SECURE Act Deep-Dive: Annuities

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The SECURE Act, in addition to increasing access to tax-advantaged retirement plan accounts, is also aimed at preventing Americans from outliving their assets. Thus, the legislation opens the door for annuities that offer guaranteed income in retirement through various annuity-friendly provisions.

THE HISTORY OF ANNUITIES

An annuity is a type of investment that pays a fixed stream of income to an individual in retirement. Annuities have existed in their present form for a few decades. At one point, they were the exclusive investment available in 403(b) plans and remain prominent in these plans today. Despite their usage in 403(b) plans, they are far less popular in 401(k) plans.

Annuities have a well-deserved reputation for being expensive and having fees that are difficult to understand. The overhead expenses for private insurers to administer annuities, pay commissions to the people who sell them, and enjoy a profit margin, is estimated to be between 30 and 40%. Despite these issues, many participants value the idea of having a lifetime income stream, and there are insurers who provide cost-competitive annuity contracts.

THE SECURE ACT PROVISIONS

The SECURE Act provisions related to annuities make it likely that annuities will become more prevalent for those who do not already have them in their plan. We explore the potential impact of each of the annuity-related SECURE Act provisions below.

Statement Illustration of Lifetime Income

The first annuity-related provision is the requirement for an estimate of lifetime annuity income to appear on participant statements. Currently, these illustrations are limited to recordkeeping websites. Unfortunately, many employees ignore their statements altogether. However, those who do pay attention tend to be closer to retirement age, and these individuals may be more receptive to the retirement "paycheck" an annuity benefit has to offer.

It is unlikely that this provision will lead to a large number of plans adopting annuities; however, it is likely to lead to more participant demand. It is important to note that a participant can always use his/her retirement account balance to purchase an annuity outside of the plan. The true measure of these illustrations' impact will not be known for some time, as the provision does not become effective until 12-months after the Department of Labor (DOL) issues guidance in this regard.

Provider Selection Safe Harbor

The second provision calls for a provider selection safe harbor for plan sponsors who wish to add a lifetime income annuity option to their plans. Given the reputation of annuities, plan sponsors who had not previously adopted them were often reluctant to do so, as there was no specific provision to help them understand whether their annuity provider selection process was prudent from a fiduciary perspective. With the new provision, currently in effect, as long as the plan sponsor follows the safe harbor, which includes a thorough search of insurance companies (presumably via an RFP, although the language is not that specific), a consideration of costs vs. benefits, and written representations from the insurer regarding licensing, solvency, etc., the plan sponsor will satisfy ERISA's fiduciary requirements. Of these three annuity-related provisions, this one is likely to be the most impactful with respect to plan sponsors adding annuities to their retirement plans.

Continuance of Lifetime Income Annuity Options

The third annuity-related provision of the SECURE Act allows for the continuance of lifetime income annuity options outside of a retirement plan, should a retirement plan discontinue. This provision is already in effect. While allowing individuals to continue an annuity option on his/her own is certainly participant-friendly, it is unlikely to factor into an employer's decision whether to add an annuity contract to the plan. Additionally, while employers often consider how to rid their plan of an annuity option without causing participant disruption, they are generally not thinking about that when determining whether to add one in the first place.

WHERE DO WE GO FROM HERE?

There's an old saying that annuities are sold, not bought. Thus, taken together, these annuity-friendly provisions will likely add fuel to the marketing machine that is behind many annuity products. However, the SECURE Act provisions do not address the primary reasons why annuities are unpopular with plan participants: high fees (aside from the cost vs. benefit analysis clause of the annuity provider selection safe harbor), lack of fee transparency, and complexity. Until these core issues are addressed, it is unlikely that the prevalence of annuities will dramatically increase.

For a comprehensive look at the SECURE Act provisions, please click here. Stay up to date with the SECURE Act by visiting the Knowledge Center on our website or following Cammack Retirement on LinkedIn or Twitter.

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