barriers and fostering adoption of retirement income solutions. As employers increasingly seek to solve this retirement income puzzle, the changing regulatory environment is a win for everyone – and for the participants in particular.

The defined contribution world seems to be talking about only one thing these days: *retirement income*. With more and more participants planning to use their defined contribution ("DC") plan to generate predictable retirement income, the community of plan sponsors, consultants, asset managers, insurers, recordkeepers and academics is now debating the best way to deliver that income stability. With 10,000 baby boomers retiring every day, retirement income has become an urgent priority for all stakeholders.

This paper is part of our series on retirement driven investing (RDI) for defined contribution plans, available at www.nisa.com/rdi.

And while retirement income has been a top priority and an area of focus for sponsors, all eyes have been on the regulators to take the first step. In just the last two years, Washington has offered both guidance and regulations (proposed and finalized) that are paving the proverbial road to retirement income solutions, as summarized in Exhibit I.

Exhibit I: Recent Regulatory Actions on Retirement Income

Date	Department	Action
February 2013	Department of Labor	Issued guidance on factors for selecting/reviewing target date funds ("TDFs"), including consideration of how well the TDFs align with the plan's particular circumstances. ¹
May 2013	Department of Labor	Proposed rules that would require DC plan sponsors to show account balance as an estimated retirement income stream on participants' statements. ²
July 2014	Department of Treasury (IRS)	Issued final regulations to allow the purchase of longevity annuity contracts in DC plans (Qualified Longevity Annuity Contracts, "QLACs"). ³
October 2014	Department of Treasury (IRS)	Guidance on the use of deferred annuities in target date funds used as a qualified default investment alternative ("QDIA") as part of a broader IRS Notice on nondiscrimination rules for target date funds. ⁴
October 2014	Department of Labor	Letter responding to October 2014 IRS Notice and confirming deferred annuities can be included in a TDF series that is a plan's QDIA. ⁵
April 2015	Department of Labor	Provides guidance to sponsors on educating participants on retirement income topics as part of a broader proposed change to the definition of "fiduciary" under ERISA. ⁶

¹ "Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries," US Department of Labor, February 2013.; ² EBSA Proposed Rules, 78 FR 26727, 5/8/2013; ³ Department of Treasury, Internal Revenue Service, 26 CFR Parts 1 and 602.; ⁴ Department of Treasury, Internal Revenue Service, Notice 2014-66; ⁵ Letter to J. Mark Iwry at the Department of Treasury from Phyllis C. Borzi, Assistant Secretary, Department of Labor, October 23, 2014; ⁶ EBSA Proposed Rules, 80 FR 21927, 4/20/2015

Let's walk through each of these actions in more detail and discuss their significance to retirement income.

Regulatory Backdrop

In February of 2013, the Department of Labor ("DoL") issued guidance that encourages sponsors to consider the use of a custom TDF if it's more appropriate for their plan and participants. Since not all plans are created equal, sponsors are encouraged not to simply select an off-the-shelf TDF as the plan's default. While this regulation doesn't deal with retirement income directly, it has prompted sponsors to examine their existing default options and consider customized investment strategies that focus on retirement income objectives through an open architecture structure.

In May of 2013, the DoL revealed plans to require a new element of participant communication: retirement income equivalence of current and projected account balance. Right now, most participants have no idea how their savings translate into retirement income, even though the large majority consider guaranteed retirement income a priority.¹ But if the participants see retirement income front and center on statements it would be clear if their retirement savings are actually capable of delivering that income. It could also go a long way towards encouraging most participants to increase their savings rate. Whenever the final rules on the retirement income calculation arrive, we think this could be a game-changer from the participant perspective.

In July of 2014, the Internal Revenue Service (IRS) set forth new regulations that allow longevity annuities in DC plans. Longevity annuities are insurance products that begin payouts in the later years of retirement (e.g., age 85), and can be an efficient way to protect against the risk of outliving assets with relatively little cost up front.² Prior to the new rule, longevity annuities were not allowed due to the required minimum distribution (RMD) rules. The new rules address this conflict by allowing for the value of the longevity annuity contract to be excluded from the RMD calculations, within certain limits (i.e., the lesser of \$125k or 25%).

