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Annuity

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The SECURE Act Brings Annuity Opportunities for Financial Advisors

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On December 20, 2019, a $1.4 trillion spending bill was signed into law in order to keep the government running. Tucked away inside this mammoth piece of legislation was the Setting Every Community Up for Retirement Enhancement (SECURE) Act. This new law includes **significant annuity opportunities for financial advisors** to share with clients who may be looking to replace all or part of their 401(k) or other company plan with a guaranteed income plan.

Annuities can provide a pension-type plan that offers the security of guaranteed income for life without burdening the client with the risk and responsibility of saving for retirement. Over the last 40 years, this risk has shifted from employers to employees. Given today's uncertain times and stock market volatility, more employees may be open to this discussion with you as their financial advisor.

SECURE Act Annuity-Related Changes to Company Savings Plans

New Incentive to Offer Savings Plan Annuities

The most widely-reported provision of the SECURE Act is the one intended to make it easier for sponsors of 401(k) plans (and other ERISA-covered savings plans) to offer annuities to participants. According to the Plan Sponsor Council of America, just 9% of 401(k) plans now offer annuities.

Congress was concerned that many savings plan participants squander their distributions as soon as they leave the plan (or even earlier if the plan offers in-service withdrawals), and few are saving those funds for retirement. This is especially harmful given the decline of traditional pension plans which are required to provide annuity distribution options.

Congress perceived that 401(k) plan sponsors have been inhibited from offering annuities for fear of violating the ERISA fiduciary rules. ERISA requires that plan fiduciaries (i.e., the plan sponsor or governing board) carry out their duties in the same way a "prudent person" would act under the same circumstances. Plan fiduciaries have been concerned they would be liable under this standard if an insurance company chosen to offer annuities later ran into financial difficulties.

The SECURE Act creates a new ERISA "safe harbor" that, if met, shields the sponsor from liability with respect to participant losses if the insurer is unable to pay the full benefits when due. The safe harbor eases a 2008 Department of Labor regulation on selecting annuity providers that many thought was too difficult to satisfy.

The new safe harbor addresses *both*:

(1) The offering of annuities as an ongoing option while an employee is participating in the plan, *and*

(2) The offering of annuities as a distribution option when a participant terminates employment (no matter how the participant's funds had been invested). This is another change from the 2008 DOL guidance which only dealt with distributions.

Example 1:

Acme Widgets sponsors a 401(k) plan that offers various mutual funds. The plan requires participants to take their account balance in a lump sum when they terminate employment. Acme wishes to add annuities as a new option for ongoing participants, and to allow outgoing participants the option of purchasing an annuity contract when they terminate. In selecting an insurance carrier to provide annuities for both purposes, Acme satisfies the SECURE Act safe harbor and picks Goliath Insurance Company. Seven years later, Goliath goes belly-up and is unable to pay its annuity holders. Those unhappy annuitants cannot come after Acme to recover their losses.

The SECURE Act safe harbor requires fiduciaries to conduct "an objective, thorough and analytical search" of potential annuity providers taking into account (1) the "financial capability" of the candidates and (2) the cost of the contracts offered.

Plan sponsors can satisfy the "financial capability" prong by simply receiving written representations from insurance companies that they are in good standing with state regulators. The company is not required to do its own due diligence.

The new law makes clear that a plan sponsor is not required to select the lowest cost contract. Rather, it may also consider other features of the contracts being offered and attributes of the candidates being considered.

This provision was effective December 20, 2019.

Advisor Annuity Opportunities

This change removes a major roadblock to offering annuity products within company plans and will likely generate new annuity sales.

Since the law is so new, most companies have not yet had the opportunity of taking advantage of it to add annuities to their plan. This delay gives advisors a great opportunity to get ahead of the curve by contacting clients, making them aware of the new law and proactively discussing guaranteed income options that may soon be available to them.

Once an employer decides to offer annuities, employees will be subjected to marketing of those products through their employer. But employees should not leave it to insurance company representatives to determine what is best for them. Advisors can provide more objective guidance in helping clients decide whether, based on the client's unique situation, an annuity makes sense as an ongoing investment opportunity or as a distribution option.

Is the employee eligible for an IRA rollover?

Advisors should consider which clients this may affect and contact them to ascertain whether their company savings plan is offering annuities as an option and whether the client is eligible to roll over the company plan account to an IRA.

All company savings plans allow distributions upon termination of employment. In addition, many plans allow in-service withdrawals after age 59 ½. Although less common, some plans offer in-service withdrawals at any age after a certain number of years of service. With the exception of hardship withdrawals, any plan distribution taken as a lump sum would be eligible for rollover.

Even if the client is not currently eligible for a rollover, advisors can lend value by counseling clients about the wisdom of annuities versus other available options (e.g., mutual funds, stocks, ETFs, etc.). By doing this, the advisor takes on the role of client advocate and plants the seed for the client to seek out the advisor down the road when the client is able to do a rollover.

Once the client becomes rollover-eligible, the advisor will be positioned to evaluate the options offered by the plan and provide alternative options that may be available within the client's IRA..

An annuity is meant to provide a lifetime of income. Financial advisors may be in a better position to help clients with such an important decision.

