

The Framework to Compare DC Plans' Lifetime Income Options – The 8 Key Factors

Studies report that individuals spending in retirement increases as their allocation to a guaranteed lifetime income solution increases¹. Surveys report that most older employees want to be offered a pension-like income option² and think their employer should offer it³. If this sounds like your workforce, you may want to explore offering a lifetime income solution within your organization's defined contribution retirement plan

As always, plan fiduciaries must properly select and monitor the plan's investment offerings. We are providing a framework to compare lifetime income options to assist in your due diligence while exploring this type of solution. The framework should be applied during the initial evaluation and on a regular basis given that a product was selected. Furthermore, this process should help you meet your as provided in SECURE Act.

#1 Determine Workforce Desire and Their Key Concerns

You can start the process by asking your workforce if they would appreciate a lifetime income solution within the retirement plan. This will help determine if the option is even worth evaluating at this time.

If so, it is important to determine your participants' concerns by asking them to prioritize the following risks:

- 1) Longevity risk – the risk of outliving their money;
- 2) Liquidity risk – the risk of not being able to access their balances in time of an emergency or urgent need;
- 3) Market risk – the risk of unpredictable market conditions and the impact on the account balance;
- 4) Inflation risk – the risk that inflation decreases their purchasing power of their retirement assets;
- 5) Legacy Risk – the risk of not having a balance to bequest to their beneficiaries; and
- 6) Utilization Risk - the risk of not understanding the lifetime income solution and not being able to make the best course of action for their situation.

Their priorities can help you determine what type of lifetime income could best meet their needs. For example, annuitization solution tend to offer higher benefit payments based on the underlying account value, while a guaranteed lifetime

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withdrawal benefit ("GLWB") tends to offer more liquidity and flexibility during retirement but may not always offer as rich an income payment.

#2 Assess the Solution's Ability to Fulfill Operational Criteria

Start with confirming that your plan's providers such as the recordkeeper can properly administer the solution/product being evaluated. If the providers cannot, we do not believe any further valuation is warranted for that solution unless a recordkeeper search is also being conducted.

Portability is an operational criterion that should be reviewed. Portability refers to the ability to move a plan participant's accrued annuity benefit to another recordkeeper, to another plan, or to an IRA. Sample review questions include: Are all the features available to the participant if the benefit is rolled into an IRA? Are the underlying investments and costs the same?

Be sure to ask about portability/liquidity if the plan removes the product, if the plan terminates, experiences a plan merger and/or a recordkeeper change.

#3 Assessment of Insurance Company or Companies Merits

It is critical to assess the underwriting company or companies ("insurer") merits. This step provides fiduciary safe harbor if the requirements of §204 of the SECURE Act are met. Taken directly from the SECURE Act §204(A)⁴:

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 year –
 - Operates under a certificate of authority from the insurance commissioner of its domiciliary State which has not been revoked or suspended;
 - Has filed audited financial statements in accordance with the laws of its domiciliary State under applicable statutory accounting principals;
 - Maintains (and has maintained) reserves which satisfies all the statutory requirements of all States where the insurer does business; and

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- 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);
- (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.

Analysis should include a review of the insurer's credit ratings across various rating agencies. Also, credit spread analysis offers the market's assessment of the insurer's credit risk. Review of the statutory accounting financial statements which are prepared by all life insurance companies and primarily focus on solvency helps assess financial stability.

These documents should be obtained at the time of selection and then annually.

#4 Assessment of Solution Track Record

Evaluate any available historical data from insurer specifically the product's income guarantees. Compare historical payout rates to those of other similar products offered to defined contribution plans as well as retail products.

Annuitization Solutions – track record can be evaluated with a direct comparison of the solution's historical payout rates with those of other annuitization-based solutions in the defined-contribution space and retail income annuities.

GLWB Solutions – do not have a market benchmark for comparison. However, a review of how the payout rates, and other features that impact the amount of guaranteed income, have changed over time, can provide some meaningful insight and help form expectations for future benefits.

Despite the approach, it is imperative to confirm that the solution's income guarantees were reasonable given the market and other economic conditions.

#5 Quantitative Assessment of Benefits Relative to Costs

To determine the value of the benefit, a quantitative cost/benefit analysis would need to be performed by comparing lifetime income solutions with traditional

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investments or each other during different market conditions. The lifetime income solution may provide a lot of benefit during a bear market, while underperforming traditional investments during a bull market.

A Monte Carlo simulation-based framework can be used to project candidate strategy cash flows across numerous independent trials. The simulation should incorporate the specific lifetime income solution features as stated in the contract. That type of approach is strongly recommended to review the full spectrum of participant outcomes compared to the alternatives. However, scenario analysis using historical data can also be used to determine the value of the benefit.

Despite the approach, be sure to include longevity risk, liquidity risk, market risk, inflation risk, legacy risk and underutilization risk in your analysis.

#6 Review of Participant Education Material and Resources

Review the education materials provided to participants and confirm they are helpful. Test out the call center with a few basic questions and confirm the call center representative's responses are accurate and understandable. Also evaluate other languages' materials and accuracy.

#7 Evaluate a participant's costs of opting out and costs of portability

Review the costs imposed on a participant that opts out of the lifetime income solution after accruing a balance. Also determine if there are any additional costs if the participant rollover the balance to another employer plan or IRA.

#8 Evaluate the Product's Portability

Ask about the solution's portability features for many different circumstances, such as plan fiduciaries removal of the solution, a plan termination, or merger or a recordkeeper change in addition to participant-directed instructions to rollover into another employer plan or IRA. Confirm that the plan's recordkeeper can properly administer the solution and its portability functions.

Sources: ¹JPMorgan Guide to Retirement 2025, ²National Retirement Institute, Pension-like income is Key to Building Retirement Confidence, Feb 2024, ³Greenwald Research, 2024 In-Plan Insights Program, Jan 2025, ⁴Secure Act §204(A), Morningstar Center for Retirement & Policy Studies, *Evaluating Retirement Plan Lifetime Income Solutions*, June 2024 by: Spencer Look, Associate Director Retirement Studies and Public Policy. PSCA 6 Factors to Consider When Comparing Lifetime Income Solutions, June 11, 2024 by John Sullivan.

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