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Auto drawdown on way to becoming new mainstay

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Brenda Grabowski (MGIC) thinks the options could help keep retirees in the company DC plan.

Auto enrollment. Auto escalation. The two have worked hand in glove as 401(k) plan sponsors tried to entice participants to save for retirement.

While the twin auto features are mainstays in 401(k) plans, the popular duo soon might be sharing the spotlight with a new rising star: the automatic drawdown.

As the earliest users of 401(k) plans get ready to retire, employers increasingly are focusing on how to help them manage the task of spending down their savings. Many are providing their retiring employees with 401(k) drawdown options that will allow them to receive regular payments or "paychecks" throughout retirement.

Today, nearly 3 in 5 plan sponsors (57%) offer employees the opportunity to draw down their funds in installments, up from 37% in 2013, according to a report released in January by Alight Solutions. Of the 43% not offering automatic payments, 32% said they are very or moderately likely to offer the capability in 2019.

Many companies are stepping forward knowing that employees need flexible distribution options regardless of whether the industry receives safe-harbor guidance on in-plan annuities. Participants who do not need or want annuities still will need mechanisms to withdraw their funds other than in a lump sum or rollover to an individual retirement account, plan sponsors said.

Mortgage Guaranty Insurance Corp., a publicly traded mortgage insurance company, added installment payments as a distribution option to its $280 million 401(k) plan in 2015. Retirees can choose to receive payments either monthly or quarterly, according to Brenda Grabowski, total rewards manager in MGIC's human resources department in Milwaukee.

In addition, in 2017 the company gave participants the ability to selectively decide from which investment funds the drawdowns should come and in which order, an arrangement that industry experts describe as cutting edge.

Ms. Grabowski said 16 retirees are taking advantage of MGIC's installment and fund-specific withdrawal options. She did not have information readily available as to the total number of retirees eligible for the services.

MGIC decided to give employees drawdown mechanisms because it wanted to encourage them to leave their assets in the plan rather than roll them over to an IRA, where drawdown options are available, Ms. Grabowski said. The decision to "rollover or stayover" — the theme of MGIC's education campaign — leaves employees in "a vulnerable place if they don't have all of the information," Ms. Grabowski said, referring to the lower cost of funds in 401(k)s vs. those in IRAs.

Stemming moves to an IRA

MGIC and other companies trying to help retiring employees with this critical decision know that having drawdown options will affect whether they will roll over their accounts. Without drawdown options, participants are more likely to move their savings to an IRA, a choice that many experts say isn't always in the best interest of participants.

Indeed, the "rollover or stayover" decision has triggered the paternalistic instincts of many plan sponsor executives who worry participants might fall prey to aggressive IRA sales tactics. As a result, many sponsors openly encourage participants to leave their savings in the plan.

"Many employers embrace the philosophy that we want our employees to leave their money in the 401(k) plan when they retire because of the low-cost investment options," said Marina Edwards, a senior director in the retirement group at Willis Towers Watson PLC in Chicago.

401(k) plans offer low-cost, institutionally priced funds that most people would never be able to buy on their own in an IRA, she said, noting that fees for index funds in large plans can be as low as 2 basis points. Ms. Edwards estimates retail investors pay an average of 15 basis points for an index fund in an IRA.

"If we could educate folks that this is a more cost-effective way to hold your retirement dollars and you still got all of the flexibility that you would have in a normal IRA, there's a little bit of, 'Why wouldn't you?' " she said.

Ms. Edwards also noted the added bonus of the low-cost investments being monitored by the plan sponsor.

"Companies and committees have put so much work into their defined contribution plans they recognize that this is a unique vehicle that participants wouldn't otherwise be able to get outside if they took a lump sum," said Greg Ungerman, the San Francisco-based senior vice president and head of Callan LLC's defined contribution practice. "They've built a better mouse trap than you can get in an IRA."

Plan executives shared strong convictions about their views.

"We don't want them to have to take on higher fees," said Dave Lenz, chief operating officer at Regal Ware Inc., a privately held manufacturer of pots and pans in Kewaskum, Wis.

Regal Ware has offered installment payments since 1994 and in 2008 provided participants with the additional ability to make ad-hoc withdrawals whenever they needed funds.

The company is trying to educate pre-retirees about the value of the $44 million plan, particularly with regard to fund fees, which Mr. Lenz said are often much lower than what they would be getting from an outside provider. Mr. Lenz estimates that 42% of retirees have elected either installment payments or partial ad-hoc distributions over the past five years.

Staying in the plan

Kevin Hanney, senior director of pension investments at United Technologies Corp. in Farmington, Conn., echoed similar sentiments.

"One of the things that we've encouraged for as long as I think the plan has been around is for our former employees to leave their money in the plan," he said of the company's $21.5 billion 401(k) savings plan master trust, which includes two separate plans.

Mr. Hanney touted the plan's stable value fund and its annualized return of 3.8%. "Our stable value fund has always been popular with former employees who remain in our plan," he said. Mr. Hanney did not say what percentage of retirees took advantage of the plan's drawdown options. The options are in addition to UTC's qualified default investment alternative, a lifetime income option that works as an insured withdrawal benefit.

The attitude marks a profound shift in plan sponsor thinking. Twenty years ago, the general feeling among plan sponsors toward retiring employees was that "they don't work here anymore; we don't need to serve them," said Kelli Send, the Brookfield, Wis.-based leader of the employee education and advisory services division at consultant Francis Investment Counsel LLC.

Now, employers see pre-retirees and retirees as "folks needing assistance with a lifelong asset," she said.

Some sponsors, like Mortgage Guaranty Insurance, are going the extra mile and allowing participants to take installment payments from specific funds, a feature that helps mitigate the impact of market downturns. The mortgage insurer tapped Fidelity Investments, its record keeper, to work with participants in setting up fund-specific systematic withdrawals.

"We allow that flexibility via our phone reps," said Dave Gray, the Smithfield, R.I.-based head of retirement products and solutions at Fidelity Investments.

An important aspect

The ability to withdraw money from specific accounts is important because it allows participants to pull down funds from money market and stable value funds that are not susceptible to market fluctuations, according to industry experts.

"Having control over which fund to pull from allows you to not sell when the markets are down," said Ms. Send of Francis Investment Counsel.

With or without the ability to make fund-specific withdrawals, 401(k) drawdown options have a big impact on participants' peace of mind. "If you get part of your accumulations in the form of a monthly check, I think that says to the person 'this is money that you can spend,'" said Alicia Munnell, director of the Center for Retirement Research at Boston College.

Retirees risk spending their money too quickly or "husbanding their resources and depriving themselves of stuff that they should be able to purchase," she said.

With automatic distribution payments, retirees can pace themselves and spend their 401(k) checks without worry — the same way they would their Social Security or pension checks.

"I don't think people ever felt like they could not spend their DB pension benefit," said Ms. Munnell. "I think it's about time that these changes are happening."

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