

Key Points

- Securing a lifetime income in retirement is important, and the *Setting Every Community Up for Retirement Enhancement Act* (SECURE Act) addresses this by providing guidance to plan sponsors in insurer and annuity selection that reduces plan sponsors' fiduciary concerns.
- The SECURE Act requires plan sponsors, when selecting a specific annuity, to consider the cost (including fees and commissions) of the contract offered by insurers in relation to the benefits, product features, and administrative services provided.
- There are a variety of approaches that provide for insured lifetime income that begins immediately, is deferred, or is provided under an accumulation product that converts funds to lifetime income. These can be based upon either fixed interest rates or subject to variable investment returns.

Adding Annuity Options to DC Plans

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The *Setting Every Community Up for Retirement Enhancement Act* (SECURE Act) reduced plan sponsors' fiduciary concerns about the selection of insurers and, thus, eliminated one hurdle to offering insured income annuities within defined contribution (DC) plans. While the SECURE Act provides the potential for additional options for plan participants, it raises a number of issues for plan sponsors to address, including whether to offer annuities—and, if so, which types of annuities to offer.

This issue paper discusses annuity options available for DC plans, specifically those plan options that are insured and provide a guarantee of lifetime income. It's also important to note that there are other payout approaches that may create a retirement income through withdrawals from investments. While these may provide added payout flexibility, they do not guarantee lifetime income.

Why Consider In-Plan Annuities?

Plan sponsors that are concerned about plan participants outliving their retirement savings may wish to consider offering insured annuities to provide guaranteed lifetime income. A primary advantage to offering in-plan annuities is institutional pricing—meaning having access to group purchasing efficiency such as elimination or reduction of commissions, administrative economies of scale, and others. Additionally, the assumed mortality in the pricing of a group annuity may be more favorable than an individual (retail) annuity if there is sufficient usage of in-plan annuities by plan participants.



AMERICAN ACADEMY
of ACTUARIES

1850 M Street NW, Suite 300
Washington, DC 20036

202-223-8196 | www.actuary.org

Craig Hanna, Director of Public Policy
Linda K. Stone, Senior Pension Fellow

On the other hand, when interest rates are low, the cost of an income annuity increases compared to when rates are higher, thus making it less attractive to current plan participants (income decreases approximately 10% for each 1-percentage-point decrease in interest rates), since it locks in the low interest for many years. Similarly, the charges for guaranteed income benefits that provide an income based upon accumulation in indexed and variable deferred annuities are also higher in a low-interest-rate environment. Nevertheless, plan sponsors may wish to start the process now as interest rates and market conditions are always changing. Additionally, plan participants may desire to use them now.

Plan participants express interest in lifetime income when asked in surveys; however, few take the opportunity to purchase an annuity.¹ The increasing prevalence of DC plans may further increase this interest. Plan participants' interest in annuities could increase, because the SECURE Act requires plan sponsors to provide participants with annual income disclosures.² Additionally, the simplified selection of annuities under the SECURE Act could increase the availability of annuities; however, the degree of increase is uncertain

What Income Options Should Be Considered?

As previously noted, one of the first questions facing plan sponsors after the enactment of the SECURE Act is whether to offer annuities. Unless offered through the plan, plan participants are restricted to electing an annuity with retirement funds via rollover into an Individual Retirement Account (IRA). Plan participants using an IRA to buy an annuity would purchase one via an agent or from an “annuity platform” that may offer institutionally priced annuities. Regardless of whether annuities are provided in-plan or through a rollover, the plan sponsor should consider providing participants appropriate educational information regarding the options, both in periodic materials and at the time a participant may be considering a distribution from the plan.

¹ [EBRI](#) and Greenwald Research 2021 Retirement Confidence Survey: Fifty percent of surveyed active workers expect a product with guaranteed monthly income for life to be a source of income in retirement; however, only 30% of surveyed retirees currently utilize such a product.
² See the Academy [letter](#) recommending changes to SECURE disclosure requirements.

