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SECURE Act 2019: A World of Opportunities for Annuity Carriers

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The Setting Every Community Up for Retirement Enhancement Act of 2019, now referenced as the “SECURE Act of 2019,” was enacted into law in the United States in late 2019 and became effective January 1, 2020. While this appears to be a case of the bill’s authors coming up with the acronym before determining what the letters stood for, that shouldn’t detract from the excitement it should create for annuity carriers.

The SECURE Act achieves its goals on several fronts, including expanding the availability of retirement plans, loosening or eliminating limits on contributions and participation, and generally increasing flexibility regarding tax-qualified retirement savings. As part of this, and the key focus of this article, there was an intentional removal of what were widely considered impediments to offering annuities within 401(k) and other similar defined contribution (DC) retirement plans.

THE OPPORTUNITY

According to research statistics published by the Investment Company Institute (ICI), Americans held \$8.5 trillion in DC retirement plans at the end of the third quarter of 2019. Of that, \$5.9 trillion was held in 401(k) plans, \$1.1 trillion in 403(b) plans, and \$342 billion in 457 plans. These are the three largest types of qualified DC plans in the United States, representing over 24% of U.S. retirement assets. All three were explicitly modified by the SECURE Act to make offering annuities in retirement plans more attractive for consumers, plan sponsors, and annuity writers.

According to other ICI research performed using data through 2016, \$335 billion was contributed into DC retirement plans



in 2016, and that number has been growing at a pace of about 7% each year since 2010. If that growth continues, contributions could well exceed \$400 billion in 2020.

Now consider this: According to LIMRA Secure Retirement Institute, individual deferred annuities contained just north of \$3 trillion of assets at the end of the third quarter of 2019. Of that, nearly 70% is held in variable annuities, which may have relatively less appeal than in the retail market as they would often be competing against similar investments offered within retirement plans. However, variable annuities offer insurance benefits that are generally not available within a typical DC plan and may provide access to some investments not otherwise available under the plan. Accordingly, there will still be a role for variable annuities within a DC plan. Non-variable (fixed, indexed, structured, and payout) annuities, however, likely stand to gain the most. They can be sold as alternatives to fixed income investments and/or lifetime income solutions. As of the third quarter of 2019, contributions to individual deferred annuities were on pace to total \$240 billion in 2019, with just over \$155 billion in non-variable annuities.

A limiting factor in today’s annuity market is that the average American’s knowledge and understanding of annuities is fairly limited. For those of us who have been working in the annuity industry in some capacity, when mentioning to people that “I work with annuities,” the most common response is undoubtedly, “What’s an annuity?” Because of that general lack of familiarity, annuities are much more often sold, not bought, by advisors with the expertise to educate those looking for ways to enhance retirement savings or income. Added to that, many advisors steer clear of annuities for a variety of reasons.

Consequently, there are a few challenges that limit the growth of annuity assets.

- Exposing retirement savers to annuities
- Providing easy access to annuities
- Educating retirement savers about the value of annuities

Including annuity offerings within DC plans will substantially reduce the first two, which easily present the largest hurdles. The third will remain an ongoing, but necessary aspect of offering annuities.

If even 5% of current assets in the defined contribution plans mentioned above finds its way into annuities, that's nearly \$370 billion of assets up for grabs. If only 5% of future contributions flow into annuities, that's conservatively \$20 billion of additional contributions per year and growing. Especially when considering only non-variable annuities, those contributions would drive significant growth in the annuity market.

THE KEY CHANGES

The changes made by the SECURE Act that open up this opportunity relate to two previous impediments:

- Fiduciary responsibility
- Portability

Fiduciary Changes

Previously, under ERISA, an annuity offered within a retirement plan subjected the plan fiduciary to the same duties and responsibilities as applied to any other investment option within the plan. Furthermore, in the case of a breach of fiduciary duties with respect to the annuity, the plan fiduciary was liable for any losses incurred resulting from the investment in the annuity and the insurer's inability to pay the guaranteed benefit.

The burden of the fiduciary duties associated with offering an annuity within the plan, and the potential liability of doing so, significantly reduced the willingness of plan sponsors to offer annuities.

The key change in the SECURE Act is the addition of an explicit safe harbor for annuities. The key parts of this safe harbor explicitly include:

1. The responsibilities of the fiduciary when selecting the insurance carrier are clearly stated and appears to be less burdensome.
2. Fiduciary responsibilities of the plan sponsor are not ongoing after the annuity is elected by the participant.
3. The annuity selected need not have the lowest cost (it is reasonable to believe this could be interpreted to conceptually apply to no longer requiring the highest credited rates and/

or income payouts). The overall value and attributes of the carrier may be considered.

4. Compliance with the above should absolve the plan fiduciary from liability resulting from the insurance company's inability to pay the guaranteed benefit.

Portability Changes

Subject to some limitations and fiduciary responsibilities, plan sponsors are permitted to change available investment options offered within a plan. In some cases, fiduciary responsibilities may require the removal of investment options (even under the new, clearly defined fiduciary responsibilities outlined in the SECURE Act).

However, prior to the SECURE Act, if an annuity was removed as an investment option available under the plan, the participant may have been forced to:

1. Liquidate the annuity, paying any fees or charges associated with such liquidation.
2. Take the annuity as a distribution from the plan, which would be a taxable event and result in an early distribution penalty, if otherwise applicable.

There was no mechanism to move the annuity out of the plan without tax consequences. This reduced the willingness of sponsors to offer annuities and was also a deterrent to participants to elect an annuity, even if the plan made one available.

Various sections of the tax code were amended to address this lack of flexibility. The combined effect of these changes will allow an annuity to be rolled out of a qualified DC plan into an eligible retirement plan, including an IRA or individual annuity, without causing a taxable event or being assessed an early distribution tax penalty.

THE FUTURE

As with any material change in law, there are a lot of unknowns. There is still significant work remaining to understand how to operate within the new law. From there, the administration, distribution, and operations necessary to take advantage of this market present another mountain to climb. However, the passing of the SECURE Act presents incredible growth potential for the annuity industry that is worthy of much attention from carriers.

The purpose of this article was to provide an overview of the changes brought about by the SECURE Act, which creates this opportunity in the annuity market. However, a great deal more remains to be discussed, such as:

- A deeper dive into the changes produced by the SECURE Act that create this opportunity
- The design and pricing of products for this market

- The potential operational challenges and solutions
- The potential distribution models

We anticipate covering various aspects surrounding this topic in more detail in future articles. ■



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