In October of 2014, as part of a broader notice providing relief from IRS nondiscrimination rules for use of target date funds within defined contribution plans, the Department of Treasury ("Treasury") provided guidance regarding the use of deferred annuities to avoid violating non-discrimination rules. The issue was that, when a plan has a series of TDFs as its default option (the qualified default investment alternative, or QDIA), it may only be appropriate to include annuity options for older participants in funds with nearer retirement dates. Sponsors were concerned this may be perceived as age discrimination, but Treasury clarified the issue. The DoL also issued a letter which addressed that Treasury ruling and provided further guidance on the inclusion of deferred annuities in target date funds. The guidance reiterated the existing safe harbor for annuity selection.

In April of 2015, the DoL released its proposed fiduciary rule aimed at protecting investors from conflicted investment advice. In addition to expanded definitions of investment advice and fiduciary, it proposes that providing education around retirement planning and lifetime income not be considered a fiduciary act. While sponsors have often wanted to help educate participants about the choices and risks they have at retirement, they were often concerned about crossing the fiduciary line. The proposed rule should give sponsors more comfort about where that line is, and give them more leeway to talk about retirement income topics before crossing it.

The proposal broadens and clarifies the topics that the DoL considers education and not investment advice, potentially freeing sponsors to educate participants on these issues and the choices available both in and out of the employer's plan. The new educational topics include estimates of future retirement income needs, retirement-related risks like

¹See "TIAA-CREF Survey: Americans Want Monthly Retirement Paycheck But Don't Know How to Get It." February 3, 2015, (https://www.tiaa-cref.org/public/about/press/about_us/releases/articles/pressrelease553.html)

²Our recent papers *Long Live Longevity Annuities* and *The Beauty of the Bundle* discuss the benefits of considering longevity annuities in lifetime income solutions. See www.nisa.com/rdi.

longevity and market/interest rate risks, as well as strategies for managing assets in retirement. In its release of the proposed rules, the DoL says that it was motivated to include these new retirement income topics based on its joint examination with Treasury of lifetime income issues, and hopes that the new guidance improves retirement security for participants.

Looking Ahead

With the road ahead and destination now made clearer by the regulatory progress, sponsors are beginning to orient their plans and their participants towards retirement income. And as they embark upon this journey, they will also be thinking about what may be coming down the pike from Washington.

One pending issue is the finalization of the proposed rule displaying retirement income on participant statements. While the final timing and methodology are still unknown, the “income is the outcome” perspective will give sponsors and participants a singular lens through which they can define success.

As the DoL is considering how retirement income should be communicated to participants, sponsors have already begun to answer the question of how their plans’ investments can be oriented to provide reliable and sustainable retirement income, an approach we call retirement driven investing (RDI).

Another issue is finalization of the broader proposed rules around conflicts-of-interest/fiduciary redefinition. The industry is still digesting and commenting on the proposed changes that DoL released last month (April 2015) that may require anyone providing advice on retirement assets (e.g., brokers, financial advisors, and insurance agents) to act as a fiduciary when doing so. If the proposed rules go forward, they may help facilitate lifetime plan participation by slowing the massive outflow of retirement assets from employer plans to IRA rollovers at retirement. As participants stay longer in their employer’s plans, there will be an even greater demand for in-plan retirement income options.

Conclusion

Regulators have made great progress towards helping secure retirement income for participants. In just the last two years DC sponsors have received guidance and regulation that encourages them to consider customization for their plans, lowers barriers to including annuities in the QDIA, and may soon require participant statements show how account balances translate into future retirement income. As more and more participants begin to transition to retirement and rely on their defined contribution plan for retirement income, the timing could not be better.

Employers are increasingly recognizing the important role that retirement income solutions can have in helping employees plan for and retire with confidence. They see Washington paving the way and are starting to plan accordingly. And while sponsors should consult counsel for legal advice, we believe these regulatory advancements have the potential to allow sponsors to provide participants with a much needed GPS system on this new road. A plan designed around retirement income can help participants get on-track towards their ultimate destination – a world in which they have a simple, sustainable, and flexible source of lifetime retirement income in their plan.

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