Members of the Lifetime Income Risk Joint Committee, which authored this issue brief, include Noel Abkemeier, MAAA, FSA; Michael Bain, MAAA, FCA, FSPA, ASA, EA; Nancy Bennett, MAAA, FSA, CERA; C. David Gustafson, MAAA, FCA, EA; Andrew Huh, MAAA, FSA; Scott Japko, MAAA, FSA, EA; Cynthia Levering, MAAA, ASA; Spencer Look, MAAA, ASA; Steven Mendelsohn, MAAA, FCA, EA; James Ritchie, MAAA, FCA, ASA, EA; Michael Schmidt, MAAA, FSA; Mark Shemtob, MAAA, FSA, FCA, EA, MSPA—*Co-Chairperson*; Mary Stone, MAAA, FSA, FCA, EA; Ricardo Trachtman, MAAA, FSA—*Co-Chairperson*; Amy Trainor, MAAA, FSA; Shuhan Wang, MAAA, FSA; and Benjamin Yahr, MAAA, FSA.

Several important factors could influence the decision about whether to provide annuities to plan participants within the plan vs. simply letting people roll over amounts to an IRA outside the plan. Sales and other expenses generally make annuities purchased outside the plan more expensive than inside the plan. However, outside the plan, annuities are priced separately for males and females, which results in a lower income (for the same premium) for females than males because females on average live longer. Inside a plan, pricing must use unisex rates, which are a blend of the male and female experience. Whether it is more favorable for a male to purchase an annuity inside or outside the plan will vary by individual circumstances.

There are other approaches for plan participants to create retirement income via a DC plan, including a disciplined use of account balances without an annuity purchase. This approach does not provide a fixed lifetime guarantee because funds could be depleted during the retiree's lifetime. On the other hand, plan participants dying earlier than expected would preserve their remaining account balance. Several such approaches are described in Appendix B. For example, these approaches could include distributions based on the 4% rule³ or a variant of it; Required Minimum Distribution (RMD) amounts; or withdrawals at a rate that reflects investment returns and life expectancy. Generally, plans have access to lower-fee investments and in some cases better investment selection expertise than most individuals can secure on their own; consequently, it may be advantageous for plan participants to have withdrawal options within the plan. In addition, by offering these options within plans, the transition to retirement income will become more seamless. Surveys indicate that many participants welcome plan-based retirement income options.⁴

How Can Annuity Income Be Provided?

There are various approaches to providing insured (guaranteed) lifetime income. A more detailed discussion can be found in appendices A and B, but first this paper provides a simplified overview.

³ The 4% rule indicates that a retiree could withdraw 4% of initial assets in a balanced portfolio immediately and increase the withdrawal annually at the inflation rate, with a very high likelihood of not depleting the assets over a 30-year period. This concept was developed in 1993 and was based on historical investments and inflation. In the current low-interest-rate environment, some consider the safe withdrawal rate to be below 4% based upon capital market expectations of future returns and volatility.

⁴ [JP Morgan Plan Participant Research 2021](#): Eighty-five percent of participants indicated that they would likely leave their balances in their defined contribution plans post-retirement if there were an option to help generate monthly income.

The most direct approach is through a single premium immediate annuity that provides an income beginning at the time of retirement. Another possibility is a deferred income annuity, which is purchased with a single premium but provides an income that starts at some specified time in the future. When the purchase of a deferred income annuity within a DC plan or an IRA satisfies certain conditions, it falls under the category of a Qualifying Longevity Annuity Contract, or QLAC (described in Appendix A).

Another approach is to develop an insured lifetime income guarantee through annual purchases while plan participants are working. Often, this is done through income annuities that provide a specified lifetime income at the retirement date. An alternative method is to invest funds on a regular basis in an accumulation-oriented annuity that provides a guaranteed minimum lifetime income (for an additional fee and subject to certain limitations). These come in a variety of forms and protect against investment risk by providing a minimum income guarantee in the event of poor investment performance.

An additional approach similar to the methods described above is to purchase annuity income in conjunction with target date funds (TDF) or other managed funds. For example, this might be in the form of including an allocation of a portion of the funds to an annuity purchase beginning at a specified age, such as 50. This could be either an income annuity that begins at a specified future date or an accumulation-oriented annuity with an income guarantee. As with any investment option, future purchases can be stopped at any time. If the TDF is a Qualified Default Investment Alternative⁵ (QDIA), special attention must be given to annually communicating the option to plan participants in order to allow for its discontinuance.

