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Making Retirement Savings Last

By Randy Myers

Helping Americans convert their retirement savings to income after they stop working is the new frontier in retirement planning, and the federal government wants to play a role. Among those searching for solutions is J. Mark Iwry, senior advisor to the secretary of the Treasury and deputy assistant secretary, tax policy, for retirement and health policy at the U.S. Department of Treasury.

Iwry brought his message to the Stable Value Association in October when he spoke at the SVIA's 2014 Fall Forum in Washington, D.C. He said that although many retirement plan participants seem to have grasped the fundamentals of accumulating assets for retirement, they still wrestle with how to draw down those assets once they stop working.

Managing longevity risk is particularly problematic. Either they plan for a typical life expectancy, Iwry said, and run the risk of outliving their assets if they live longer than the averages, or they hoard too much of their money and deny themselves a better standard of living. One way the Treasury Department is trying to help, he said, is by working with Department of Labor to remove impediments to making lifetime income options, including annuities, available in defined contribution retirement savings plans.

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Iwry called annuities an "elegant solution" to the problem of managing longevity risk. But he observed that even in plans where participants have access to an annuity in retirement, many opt for a lump sum benefit instead.

Iwry confessed that his enthusiasm for lifetime income options is a bit ironic; in the early 1990s he helped to shape rules allowing 401(k) plans to get rid of annuities as a payout option if plan participants weren't using them. The goal was to simplify plan structures that were becoming complex, but also to convince plan sponsors to give annuities a try by not forcing them to keep them in their plans if participants weren't using them. Now, the Treasury Department is being less subtle.

"We are now trying more affirmatively to encourage plans to consider putting lifetime income in one way or another, and that includes defined benefit plans," Iwry said. He characterized defined benefit plans as "the lowest-hanging fruit when it comes to encouraging lifetime income" because they are already required to have an annuity as their default payout option.

"What we have suggested through regulations is that DB plans focus more on the behavioral issues leading people to take lump sums, including the all-or-nothing problem," Iwry said. He explained that many defined benefit plans present the payout choice as either an annuity or a lump sum, without explaining to participants they could split their benefit between the two, taking some in the form of an annuity and the rest as a lump sum.

"That is an offer that has had some minor technical impediments, and we've removed those in proposed regulations we are soon going to finalize," Iwry said.

Iwry conceded that promoting lifetime income products in defined contribution plans presents bigger challenges, including figuring out how to treat deferred or "longevity" annuities under plan qualification rules. "We've got (rules), but people had questions about how some of them applied, so we resolved some of those questions some time ago in guidance," Iwry said.

Specifically, Treasury spelled out that longevity annuities, which typically don't start paying benefits until the policyholder reaches age 80 or so, are now exempt from the tax rules requiring that participants begin taking required minimum distributions from retirement accounts at age 70½. Individuals can invest up to a quarter of their retirement account balance, or a maximum of $125,000, in a longevity annuity without triggering required minimum distributions at age 70½. This applies both to defined contribution plans, such as 401(k)s, and to Individual Retirement Accounts. The annuities also are now allowed to offer a death benefit.

Iwry said the Treasury Department also continues to encourage the Department of Labor to strengthen the fiduciary safe harbor provided to plan sponsors who offer an annuity in a defined contribution plan. Elsewhere, it has issued guidance on how disability insurance premiums can be paid from a defined contribution plan account, and guidance aimed at making it easier for 401(k) plans to accept rollovers from other plans.

Iwry applauded the growing use of automatic enrollment and automatic escalation of participant deferrals by 401(k) plans, and encouraged plan sponsors and their service providers to "do more to make defined contribution and defined benefit systems more effective savings tools." SVIA