Here’s One Way to Turn 401(k) Assets into Dependable Retirement Income

June 5, 2017

MarketWatch Blog by Alicia H. Munnell

Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

People are more likely to hoard their savings accounts in retirement.

Employers, academics, and policymakers all recognize that drawdown is the major challenge facing the 401(k) system.

Participants face the risk of spending their money too quickly and exhausting their assets or hoarding their balances and depriving themselves of necessities.

My view is that reluctance to spend is the greater threat for three reasons. First, people form an unnatural attachment to their pile of assets, which they have spent a lifetime accumulating. Second, people are fearful of end-of-life health and long-term care expenses. Third, many people want to leave a bequest to ensure their immortality. Thus, given the modest size of 401(k) balances, without some orderly drawdown mechanism many retirees could live in self-imposed deprivation.

With these concerns in mind, in 2014, the Department of Treasury in collaboration with the Internal Revenue Service (IRS) and the Department of Labor (DOL) issued guidance on how plans might incorporate auto-annuitization features into target-date funds (TDFs).

Under this arrangement, a fund will allow participants, say, age 50 or older to invest a portion of their assets in deferred annuity accounts. When the fund reaches its target date, it will dissolve, participants will receive an annuity certificate providing for immediate or deferred annuity payments, and the remaining portion of the participant's investment would need to be reinvested, either by the participant or a plan fiduciary, in other alternatives.

Because the annuity purchase is age-contingent, this arrangement could raise an issue of discrimination in favor of older, highly-compensated employees. The Treasury/IRS notice addressed this concern. Specifically, it stated that, if certain criteria were met, a series of target date funds that include deferred annuities among their assets would be treated as a single benefit and therefore should not raise plan qualification concerns. (Interestingly, the notice specifically excludes deferred annuities that include guaranteed minimum withdrawal benefits and guaranteed lifetime withdrawal benefits, which allow withdrawals from the invested amount without having to annuitize the investment.)

In addition to how a TDF series may satisfy Internal Revenue Code nondiscrimination requirements, Treasury asked for DOL views on these TDF/deferred annuity structures.

- The DOL confirmed that the TDF series with the deferred annuity feature may qualify for Qualified Default Investment Alternative (QDIA) designation.

- The DOL said that the annuity selection safe harbor (2008 Safe Harbor) applicable to defined contribution plans establishes a means for plan fiduciaries to satisfy responsibilities under the Employee Retirement Income Security Act of 1974 (ERISA) regarding annuity selection. The 2008 Safe Harbor guidance for annuities says fiduciaries must: 1) conduct an objective, analytical, and thorough search; 2) assess the ability of the annuity provider to make benefit payments; 3) pay attention to the fees; 4) conclude that the annuity provider can make future payments and that fees are relatively reasonable; and 5) hire an expert to assess the above criteria, if needed.

The 2014 guidance confirmed the agencies' interest in encouraging plan sponsors to find ways to help employees manage their 401(k) and other defined contribution plan accounts so that their retirement savings will last through their retirement years.

It's now 2017, and very few firms have adopted lifetime income strategies within their target date funds. What's holding them back?