Retiree Income Concerns

A retiree's basic choice concerning the method of managing a retirement income is between a lifetime annuity and a withdrawal program.

If a lifetime annuity is selected, income is guaranteed for life but the assets in the account are no longer available for withdrawal and any remaining value at death is no longer available, unless the income option chosen includes some continuing payments. Additionally, investment returns may be lower due to a conservative investment style of an insurer than if the account was still being actively managed. Generally, annuities provide only a level income and, thus, may fail to provide protection against inflation.

⁵ A qualified default investment alternative (QDIA) is the plan's default investment. It is used when 401(k) plan participants haven't made an active investment election.

If a withdrawal approach is used, assets are always available, but they may become depleted in the event of a very long life or poor investment performance. A diversified portfolio could provide some protection against inflation; however, there is also the risk that investments may perform poorly and increase the risk of asset depletion.

Annuity Selection Process

Plan sponsors select which annuities to make available in the plan. The SECURE Act requires plan sponsors to consider the cost (including fees and commissions) of the contract offered by insurers in relation to the benefits, product features, and administrative services provided. If plan sponsors choose to offer annuities, they have a fiduciary duty to conclude that the cost is reasonable (see Appendix C, section (e)(1)(C)(ii)). Plan sponsors are not required to choose the lowest-cost annuity.

There are many annuity types available in the market. Plan sponsors performing their due diligence could benefit from the assistance of an independent expert. Appendix A offers a detailed look at the many choices available. Plan sponsors can choose to offer more than one option.

Insurer Choice

Prior to the passage of the SECURE Act, the concern over fiduciary liability was one of the top reasons expressed by plan sponsors (e.g., employers and other entities), along with administrative concerns and questions over participant interest, for not offering annuity options within their defined contribution plans.⁶ There was no protection from plan participants, who could sue if they were dissatisfied with the insurer-selected annuity, the transfer of the insurer's liabilities to another insurer, or a reduction in interest crediting. To encourage offering annuities, the SECURE Act mitigated this concern by establishing specific criteria that insurers must meet (fiduciary safe harbor), as described in Appendix C, and which, if satisfied, shield plan sponsors from certain fiduciary liabilities. These requirements are quite broad; consequently, plan sponsors might want to use additional metrics of insurer strength to differentiate among insurers being considered.

It is also important for plan sponsors to understand the arrangements that an insurer has made with in-plan annuities in the event that there is a change in circumstances such as a change in custodian or administrator, a decision to cease offering annuities, a change in the insurer that is providing the annuities, plan termination, or participant termination

⁶ Willis Towers Watson; "[Lifetime income solutions: Progress, with work ahead](#)"; Sept. 3, 2019.

when the annuity is not yet in payout status. Of particular importance is understanding the ability to transfer annuities out of a plan in which they are no longer being used. The purpose is to retain the value that was created by prior charges and allow continued payment of guaranteed benefit charges and later receipt of benefits. Lack of such an arrangement could lead to forfeiture of benefits funded by prior charges or the loss of benefits that would have been funded by future charges. The arrangement may include rolling over the annuity contract to an IRA, so that charges and benefits could continue.

What Might the Impact of PEPs Be?

The SECURE Act provides for the creation of Pooled Employer Plans (PEPs) as an alternative to traditional single-employer plans. This innovation leads to an additional approach for providing in-plan annuity and structured withdrawal options.⁷ Concerning annuity options, in single-employer plans, insurer selection and annuity selection must be done by plan sponsors, possibly with the assistance of a consultant(s). Alternatively, in a PEP, the PEP sponsor performs this function, thus relieving plan sponsors of this responsibility. Additionally, there could be a range of annuity and structured withdrawal choices, because PEPs are sponsored by various employers. The range of choices offered in a PEP, including the availability of insured income options, could be a determinant of which plan to choose.

Conclusion

Annuities can be a useful tool in retirement planning, including notably guarding against longevity risk. There are many considerations for plan sponsors when deciding whether and which types of annuities to offer in DC plans. Plan sponsors should be aware of the direct cost of an administration charge that reflects the cost of administering and maintaining records for annuity and other payment methods. Plan sponsors and plan participants would benefit from a clear understanding of the term “annuity,” because it can have many meanings.

