American Academy of Actuaries

Issue Brief

Impact of the SECURE Act on Retirement Security

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Key Points

- The Setting Every Community Up for Retirement Enhancement (SECURE) Act contains a wide range of provisions to strengthen the retirement system, some of which will have an immediate impact, while others will depend on whether employers implement them.
- The act's mandated disclosure requirement for defined contribution (DC) plans will educate participants on how to make their assets last for their lifetimes by showing numerical examples of how much income might be derived from their account balances.
- The act contains provisions intended to increase the number of DC plans offering annuity options. Utilizing annuity options can improve retirement outcomes for some participants, especially those without access to a defined benefit plan.

American Academy of Actuaries

Objective. Independent. Effective.™

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

The Setting Every Community Up for Retirement Enhancement (SECURE) Act enacted on December 20, 2019, sets the stage for the possible improvement of retirement outcomes for millions of Americans. The SECURE Act contains a wide range of provisions for individuals, plan sponsors and business owners. Some of these provisions are requirements that will have an immediate impact, where others will depend on whether employers implement them. The requirement for plan sponsors to expand coverage to certain part-time employees will be beneficial to millions of Americans previously unable to save in employer plans. Another mandatory provision requires illustrations of how much retirement income their account balances could provide, helping participants understand how much additional savings they may need in order to achieve their desired retirement security. The impact of certain provisions, such as pooled employer plans (PEPs) and defined contribution (DC) lifetime income options, will depend on whether employers/plan sponsors find these provisions attractive enough to implement and how the markets react with solution development.

This issue brief focuses on three provisions that impact employer-sponsored retirement plans in the SECURE Act: 1) open PEPs, 2) provision for savings plan annual statements that estimate what workers' savings are worth in the form of lifetime income, and 3) the safe harbor provisions for employers that add lifetime income annuities to their defined contribution plans.[1] The discussion focuses on observations of the impacts of the SECURE provisions and suggestions for how any future regulatory guidance could be constructed to ensure that plan sponsors and participants have the information they need to move forward and realize the goals of the SECURE Act.

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[1] The Academy submitted comments to the Department of Labor (DOL) in 2013 when an earlier version of the annual statement was proposed and published a position statement in 2017 supporting the inclusion of income options in DC plans.

Pooled Employer Plans

The SECURE Act enables the formation of PEPs, effective for plan years beginning after 2020. This new type of retirement plan is a defined contribution plan that would allow multiple, unrelated employers to participate in the same plan without having the "common nexus" that has historically been required for multiple employer plans. As a result, PEPs have also been referred to as "open multiple employer plans." PEPs will be 401(k) plans, not 403(b) or 457 plans. The primary fiduciary and administrative (compliance) responsibilities for the plans would be borne by the pooled plan provider offering the plan, rather than the individual participating employers.[2] Further, any plan compliance failures by one participating employer would not jeopardize the plan's qualified status for other participating employers.

PEPs have the potential to significantly expand retirement plan coverage among U.S. workers. According to the Department of Labor (DOL), in 2019, only 54% of workers at businesses with fewer than 100 employees (compared to 67% of all workers) had access to a workplace retirement plan.[3] Many of these employers may not have offered a retirement plan due to the associated administrative cost and compliance burden. Because PEPs pool resources from many individuals working for different employers, they offer the potential for greater efficiency and lower investment and administrative costs than a single, small employer would be able to achieve on its own.

Challenges that will be faced by employers participating in PEPs include the initial PEP selection and the ongoing responsibility for determining whether the PEP that has been selected remains an appropriate choice. The analysis of the PEP's services and fees will remain a fiduciary responsibility of the participating employer. In addition, the SECURE Act allows plan investment fiduciary duties to be provided by an entity other than the PEP provider. In this situation, where the PEP outsources these tasks, the employer has fiduciary responsibility to review this selection in its evaluation of the PEP. Employers may need unbiased professional advice in the process of selecting and monitoring PEP providers and other fiduciaries.

