# VULNERABILITY AT RETIREMENT

October, 2009

## INTRODUCTION

Much has been written and discussed about reducing the vulnerability of retirees during retirement but very little about reducing the vulnerability of investment firms when plan participants reach retirement. The history in this area has been to treat this inflection point as a new opportunity for competitors to gather rollover assets from the plan.

This discussion examines the alternative of creating a seamless transition into retirement and eliminating the inflection point for the majority of participants in defined contribution plans.

The seamless transition permits providers to retain participants and assets that are already on the books, without having to compete for them in the form of rollovers. Such an approach reduces the vulnerability at retirement for providers of retirement plan products and services.

The key to this seamless transition is acceptance by plan sponsors. Acceptance is achieved by the protection of the Qualified Default Investment Alternative (QDIA). This powerful safe harbor provides fiduciary relief to plan sponsors who default any non-electing employees into a qualified investment.

## SEAMLESS TRANSITION

Maximum asset retention is achieved when retiring employees are given the choice of “electing” a post retirement investment portfolio or doing nothing, resulting in “defaulting” into an income replacement option that also professionally manages any capital in excess of income replacement needs.

It can be expected that relatively few retirees will opt to elect investments and most will default to the income replacement and capital growth. In this way, this majority is never “in play” and vulnerable to rollover marketing.



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## IMPLEMENTATION

This seamless transition into retirement is accomplished within current regulations by taking advantage of existing QDIA features.

Each plan is upgraded with two features:

- Addition of a variable annuity (with income for life) within the default(s) used by the plan. This is explicitly permitted by QDIA regulations[1].
- Addition of an investment election at the time of retirement that permits the participant to create a post-retirement portfolio. This election process is required for plan sponsors to qualify for the protection of the QDIA.

When properly constructed, these changes are likely to capture the majority of assets at retirement into the default with no additional liability for plan sponsors.

## RETIREMENT DEFAULT PRODUCT

The product used to support the seamless transition requires:

- An automatic payout mechanism that calculates income replacement and makes direct disbursements to retirees, unless notified to the contrary.
- Transfer of funds needed for income replacement into an appropriate investment and invest any excess in growth holdings in the account.
- Ability to reverse defaults for up to 90 days with no penalty and to restructure program at other times in the future.
- Option for retiree to select a lifetime income or other guarantee.

[1] (vi) An investment fund product or model portfolio that otherwise meets the requirements of this section shall not fail to constitute a product or portfolio for purposes of paragraph (e)(4)(i) or (ii) of this section solely because the product or portfolio is offered through variable annuity or similar contracts or through common or collective trust funds or pooled investment funds and without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment fund product or model portfolio.



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## SUPPORTING THIS CASE

The argument for this approach was made in DALBAR's comment letter to the Department of Labor of October 10, 2006.

> *"Inappropriate Retirement Default*
>
> *The proposed age based defaults address the accumulation of retirement assets but fails to include consideration for the critical pre-retirement employment stage. Employees that make no election are supported by the proposed regulation during working years but face an abrupt end to this support at the important decision of using those assets for retirement income.*
>
> *The proposed regulation is seriously flawed since the age based defaults are inappropriate for an employee at retirement. The most important need at retirement is for long-term income and this is true whether the employee is retiring at 40 or at 80 years old.*
>
> *Employees relying on the default will find that their retirement portfolio is very poorly structured to replace a paycheck for the rest of their lives.*
>
> *The proposed alternative of using an average risk is equally inappropriate for the pre and post-retiree. The demographic of the employee base is not applicable to the employee that enters retirement.*
>
> *The Pension Protection Act requires that the default arrangement address the contributions and earnings in the plan but the proposed regulation fails to address the needs of employees at retirement, the time when a default is most urgently needed.*
>
> *The three proposed default alternatives should be amended to require an automatic switch into an appropriate post-retirement fund or portfolio at the time employees are retired.*



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