

Creating Better Retirement Outcomes through Lifetime Income



Barbara Novick
Vice Chairman



Anne Ackerley
Head of Retirement Group



Joseph Craven
Head of U.S. Retirement, Global Public Policy Group



Dan Basile
Head of DC Product Management, Retirement Group



Nicole Rosser
Legal & Compliance



Rachel Barry
Global Public Policy Group

Individuals are living longer and are increasingly responsible for managing their own retirement savings, primarily through defined contribution (DC) plans. We must consider ways to make it easier to affordably manage the longevity risk created by the confluence of these two trends. In the U.S., two thirds of retirees utilize Social Security as their primary source of retirement income.¹ Since Social Security alone is likely not enough for many of these retirees to maintain an appropriate standard of living,² they would benefit from a second source of lifetime income.

Lifetime income products, such as annuities, pool longevity risk and are a critical tool to help people effectively spend their savings throughout retirement. In our *ViewPoint* titled [Roadmap for Improving U.S. Retirement Savings: Make It Easier](#), we outline policy recommendations for the DC system to (i) expand access to employer-sponsored retirement plans, (ii) increase participation in those plans, and (iii) help individuals achieve better outcomes throughout retirement. This paper focuses on the use of lifetime income as part of the third principle: improving outcomes through the decumulation phase of retirement.

Workers can set up regular “paychecks” for their post-retirement life through the use of lifetime income products, which serve as a source of predictable income and help them manage their money in the decades after they retire. However, lifetime income products are not typically offered as an investment option in DC plans, in part due to employer discomfort with the perceived legal exposure of current regulatory requirements. In addition, in plans where a lifetime income option is offered, many participants continue to choose “lump sum” distributions of cash.³ In this paper, we offer policy recommendations to facilitate the use of lifetime income products in DC plans, as we believe the combination of investment solutions and longevity pooling can lead to better retirement outcomes.

Key Policy Changes to Facilitate the Use of Lifetime Income Products

1. We support legislative efforts to amend the current annuity safe harbor to provide more objective guidance to an ERISA fiduciary on how to appropriately select an annuity provider, thereby increasing access to lifetime income options within DC plans.
2. We support legislative efforts to provide portability for lifetime income options by permitting participants to transfer such strategies, under certain conditions, outside their plan without penalty.
3. We recommend that the Department of Labor (DoL) provide guidance on how ERISA fiduciaries may include lifetime income strategies within target date funds, managed accounts and balanced funds, so that such products may remain a qualified default investment alternative (QDIA). This would drive greater adoption of lifetime income strategies by plan participants.
4. We support efforts to encourage lifetime income disclosure within retirement plan statements, which can help individuals understand how their savings translate to retirement income, and we believe policy makers should provide flexibility and allow for innovation in lifetime income disclosures.

Importance of Products that Help Individuals Manage Longevity throughout Retirement

People are living longer and are increasingly responsible for planning their own retirement. In the U.S., average life expectancies have risen from 69.8 in 1960 to 78.5 today.⁴ About one out of every three 65-year-olds today will live past age 90.⁵ And, for married couples at age 65, there is a 45% chance that one spouse will live to 90.⁶ Looking forward, life expectancies are expected to continue to increase.⁷

Exhibit 1: U.S. Longevity Continues to Increase

79

Life expectancy in 2017¹

104

Oldest age 50% of babies born in 2017 are predicted to still be alive²

Sources: (1) St. Louis Fed as of Dec. 2017; (2) World Economic Forum, We'll Live to 100 – How Can We Afford It? (May 2017).

Coincident with this increase in longevity, DC plans have become the primary source of retirement savings for many Americans, as employers have shifted from defined benefit (DB) to DC plans.⁸ Employers moved from DB to DC as a way to increase portability of benefits for an increasingly mobile work force, and also to shift costs and risk away from their income statements and balance sheets.⁹ As a result, employers shifted away from pooling longevity risk, which is a critical tool to address the financial risk of longer life spans. We believe that given this shift to DC, in combination with demographic changes, it is important to provide individuals with the tools to manage their retirement savings for increased longevity.