2 The SECURE Act does not specify what types of organizations may serve as pooled plan providers. While it remains to be seen how the market will develop over time, organizations that could potentially register to serve in this role might include Professional Employer Organizations, investment management and recordkeeping firms, or consulting firms, among others.
3 Bureau of Labor Statistics; *Employee Benefits in the United States;* Table 2a; March 2019.

Senior Pension Fellow Linda K. Stone, MAAA, FSA, led the development of this issue brief. Primary drafters of various sections include Eric Keener, MAAA, FSA, FCA, EA (chairperson of the Retirement System Assessment and Policy Committee [RSAP]); Mark Shemtob, MAAA, FSA, FCA, EA (co-chairperson of the Lifetime Income Risk Joint Committee); and Noel Abkemeier, MAAA, FSA (co-chairperson of the Lifetime Income Risk Joint Committee). Members of the RSAP, which aided in the development of this issue brief, include Kelly Coffing, MAAA, FSA, EA; David Driscoll, MAAA, FSA, FCA, EA; Lee Gold, MAAA, ASA, EA; Scott Hittner, MAAA, FSA, FCA, EA; Cynthia Levering, MAAA, ASA; Andrea Sellars, MAAA, FSA; and Claire Wolkoff, MAAA, FSA.

In addition to smaller employers, over time, existing sponsors of medium-sized and large defined contribution plans could also consider moving from their current single employer plan to a PEP. While these sponsors might already benefit from low-cost institutional investment options and efficient administration, they may find further opportunities for economies of scale by pooling resources with other employers. Some larger sponsors could also find it desirable to outsource some of their fiduciary and compliance responsibilities to a third party. However, others may prefer to retain their current level of control over plan operations or to retain plan features that might not be offered under available PEP options.

Like other defined contribution plans, PEPs will be able to offer lifetime income options and would be required to provide lifetime income illustrations to individual participants. PEPs could be more likely to offer lifetime income options than single employer plans (especially smaller ones) because of the efficiencies afforded by scale. PEPs that offer such options may be at a competitive advantage when employers search for a PEP in which to participate, since some employers may wish to make lifetime income options available to their employees. Also, a PEP's scale should lead to a greater level of expertise in the lifetime income option vetting and provider selection process. The lifetime income safe harbor provisions contained in the SECURE Act will benefit PEPs as well as single employer plans both existing and prospectively.

Select states have recently enacted their own retirement initiatives (such as automatic individual retirement account [IRA] arrangements), attempting to address retirement coverage and adequacy concerns. In some cases, such state programs are required to be offered by employers that do not sponsor a workplace retirement plan. These state programs may need to be modified so that employers participating in a PEP are treated in the same manner as employers directly sponsoring a plan.

For the PEP structure to be implemented as a component of the U.S. retirement system going forward, guidance will be needed from the DOL and other regulatory agencies regarding the various requirements that pooled plan providers must meet. Once guidance is provided, prospective providers will need to file for approval to offer their services to employers. PEPs have the potential to improve retirement outcomes for many American workers, provide retirement benefits in a more efficient manner, and better align the roles and skills of workers, employers, and service providers. Employers and prospective PEP providers will need clarity from regulatory agencies on the implementation requirements for PEPs before the impact of PEPs on the U.S. retirement system is fully understood.

Disclosure Regarding Lifetime Income

The SECURE Act requires that defined contribution plans provide participants with an annual estimate of the monthly lifetime income that their account balance would provide. This information is intended to help participants better gauge their progress toward meeting their retirement income goals. Many larger plans as well as larger record-keepers already provide some type of retirement income projections to plan participants. The DOL, pursuant to the SECURE Act, is expected to issue a model notice for implementation by December 20, 2020, with the effective date being a year after DOL regulations are issued[4]. Employers will not have any fiduciary liability with respect to these disclosures if they follow these DOL regulations.

The SECURE Act requires that income forms to be shown on the model notice to be used by employers for the required annual statements are to be shown as a life annuity as well as a qualified joint and survivor benefit. The model notice will explain that the income stream is only an illustration and actual lifetime income will depend on many factors such as actual investment earnings. The DOL can prescribe a single set of assumptions or a range of assumptions, which will be disclosed to participants. Plan sponsors can show additional illustrations and features to the extent these are permitted by the DOL.