⁷ American Academy of Actuaries; [Pooled Employer Plans—Employer Considerations](#); May 2021.

Appendix A—Description of Annuity Types

The following discussion addresses common types of annuities that might be offered as in-plan options.

An annuity is a contract issued by an insurance company wherein the purchaser makes either a lump-sum payment or a series of payments and receives disbursements from the insurance company in return, either in the form of continuous payments or payments upon request of the contract owner. Unlike mutual funds, annuities have benefit guarantees.

There are many different types of insured annuities in the U.S., but they are all often simply referred to as “annuities,” which can cause considerable confusion. The purpose of this discussion is to provide clarity by explaining the general types of annuities and their potential uses.

Definitions:

Account Value is the value of a deferred annuity (discussed later). It comprises the amount of money that is paid into the annuity by the owner, plus any interest or investment results (positive or negative) earned, with deductions for expense charges and charges for optional benefits, which are also discussed later.

Annuitant is the person during whose life the payments are made. This person would generally be the participant and, possibly, another person.

Beneficiary is the person or entity (for example an estate or trust), if any, named by the participant to receive any value remaining in the annuity upon the death of the sole annuitant or both joint annuitants.

Crediting Interest Rate is the interest rate credited to the account value, where applicable. The rate is declared by the insurer in advance, usually at the beginning of the contract year.

Owner for an in-plan annuity is the plan. Ownership may be transferred to the participant if they leave the plan.

Note that annuities, other than certain funds⁸ in variable and structured variable annuities (defined below), are backed by the financial strength of the issuing insurance company and may have additional protection from state guaranty associations. All states and the District of Columbia have life and health guaranty associations that provide protection up to a certain level in case of insolvency. The level of maximum protection varies by state, ranging from \$100,000 to \$500,000, but with a common limit of \$250,000, and is based on the account value of a deferred annuity or the present value of benefits for an income annuity.

Some annuities are tools designed solely to generate guaranteed income while others are mainly used for saving. **Income annuities** are used to generate guaranteed income in retirement and **deferred annuities** are generally geared toward saving for retirement, although they also include a guaranteed income option. More details on the various types of annuities are discussed below.

Income Annuities

There are two primary types of income annuities. Annuities that begin payments within one year are called single premium immediate annuities (SPIA); annuities that defer payments to a future date are called deferred income annuities (DIA). Variations exist within each type and are described below.

Single Premium Immediate Annuity—SPIA

Fixed SPIAs: With a fixed SPIA, the purchaser (the plan for an in-plan purchase) pays a single premium in a lump sum to the life insurance company. The annuity payment is fixed and guaranteed by the insurance company. It also cannot be redeemed for cash. There are features available in the marketplace where benefit payments increase by a set percentage, typically between 2% and 3% per year, compounded annually, to offset the effect of inflation.⁹ This feature will decrease the initial benefit payment, assuming the same amount is available for the annuity.

Variable SPIAs: Variable SPIAs are similar to fixed SPIAs, but the periodic payments fluctuate with the change in value of the underlying investments in relation to the interest rate assumed in the original annuity calculation. The number annuity payments is fixed, but the value of each payment varies with investment performance. It is possible for the annuity payments to become close

⁸ The value in separate accounts of variable annuities is not guaranteed by the insurer but rather flows directly to the contract owner. Only amounts guaranteed by the insurer are eligible for guaranty association coverage.

⁹ Increases based on actual inflation generally are not available.

to zero if the investments perform very poorly. The investments may include a wide variety of asset types, including but not limited to equities, fixed-yield investments, real estate, and others.