Exhibit 2: The Burden of Saving has Shifted to the Individual

Fortune 500 companies offering DB Plans



Source: Willis Towers Watson, Retirement Offerings in the Fortune 500: A retrospective, 2018. Includes both traditional and hybrid DB offerings.

When individuals reach retirement, many don't know how to transition from saving to spending. They are often given a lump sum of money that they have spent their entire working lives accumulating, and are left to figure out how to make that money last for the rest of their lives – which is referred to as the decumulation phase. This decumulation phase can last decades.

“Decumulation is the nastiest, hardest problem in finance.”

– William Sharpe, Nobel Laureate¹⁰

Individuals are increasingly concerned about their ability to spend down their nest egg. BlackRock conducts an annual research study of over 1,000 participants in U.S. DC plans (DC Pulse Survey).¹¹ As shown in Exhibit 3, many plan participants are saying how difficult it is to translate their savings into retirement income and to manage their spending to make that money last a lifetime.

Exhibit 3: Growing Concerns around Retirement Income and Spending

It's difficult to know how my retirement savings will translate into monthly retirement income



I'm not sure how to calculate how much spending I'll do in retirement



The thought of having to generate my own retirement income worries me



Source: BlackRock, DC Pulse Survey, 2019.

Traditional lifetime income products, such as annuities, can help mitigate longevity risk and address some of the challenges individuals experience in managing withdrawals throughout retirement. In its simplest form, an annuity is a financial product offered by an insurance company that is designed to provide investors with a steady stream of payments beginning at a predetermined date. Upon making a lump sum payment or series of payments to the insurance company, the insurer will provide regular disbursements to the individual beginning either immediately or at some point in the future. Most annuities provide these payments for the duration of an individual's life, which is why annuity products are considered “lifetime income”. A lifetime annuity is both a financial product and an insurance policy, as it generates income and distributes principal and, most importantly, insures that the specified payment will last for the individual's lifetime. The insurance company determines the amount of the payment by pooling longevity risk, making an actuarial estimate of the longevity of all annuity buyers, and then insuring that the agreed upon payments will last for each individual's lifetime.

Social Security and DB plans are examples of retirement benefits that pool longevity risk to provide a guaranteed income stream for retirees. Social Security is the bedrock of our retirement system and longevity pooling is used by the actuaries of the Social Security Administration to determine everyone's benefits. In addition, this pooling is the foundation of DB plans, which serve 40 million public and private employees in the U.S.¹² While longevity pooling has proven effective and popular for Social Security and DB participants, there has not been widespread adoption of lifetime income products by individuals when included in a DC plan. There are a number of potential reasons why individuals may be reluctant to buy annuities, including concerns around the perceived unfairness for individuals who may not live as long,¹³ the desire to leave a legacy, fees, complexity, lack of liquidity, and lack of transparency.

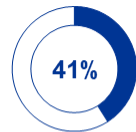
“Lifetime income products, such as annuities, can help mitigate longevity risk and address some of the challenges individuals experience in managing withdrawals throughout retirement”

With these concerns in mind, BlackRock is considering innovative products that provide some of the attributes of fixed deferred annuities in traditional DC plans. Our goal is to make lifetime income solutions simpler, more transparent, and less expensive, and to offer these solutions in combination with existing DC plan product offerings to facilitate their adoption. Innovations in this space would provide plan sponsors with more flexibility to use investment products that incorporate lifetime income, leverage technology to make it easier for participants to understand their assets, and demonstrate how those assets may translate into a stream of retirement income.