It is important that plan participants understand their retirement accounts in terms of a lifetime retirement income and the decumulation challenge that many retirees face (i.e., how to draw down their assets each year and make them last for their lifetime). This disclosure requirement is a valuable opportunity to educate employees about this challenge, in particular by providing them with a numerical example of how much income might be derived from their account balance. Many participants have little to no understanding of this dynamic and therefore may be undersaving for retirement.

The SECURE Act can provide for an important step toward enhancing participants' understanding of their need to provide for a reliable lifetime income and their ability to do so. Additional context and illustrations could further enhance participants' understanding.

The DOL will be providing guidance through regulations that will provide the details on how employers must implement this provision. Some areas for the DOL to consider are noted below.

4 12 months after the latest of the issuance by the DOL of interim final rules, the model disclosure or the assumptions.

Commentary should be included about the assumptions that are used to convert a current account balance to a stream of lifetime income payable at retirement. This calculation is based on several assumptions, including a life expectancy assumption. One option for assumed life expectancy would be a unisex mortality table, which is consistent with the requirement within tax-qualified plans. However, such a practice would tend to overstate the available monthly lifetime income for female participants and understate it for male participants, compared to using a gender-distinct table for actual lifetime income. In that case, gender-distinct mortality tables may be the preferable assumption to provide the best information possible to plan participants.[5] If unisex factors are used, it may be worth noting that women generally are expected to live longer than men.

The actual retirement age at which the lifetime income stream will start should be disclosed in the illustration. While individuals generally don't know when they will retire until closer to that actual date, the use of a range of ages can illustrate the reduction in a monthly benefit amount if it commences at an earlier retirement age. This information could encourage more savings and the postponement of retirement until enough resources can be accumulated. Showing more than one retirement age, such as those with Social Security claiming, could be beneficial to illustrate the benefit of working longer, as their lifetime income will be higher when commencing at later ages.[6] This complexity and the level of additional education needed should be weighed against the benefit to participants of providing these alternatives.

The conversion from account balance to lifetime income also requires an interest rate assumption, which should be shown and explained to participants. The level of interest rates available at retirement can significantly affect the amount of income available, with lower interest rates leading to less available income. Therefore, the interest rate assumption should consider the appropriate balance between stability in estimates of retirement income and market-responsiveness to provide currently relevant information.

The illustrations should specify whether any provision for inflation has been considered in determination of the lifetime income. If inflation is not reflected, projections would be based upon today's dollars, which may not be reflective of the future purchasing power of money. Reflecting inflation, however, produces a level anticipated real income stream. If a retiree's spending decreases as he/she ages, such a level income stream might tend to provide too much income in later years, leading the retiree to underspend his/her potential in early years.

5 As of the date of publication, a $10,000 lump sum (using assumptions based upon an insurer's annuity purchase rates) would produce a $50-per-month life annuity benefit for a 65-year-old male and a $47-per-month benefit for a 65-year-old female.

6 Age 62 (earliest age available), age 67 (age when benefits will not be reduced for most workers), and age 70 (latest claiming age) might be reasonable dates to show.

Consideration should be given as to whether supplemental disclosure information should be provided regarding specific assumptions related to the joint and survivor calculations. SECURE requires that a joint and survivor option be shown in addition to the life annuity option. The act requires this option be determined by assuming that a participant's spouse is the same age as the participant. It may be advisable to have language in the model disclosure of the impact on the amount if the spouse is significantly younger or older.

Additional information with respect to future contributions may improve participant understanding. It does not appear that the SECURE Act requires any illustrations of the impact of future contributions on a participant's account balance and therefore, the lifetime income those contributions would provide. It is challenging to predict the level of an individual's future contributions within an employer's plan, and many employees move in and out of employment such that they may or may not have access to save within an employer's plan. Nevertheless, this lack of information makes it difficult for employees to know whether they are on track with their retirement savings or whether their contributions under the plan should be increased. Some illustration of the value of future contributions would be extremely helpful in building participant understanding, even if it is provided in a generic table format.