Payment Options for Both Fixed and Variable Income Annuities

Annuity income can be taken under various options:

- Life Only: Benefit payments are made as long as the annuitant is alive. Among the life-contingent payment types, this provides the highest benefit based upon the premium being paid.
- Period Certain Only: Payments are made for a fixed period (the period certain), say, 10 or 20 years, whether the annuitant is alive or not. If the annuitant dies before the end of the certain period, payments continue to the named beneficiary as scheduled.
- Certain and Life: This is a combination of the previous two payment types. If the annuitant dies during the certain period, payments continue to the named beneficiary until the end of the certain period. If the annuitant lives beyond the certain period, payments continue as long as the annuitant lives.
- Installment Refund: This annuity type is nearly the same as a certain-and-life annuity, except that the certain period is set equal to the premium paid divided by the monthly payment.
- Cash Refund: This annuity type is similar to an installment refund annuity except that if the annuitant dies before the sum of the benefit payments made at least equals the premium, instead of continuing benefit payments, a lump-sum payment will be made to the named beneficiary equal to the premium paid less the payments previously received.
- Joint and Survivor: Payments are set up to be contingent on the lives of two people and the price depends on the age of both of them. Payments can remain level as long as either of two people are alive, or it can be set up for payments to decrease upon the death of either or just a specified one of the annuitants.

Qualifying Longevity Annuity Contract (QLAC)

A QLAC is a special type of deferred income annuity (DIA) that can be used in DC plans and IRAs. QLAC/DIA is similar to a SPIA, except payments start at some point later than one year from the date of purchase, generally five to 20 years in the future. When payments begin at an advanced age, such as 85, a QLAC/DIA is often referred to as longevity insurance. Its primary use is to provide a lifetime income if the annuitant

lives much longer than expected. It may be preferable to a SPIA for people who believe they are likely to have enough money for a certain number of years in retirement but are concerned about what might happen if their other investments are exhausted or perform poorly.

The deferral of benefit payments can result in a significantly higher monthly income once payments begin than under a SPIA for the same premium. The values below are unisex; sex-distinct rates would generally be used with retail annuities, but the relationship between SPIAs and DIAs would be similar.

Estimated Income Comparison ¹⁰ for In-Plan SPIAs and QLACs—\$100,000 Premium at Age 65			
Product	SPIA—Income at 65	DIA—Income at 75	DIA—Income at 85
Monthly Income	\$528	\$1,118	\$3,129

One concern that people may have with a DIA is that if the annuitant dies between the date of purchase and the start of income payments, no benefit payments are made. One option is to add a death benefit to the annuity (for example, equal to the premium paid), but doing so will lower the monthly income.

Charges and Taxation in Income Annuities

For fixed-income annuities, the costs are built into the single premium that is charged for the benefit payments being paid out and guaranteed by the insurance company. Variable-income annuities may have periodic asset-based charges, generally reflected in the annuity unit values.

All income annuities purchased with pre-tax assets—such as 401(k), 403(b), and traditional IRAs—are fully taxable as each benefit payment is received by the taxpayer. Benefit payments from income annuities purchased with Roth assets are tax-free.

Deferred Annuities

Deferred annuities have two distinct phases: an *accumulation* phase and a *payout* phase. During the accumulation phase, the purchaser's contributions accumulate with either interest or net investment return. During the payout phase, the contract owner receives either a single lump-sum payment or a series of payments such as those described for income annuities. Deferred annuities are different than deferred income annuities, which solely provide an income. The types of deferred annuities (fixed, fixed indexed, variable, and structured variable) are differentiated by how the value of the annuity grows and the degree of investment risk passed through to the participant. Additional information about

¹⁰ Average of male and female rates from Immediateannuities.com in May 2022. Actual rates will vary from the average, depending upon the insurance company methodology.

deferred annuities can be found in the National Association of Insurance Commissioners (NAIC) “[Buyer’s Guide for Deferred Annuities](#).”

Types of deferred annuities:

Fixed Annuity: A fixed annuity is generally the simplest form of deferred annuity. During the accumulation phase, the purchaser’s contributions earn interest based on a *fixed* rate (which can change annually)—e.g., 3%—declared by the insurance company. The initial credited interest rate is frequently guaranteed for one year but may also be guaranteed for a longer period, sometimes as long as 10 years. Credited rates are subsequently reset periodically, generally annually, and there is a minimum interest rate set or defined in the annuity contract.