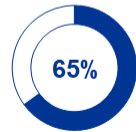
Incorporating annuities and financial guarantees into DC plans would help individuals face retirement by providing them with periodic paychecks throughout retirement, helping them manage their assets over time and serving as a cushion in addition to other investments. While there is no one-size-fits-all solution for retirement savings, lifetime income products can serve as a tool to provide a level of baseline income to help people maintain their standard of living throughout retirement. These products allow individuals to essentially create their own stream of defined benefit-like payouts over the course of their lifetimes, which can provide them with a greater sense of confidence and security that they will not outlive their savings. When used in conjunction with a traditional retirement savings portfolio, lifetime income products may enable investors to take on more risk elsewhere in their portfolios to potentially increase their expected returns over time, which is particularly important in a prolonged low interest rate environment.

As DB plans no longer serve as the primary source of retirement income for many, and Social Security may not be enough, it is increasingly important that DC plans offer tools to provide a layer of guaranteed retirement income. To achieve this, we provide recommendations to enhance the existing regulatory framework to allow for greater adoption of lifetime income products in DC plans, which would make it easier for individuals to access these products.

Exhibit 4: Individuals Would Benefit From Lifetime Income Options in DC Plans



Income generation is an extremely important consideration when selecting investments



Would save more for retirement if they could choose an option providing guaranteed retirement income

Source: BlackRock, DC Pulse Survey, 2019.

Amend Annuity Provider Safe Harbor

Currently, DoL Regulation Section 2550.404a-4 provides a safe harbor for the selection and monitoring of annuity providers and annuity contracts for benefits distributions from individual account plans. This regulation requires the plan sponsor to engage in a facts and circumstances analysis, which includes consideration of the financial ability of the annuity provider to make payments. In 2015, the DoL issued interpretive guidance on how to apply the facts and circumstances test.¹⁴ Although an improvement, this additional guidance did not clarify how plan fiduciaries should assess the financial health of an insurer and its ability to make all future payments. Additionally, the regulation and the interpretive guidance only address the selection and monitoring of annuity providers and annuity contracts for benefit distributions and do not specifically apply to the selection and monitoring of annuity providers and contracts that are offered as investment options or used as an investment within an investment option. Although the DoL indicated in its 2015 interpretive guidance that it was considering issuing guidance with respect to annuity contracts that are offered as investment options, additional guidance has not yet been issued.

Under the current framework, plan fiduciaries remain reluctant to bring lifetime income options into their 401(k) plans due to fears of fiduciary liability.¹⁵ We believe plan fiduciaries would find greater comfort including annuities as an investment option in their defined contribution plans if they could evaluate the annuity provider's financial ability to make all future payments under the annuity contract based on more objective criteria.

As outlined in our August 2018 [letter to the ERISA Advisory Council](#), BlackRock has encouraged policy makers to amend the safe harbor to allow fiduciaries to rely on criteria such as credit ratings together with representations from the annuity provider regarding its licensing, satisfaction of certain state and regulatory requirements, and financial examinations conducted by other regulatory bodies as a basis to conclude that the annuity provider is financially able to make all future payments under the annuity contract.¹⁶

We support recent legislative provisions to amend the safe harbor rule to provide greater clarity to an ERISA fiduciary when selecting an annuity provider and encourage adoption of this provision. The lifetime income safe harbor included the recent House bill called the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) would make these changes legislatively and help ease plan sponsor concerns with the selection of lifetime income products. The Senate's Retirement Savings and Enhancement Act (RESA) includes a similar provision.

The SECURE Act passed the House of Representatives on May 23, 2019 with overwhelming bipartisan support in a vote of 417-3. We encourage the Senate to now take up retirement legislation and pass a final bill into law. In the absence of final legislation, we recommend the DoL amend the safe harbor rule to the same effect.