Another significant challenge with forecasting a future account balance is determining an appropriate investment return assumption to apply to those savings amounts. Due to the range of individual circumstances and uncertainty about future economic scenarios, the use of more than a single assumption in the accumulation stage should be considered. One approach would be to use assumptions based on the age of the individual that become more conservative as individuals age, like the glide-path approach used in target-date funds. Alternatively, two longer-term return assumptions could be used: one based on a higher return assumption, perhaps reflecting a more optimistic economic forecast and/or a more heavily weighted equity portfolio, and the other a lower rate assumption, reflecting a more pessimistic economic scenario and/or a more heavily weighted fixed-income portfolio.

Lifetime Income in Defined Contribution Plans

The SECURE Act contains provisions intended to increase the number of defined contribution (DC) plans offering their participants lifetime income options. A plan sponsor considering the addition of a lifetime income option to its DC plan would undertake a three-step process: evaluate the inclusion of a lifetime income option, then, if option is to be included, select an insurer, and finally, choose the annuity product(s).

Deciding to Offer a Lifetime Annuity Option

The primary method of distribution from DC plans has been as a lump sum and few plans currently offer annuity options or methods of periodic distribution. Research has shown that annuitizing a portion of their DC account balance can improve retirement outcomes for some participants, especially those without access to a defined benefit plan. Annuity income in retirement can help mitigate the risk of outliving one's assets and can enable participants to spend the income they receive with confidence. With fewer workers covered in recent years by defined benefit plans that provide annuity income for life, having access to other sources of consistent, lifetime income (in addition to Social Security) is becoming increasingly important.

Plan sponsors are starting to focus more on providing assistance for their employees when they are in the decumulation phase. In evaluating ways to do this, plan sponsors could consider the advantages of offering annuities inside their DC plans. The annuity may be priced more attractively than an annuity that participants could buy on their own in the retail market due to institutional pricing. Prices may be lower due to the elimination or reduction of commissions as well as possible administrative economies of scale, for example. Additionally, the overall mortality of plan participants selecting this option may be expected to be higher than for individuals who purchase retail income annuities. This is due to purchasers of retail annuities generally being in very good health, whereas purchasers within a DC plan would be expected to be more reflective of the general population. Institutional pricing and more favorable mortality could cause in-plan prices to be lower; however, the magnitude of the price differential will depend upon the expected utilization rate of income options in DC plans and how annuity products evolve over time. Lastly, because annuities in qualified plans must be based on unisex mortality, the price advantage of an in-plan annuity option could be increased for females, with corresponding reduced advantage (or even a disadvantage) for males.

Plan sponsors have the ability to provide education to employees about the potential benefits of lifetime income. Having this option available in-plan could encourage participants to address lifetime income needs prior to retirement and understand the availability of solutions. The education and availability of options through the plan can provide support in the decision-making process, especially significant if the participant does not have a financial adviser.

Selecting an Insurer

Among the reasons that plan sponsors have not included annuity options is their concern about their fiduciary liability related to the choice of an insurer. The SECURE Act establishes a safe harbor for determining the financial capability of an insurer.

In the selection of an insurer, plan sponsors will continue to be required to engage in an "objective, thorough and analytical" search of insurers and consider the financial capacity of the insurer to satisfy its obligations. The SECURE Act then defines a safe harbor for determining financial capacity. The safe harbor provision basically requires that the insurer must have complied with state financial reporting and solvency requirements for the last seven years. Some would view this safe harbor definition as being too low a bar by sweeping in all insurers who are eligible to operate within the state. The safe harbor does not include any criteria to distinguish financially strong insurers from those that aren't as strong but are still in compliance with the safe harbor. Some plan sponsors could choose to apply additional criteria rather than rely on the safe harbor alone.