Fixed Indexed Annuity: A fixed indexed annuity (FIA) credits interest based on, but not necessarily equal to, the change in a stock market index (e.g., S&P 500 without dividends) or an index that is based on some combination of equity and fixed-income investments. The annuity generally receives less interest credit than the change in the corresponding index via some combination of a limit (cap), reduction (participation rate), or an exclusion of some initial increase (spread, margin, or hurdle). The interest credit generally cannot be less than zero, in any given year.

Variable Annuity: A variable annuity allows investments in a variety of subaccounts (essentially mutual funds, each of which is characterized by its type of investments), primarily invested in equity and/or bond funds, but possibly also a fixed interest account. A variable annuity is considered a security and can be sold only by a registered representative, i.e., a registered security salesperson. Some variable annuities include index-linked accounts, which are discussed below as a structured variable annuity.

Structured Variable Annuity (aka Registered Index-Linked Annuity [RILA]): A structured variable annuity is a type of indexed annuity that credits interest based upon the change in a specified index. It is more like a variable annuity than it is like an FIA. It is a security that credits increases like other variable annuities and provides a limited amount of downside protection while leaving some risk to the owner. This contrasts with an FIA, which is not a security, and which typically protects interest crediting against all decreases in the index. Like other variable annuities, it can be sold only by a registered representative.

Characteristics of Deferred Annuities

Fixed, indexed, variable, and structured variable deferred annuities in DC plans generally share some of the same characteristics:

- Tax Deferral. With some exceptions, e.g., Roth accounts and other after-tax savings, taxes are assessed at the ordinary income tax rate when funds are withdrawn from a DC plan. Although annuities provide tax deferral, this does not provide any value beyond the tax deferral that is already provided with an IRA or other tax-qualified vehicle.
- Guaranteed Benefit Riders. When deferred annuities are used in DC plans, it is generally for the purpose of providing a lifetime income; consequently, the annuities will include guaranteed lifetime withdrawal benefits (GLWB) or guaranteed minimum income benefits (GMIB). Generally, the guaranteed benefits are paid for with an explicit fee that is deducted periodically from the account value; some products include them automatically with the cost built into crediting rate or the method of recognizing the gain or loss on the account value.

A GLWB provides the right to withdraw a certain amount annually as long as the annuitant lives, even if the contract value is exhausted. When added to a deferred annuity, this is an alternative to an income annuity, with the advantage being that there always is access to the account value. At death, the residual value passes to the beneficiary.

A GMIB provides a floor to the income that is payable at the time of annuitization. The income guaranteed by the GMIB is based on a hypothetical account value that never decreases, whereas the income guarantee in the basic annuity is based on the account value, which could decrease or grow slowly. At death, the annuity has no value other than any benefit provided to the beneficiary through the payout option. The annuity must be held for a given number of years and/or to a certain age before exercising the guaranteed benefit.

Additionally, many variable annuity contracts include a guaranteed minimum death benefit that will pay the participant's beneficiary a minimum death benefit, e.g., the total premiums minus prior withdrawals regardless of subsequent market performance. The charge for this death benefit is typically included in the "mortality and expense" (M&E) charges of a variable annuity or in a reduction of credited interest in other types of annuities (discussed below).

- Annuitization of a Deferred Annuity. The idea behind a deferred annuity is that money will accumulate during the pre-retirement lifetime of the annuitant and then, when retirement income is desired, the retiree can “annuitize,” i.e., turn the annuity into an income annuity as described above. There are guarantees concerning the conversion of account value into income inherent in this contract feature that can be useful and/or valuable in certain interest rate environments.
- Surrender Charge. A surrender charge is an amount that might be deducted when money is withdrawn from an annuity prior to taking annuity income. Generally, surrender charges are not applied to in-plan annuities.
- Market Value Adjustment (MVA). Fixed-interest asset allocations in in-plan deferred annuities may have an MVA applied to withdrawals or transfers to a different investment option, which adjusts the value of the withdrawal. If interest rates have fallen since the allocation to the fixed-interest option, the amount of the transfer is increased. If interest rates have risen since the allocation, the amount of the transfer is decreased. When withdrawals are taken under a GLWB as part of a lifetime income program, this adjustment is not made.
- Free Partial Withdrawal. There generally is a free partial withdrawal provision in retail annuities—i.e., a percentage of the account value that can be withdrawn each year with no surrender charge and no market value adjustment. If there are no surrender charges on an in-plan annuity, this benefit has limited value; however, a market value adjustment could still apply to withdrawals.