Provide Portability for Lifetime Income

Both the SECURE Act and RESA include provisions to enhance the portability of lifetime income investments by making it easier for plan participants to transfer annuity contracts outside of their plans without penalty, under certain circumstances. For example, participants would be permitted to rollover the lifetime income investment to an IRA or another employer-sponsored retirement plan, or to receive direct distributions in the form of a qualified plan distribution annuity if the lifetime income investment is no longer authorized as an investment option in the plan. We are supportive of policy changes to improve portability, which would allow plan participants to preserve their lifetime income investments without imposing fees for transfers.

Clarify Inclusion of Lifetime Income Options as Permissible QDIA Components

Cerulli estimates that 75% of DC plan flows will be directed to target date funds, which are the most common type of QDIA, by 2020.¹⁷ In order to deliver the most benefit and encourage greater use of lifetime income solutions by plan participants, we recommend integrating lifetime income solutions as a component of plan QDIAs. The annuity provider safe harbor described above paves the way for selection of lifetime income products, but it doesn't mean these products will be included in default plan options, which comprise the majority of new DC plan contributions.

Plan default features, such as automatic enrollment and automatic escalation, have proven to be powerful mechanisms to drive positive behavior on the accumulation side of the DC system. We encourage harnessing the power of QDIAs to deliver better outcomes in decumulation as well, by allowing lifetime income products to be utilized within the target date funds, balanced funds, and managed accounts that are currently defined as QDIAs.

The QDIA regulation describes the attributes necessary for an investment fund, product, model portfolio, or managed account to be a QDIA. For example, a target date fund that meets the specific requirements of the regulation is a type of fund that could be a QDIA. In an October 2014 letter to J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy at the Department of the Treasury, Phyllis C. Borzi, Assistant Secretary of the Employee Benefits Security Administration at the DoL, stated the DoL's view that the use of unallocated deferred annuity contracts as fixed income investments would not cause target date funds to fail to meet the requirements of the QDIA regulation.¹⁸ BlackRock recommends that the DoL confirm in the QDIA regulation that the views expressed in this letter continue to be the DoL's position.

Facilitate Lifetime Income Disclosure

There are significant benefits to providing plan participants with estimates of the income they can expect to receive in retirement. These estimates can be particularly useful planning tools when presented together with the potential impact of certain variables (e.g., saving more, delaying retirement, or investing more conservatively or aggressively).

We appreciate efforts by legislators to effectuate policy changes that would provide meaningful disclosures to plan participants that translate lump-sum savings into a more relatable projection of income. The SECURE Act and RESA both include a provision that would require DC plan benefit statements to include a lifetime income disclosure illustrating the amount of monthly payments the participant would receive if their total accrued benefits were used to provide lifetime income through an annuity. The provision also clarifies that plan sponsors and fiduciaries would not bear ERISA liability by providing this disclosure, as long as they meet the applicable rules and assumptions and include certain explanations of the projections.

If such a provision passes into law, the regulations that govern how it is implemented will be important. To promote meaningful income illustrations, we believe it is imperative to allow for flexibility and innovation in determining how total accrued benefits are translated into lifetime income, without imposing additional fiduciary burdens on plan sponsors. This type of disclosure would be an important step to help individuals understand how their assets can translate into income.

Conclusion

Increased longevity means that people will need to support longer retirements and, at the same time, the shift from DB to DC plans means that more and more individuals bear the responsibility for funding their own retirement. While there has been a significant focus to date on increasing retirement savings, until recently, there has not been enough focus on how individuals can successfully manage withdrawals throughout retirement.

As individuals struggle with fears of outliving their retirement savings, we encourage policy makers to take actions to make it easier for individuals to get in and stay in investment products that can provide them with a steady stream of income throughout retirement. Specifically, we support policy solutions by Congress and the DoL that provide a fiduciary safe harbor for the selection of annuity products, provide for the portability of these products, clarify that products including a lifetime income component may qualify as a QDIA, and facilitate the disclosure of lifetime income projections.

Related Content

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ViewPoint – [Increasing Access to Open Multiple Employer Plans](#) – Jan. 2018

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