Choosing the Annuity Product(s)

There are design choices to be made, for example incremental annuity income could be purchased throughout the period of active employment and/or an annuity could be purchased at retirement. There are several different products to be considered, which are discussed in more detail later. Plan sponsors should consider what product design will be appropriate for their circumstances, including the ability to be understood by participants.

The annuity product selection process in the SECURE Act requires the plan sponsor to consider the cost (including fees and commissions) of the contract offered by the insurer in relation to the benefits, product features, and administrative services provided. To move forward, the plan sponsor must conclude that the cost is reasonable. The plan sponsor does not have to choose the lowest-cost provider. As the selection of a product that has "reasonable" cost is subjective, it is possible that employers' current concern about fiduciary risk may shift from insurer selection to product selection. Thus, there still could be a hurdle to getting plan sponsors to offer annuity products in their plans.

Retail annuities have commissions, fees, and/or surrender charges. As plan sponsors look to offer annuities to their participants at what they determine to be a reasonable cost, they will need to evaluate any fees, charges, and commissions (and how these may be embedded as a margin verses directly assessed) inherent in these products. Because the election rate of annuities in DC plans is still evolving, insurers may price them cautiously at first. Once their mortality risk is better understood, insurers can reprice them. Those purchasing annuities within DC plans might have closer to average mortality (and this could vary by industry), but there likely would be some anti-selection, i.e., purchasers more likely to be in above-average health, involved in who decides to purchase an in-plan annuity.

The SECURE Act defines an annuity contract in a broad way, encompassing both an income stream payable for only a fixed period as well as one paid for at least the remainder of the life of the participant (or the joint lives of the participant and their beneficiary). It is only this latter option that fully addresses the longevity risk that retirees can face.

The SECURE Act does not specify which annuity products could be offered within a defined contribution plan; consequently, there is a full spectrum of possible products. The most straightforward of these would be single premium immediate annuities (SPIAs) and Qualifying Longevity Annuity Contracts (QLACs) that are purchased for a specified single premium at retirement and guarantee an annual amount of lifetime income, starting at retirement (SPIAs) or at a later date (QLACs). Another option is annuities that would begin payments at retirement or even later that would be purchased while working. These could be QLACs, annuities embedded in target date funds, and accumulation-oriented deferred annuities with guaranteed living benefits, such as, guaranteed lifetime withdrawal benefits (GLWBs), or guaranteed minimum income benefit (GMIBs).

If the goal of plan sponsors is to provide their employees with options for lifetime income, they need to know that some of the options they add to their plans may meet this goal better than others. Education is needed if there is a choice between a guaranteed lifetime income and a series of periodic withdrawals (for example, systematic withdrawals) that are not guaranteed to last a lifetime. Annuities that have additional investment-based guarantees attached or that mix investments with insurance add complexity to the education process and may be less effective in providing lifetime income than simpler products. Participant education will be critical as employees make decisions about these options.

The SECURE Act provides more flexibility with in-plan annuity portability, but more attention is needed to make sure portability can be implemented effectively. Concerns about portability could deter participants from selecting annuity options, particularly those that accumulate income guarantees while the participant is working. For example, if an insurer does not have a relationship with a participant's new employer/plan, additional accruals of annuity benefits may be affected. It is helpful that if a new trustee cannot accept an annuity, it can be transferred to an IRA account tax-free; however, the annuity may not be able to accept future contributions.

Conclusion

The SECURE Act can strengthen the retirement system at a time when many Americans do not have access to saving within an employer-sponsored retirement plan. Those fortunate enough to have access to these plans may not have the information necessary to understand how much savings they need to provide a life-long, financially secure retirement. Very few participants currently have access to options within their DC plans that can provide guaranteed lifetime income.

The SECURE Act's creation of PEPs could increase access to employer-sponsored plans. The increased plan disclosure will provide educational opportunities for more participants on their longevity risk. Enabling more sponsors to add lifetime income options to their retirement plans could empower participants to better address that longevity risk by providing income they won't outlive.

The SECURE Act comes at a critical time in the increasingly DC-focused, private-sector retirement system.