New Portability Options for Company Plan Annuities

New Incentive to Offer Savings Plan Annuities

A separate provision of the new law is designed to further encourage company plan sponsors to offer annuities as an ongoing option.

Congress believed that plan sponsors were reluctant to offer annuity products not only because of potential fiduciary liability, but also because of uncertainty if the company changes providers or eliminates the annuity option altogether. This could easily happen if the administrative burden of offering annuities becomes overwhelming or if only a few participants take advantage of the annuity option.

Without relief, plan participants who had invested their savings plan funds in annuities would be required to change their plan. In addition, participants could be saddled with termination penalties, surrender charges or other fees upon liquidation of the annuity. Finally, participants often cannot get their annuity out of the plan because of restrictive IRS company plan distribution rules. To prevent these outcomes, many plan sponsors would simply not offer annuities in the first place.

The SECURE Act provides an opportunity for participants to preserve their annuity choice if the annuity option is eliminated from the plan. Plans can (but are not required to) give affected participants **two tax-free options:**

(1) Making a direct trustee-to-trustee transfer to an IRA or another company plan that accepts such transfers; and/or

(2) Receiving an in-kind distribution of the annuity contract. Both must occur within 90 days before the investment is scheduled to cease being available under the plan.

To accomplish this, the SECURE Act adds a new distributable event for 401(k), 403(b) and 457(b) plans.

Example 2:

Vandelay Industries sponsors a 401(k) plan with a mix of mutual funds as investment options. In 2020, Vandelay decides to begin offering annuities as an additional choice. It also amends the plan to allow in-service transfers or in-kind distributions of annuities if the annuity option is eliminated. Only one employee, George, elects to have his account invested in the annuity product. Two years later, Vandelay decides to eliminate that investment because of poor participation. If this happened before 2020, George would have been unable to retain the annuity and would have likely been hit with surrender charges and fees upon liquidation. Vandelay may have been sued by George. Now, George can either directly transfer his annuity to an IRA or receive an in-kind distribution of his annuity, and Vandelay has nothing to worry about.

This change is effective for plan years beginning after December 31, 2019 (January 1, 2020 for most plans).

Advisor Annuity Opportunities

This new transfer/in-kind distribution option could provide meaningful new opportunities for advisors when companies offer annuities as an option but later decide to change carriers or drop the option altogether.

Advisors can counsel clients about whether it is better to do an IRA transfer or an in-kind distribution. In either case, an advisor can also help clients consider customized lifetime income products that may better suit the client's needs beyond the limited investment options that were available in the company plan.

Illustrations of Annuity Values Required in Participant Statements

The SECURE Act also requires company savings plan sponsors to begin including lifetime retirement income illustrations in their participant benefit statements.

ERISA already requires most companies to provide benefit statements to 401(k) (and other ERISA savings plan) participants at least quarterly. Under the new law, at least annually these statements must include illustrations of the monthly payments participants would receive if their account balance were used to provide a single life annuity or a joint-and-survivor annuity. These illustrations must be based on assumptions developed by the Department of Labor. The DOL is also directed to produce an "easy-to understand" model notice for companies to use.

The assumption is that, once employees see the annuity values on their annual statements, they will lobby their employer to begin offering annuity options in the company savings plan. And, because of the two previously discussed SECURE Act changes, employers will be more willing to acquiesce.

This requirement is not effective anytime soon. Plan sponsors do not have to include the new information until the first annual statement provided more than 12 months after the DOL issues guidance, including required assumptions and a model notice.

Annuity Advisors Needed!

These annuity provisions will remove a roadblock and generate more opportunities for advisors to help clients evaluate their annuity options.

More employees will be marketed to through their employers. **But employees should not leave it to the employer to determine type and quality of the annuity contract.** This is a long-term investment meant to provide a lifetime of income.

Advisors can play a valuable role here in helping clients looking for lifetime income options. Financial advisors, rather than employer reps, are better suited to help their clients / employees select the right income annuity based on their own situation.

Regardless of the client's situation, there are numerous opportunities for advisors to take advantage of the SECURE Act annuity provisions:

- Even if the client's plan has not yet begun offering annuities, it is not too soon for the advisor to initiate a conversation about guaranteed income options.

- Once an annuity product is offered as a retirement savings option, advisors can provide counsel on the merits of that product compared with other available investments.

- If the company changes annuity carriers or eliminates annuities as an investment option, advisors can help clients decide whether to do a direct transfer or an in-kind distribution of the existing annuity. Then, once the annuity is out of the plan, the advisor can introduce the client to a replacement guaranteed income product that may be more appropriate.

- Finally, once the employee becomes eligible to roll over all company plan funds to an IRA, the advisor can show the client that an IRA rollover could allow the client to select a product that may be better suited for his or her particular retirement income needs than those options offered by the employer, balancing, for instance, costs and other factors.

Annuities will soon be coming to many company plans for the first time, and advisors should not be left behind. They should harness this development as an opportunity to target prospects and strengthen existing client relationships. Laying a groundwork now – even before a client is in a position to roll over company funds to an IRA – can reap dividends later on when an IRA rollover is on the table.