Charges and Taxation in Deferred Annuities

The costs for deferred annuities vary from product to product. In some cases, all the costs are embedded in the interest crediting. This is common with fixed annuities and fixed indexed annuities, where the crediting interest rate is less than what the insurance company expects to earn on the investment of the premiums paid. This margin provides the insurance company with the funds needed to pay all its expenses and earn a profit.

Some deferred annuities such as variable annuities often include more explicit charges because there is no crediting interest rate to adjust. This amount will be a percentage of the account value and is deducted periodically. An investment management charge generally applies to each subaccount in the separate account.

The surrender charge noted above is another potential cost to the annuity purchaser.

State premium taxes are payable on annuity purchases in some states.

Appendix B—Description of Non-Insured Distributions

Unlike defined benefit plans, defined contribution plans generally tend to offer to departing employees only lump-sum distributions or rollovers. Plan sponsors might consider amending their plans to allow that distributions be available based on a payout strategy that extends over a period of time. This alternative to the use of insured lifetime income can offer income options based on the distribution of investment assets and earnings on account balances. This approach, unlike insured options, is not able to guarantee a fixed level of income for an uncertain lifetime, although it can offer a disciplined method of distribution that may last a lifetime. The value of such in-plan options (as opposed to rolling assets over to an IRA) is that plans have access to lower-fee investments and greater investment selection expertise than most individuals can secure on their own. In addition, by offering these options within plans, the transition to retirement income will become more seamless.

Prior to discussing investment-based income options, there are two fundamental issues to be addressed. First is the extent to which plan sponsors offer or are willing to offer these options. A plan may offer retirement income options that do not require an annuity purchase. Potential reasons for not offering these options include fiduciary liability concerns and additional costs/efforts to make payouts. Second is the importance of understanding the needs of plan participants pertaining to retirement income options. Many participants may welcome plan-based retirement income options, but some may prefer to not purchase insured annuities.

Many alternative payout approaches are available. Among them are the following:

Required Minimum Distribution (RMD) Approach

This approach is simply to draw down assets at the rate specified for RMD, including an extension of the withdrawal percentages for the period prior to age 72.¹¹ There are some variations on this approach that can be used to limit the fluctuations between increases and decreases in income in any given year, although the RMD requirement must be met in aggregate across plans.

The annual drawdowns are based on the referenced tables that reflect life expectancy, so the income is assumed to continue throughout a lifetime, while it automatically adjusts for annually reducing life expectancy.

¹¹ There are no RMDs under the Internal Revenue Code prior to age 72; however, using the same table and methodology, factors can be calculated.

The life expectancy used is “one size fits all” and is not tailored to an individual’s situation. It is based on the lives of the retiree and a beneficiary (assuming a 10-year-younger age for the beneficiary) and thus will understate the amount of income that can be withdrawn relative to using a table that relies on only a single life expectancy (or one with a same-age spouse).

Although this approach always provides income, the amount varies from year to year because the withdrawals are based on the account balance at the end of the prior year.

Distribution Based Upon Life Expectancy and Investment Return Assumptions

This approach estimates assumed investment returns and longevity and solves for income. The life expectancy is calculated from a mortality table and is based on current age and sex. These figures could be adjusted to reflect health status or conservatism (e.g., addition of several years to life expectancy). It may be calculated using an inflation assumption.

This approach can be adjusted easily in future years to reflect past experience or a change in future expectations.

4% Rule

This approach is based upon a strategy where the initial amount of distribution is 4% of the account balance using a balanced portfolio. Each year the distribution is increased by a cost-of-living adjustment. In 1994 this withdrawal level was historically shown to last at least 30 years with a 95%+ probability of not running out of funds.¹² However, analysis done based upon current market expectations as to returns and volatility suggests that a rate lower than 4% will be required to achieve the 95% rate.¹³

The amount of annual distribution can always be restarted based on an up-to-date account balance and/or a new percentage.

There is the danger that significant early-year investment losses would cause assets to run out too soon (sequence-of-return risk).

¹² *Journal of Financial Planning*; “Determining Withdrawal Rates Using Historical Data”; January 1994.

¹³ *The Wall Street Journal*; “[Cut Your Retirement Spending Now, Says Creator of the 4% Rule](#)”; April 19, 2022.

Other Considerations

Other Approaches: Many other approaches can be created to pay out income at retirement. The three noted above have been selected because they are well known and easy to use.

Employee Education: The three approaches described above are simple to explain to plan participants and easy for the plan sponsor to initiate. However, the pros and cons may not be easy for many retirees to appreciate. Thus, if a plan were to provide any of these options, it would be imperative that plan participants understand the inherent risks.

Administrative Issues: There will be a cost associated with providing periodic income that will exceed the cost of simply paying out a single lump sum. The *Employee Retirement Income Security Act of 1974* (ERISA) permits charges associated with maintaining the plan to be borne by plan participants, provided they are not unreasonable. Many plan sponsors may prefer to find outside vendors that can implement the distribution of benefits, tax withholding, and reporting. Such vendors already exist and are used in the defined benefit plan world.

Pooled Employer Plans (PEPs): Providing income options directly from the plan may remain unpopular, particularly with smaller plans. Pooled employer plans are new to the market and may offer withdrawal programs that could change the outlook for smaller plans.

Appendix C

SECURE Act Safe Harbor for Annuity Selection

“(e) SAFE HARBOR FOR ANNUITY SELECTION.

“(1) IN GENERAL. With respect to the selection of an insurer for a guaranteed retirement income contract, the requirements of subsection (a)(1)(B) will be deemed to be satisfied if a fiduciary

“(A) engages in an objective, thorough, and analytical search for the purpose of identifying insurers from which to purchase such contracts;

“(B) with respect to each insurer identified under subparagraph (A)

“(i) considers the financial capability of such insurer to satisfy its obligations under the guaranteed retirement income contract; and

“(ii) considers the cost (including fees and commissions) of the guaranteed retirement income contract offered by the insurer in relation to the benefits and product features of the contract and administrative services to be provided under such contract; and

“(C) on the basis of such consideration, concludes that—

“(i) at the time of the selection, the insurer is financially capable of satisfying its obligations under the guaranteed retirement income contract; and

“(ii) the relative cost of the selected guaranteed retirement income contract as described in subparagraph (B)(ii) is reasonable.

“(2) FINANCIAL CAPABILITY OF THE INSURER. A fiduciary will be deemed to satisfy the requirements of paragraphs (1)(B)(i) and (1)(C)(i) if—

“(A) the fiduciary obtains written representations from the insurer that—

“(i) the insurer is licensed to offer guaranteed retirement income contracts;

“(ii) the insurer, at the time of selection and for each of the immediately preceding 7 plan years—

“(I) operates under a certificate of authority from the insurance commissioner of its domiciliary State which has not been revoked or suspended;

“(II) has filed audited financial statements in accordance with the laws of its domiciliary State under applicable statutory accounting principles;

“(III) maintains (and has maintained) reserves which satisfies all the statutory requirements of all States where the insurer does business; and

“(IV) is not operating under an order of supervision, rehabilitation, or liquidation;

“(iii) the insurer undergoes, at least every 5 years, a financial examination (within the meaning of the law of its domiciliary State) by the insurance commissioner of the domiciliary State (or representative, designee, or other party approved by such commissioner); and

“(iv) the insurer will notify the fiduciary of any change in circumstances occurring after the provision of the representations in clauses (i), (ii), and (iii) which would preclude the insurer from making such representations at the time of issuance of the guaranteed retirement income contract; and

“(B) after receiving such representations and as of the time of selection, the fiduciary has not received any notice described in subparagraph (A)(iv) and is in possession of no other information which would cause the fiduciary to question the representations provided.

“(3) NO REQUIREMENT TO SELECT LOWEST COST. Nothing in this subsection shall be construed to require a fiduciary to select the lowest cost contract. A fiduciary may consider the value of a contract, including features and benefits of the contract and attributes of the insurer (including, without limitation, the insurer’s financial strength) in conjunction with the cost of the contract.

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