
Can Annuities Slow the Cash-Drain from 401(k)s?

By Kerry Pechter Thu, Nov 19, 2020

The Defined Contribution Institutional Investors Association held its annual Academic Forum virtually this week. The ongoing dilemma for this organization of asset managers and others is: How to keep money in 401(k)s longer.



As they convened virtually for their annual Academic Forum this week, members of the Defined Contribution Institutional Investors Association (DCIIA) faced a stubborn problem: the gradual but unremitting drain of money from 401(k)s and other qualified savings accounts.

DCIIA members include asset managers that distribute target date funds and other mutual funds through employer-sponsored plans. It's a multi-trillion dollar business involving some of the world's biggest financial firms.

When participants change jobs, retire, cash out their plan balances, or take loans from their accounts, money leaves the retirement plans. Much of that money rolls over into IRAs at brokerage firms. That's good for brokers, but it's terrible for asset managers that don't have their own rollover businesses.

It's arguably bad for participants too. First, they may end up with paltry 401(k) balances when they finally do retire. Also, products and services at brokerage firms tend to cost more than in 401(k) plans, for the simple reason that the Department of Labor oversees 401(k) firms but the SEC oversees brokerage firms. (The Obama DOL tried to exercise authority over rollover IRAs with its 2016 fiduciary rule but that rule was shot down in court and left to die by the Trump DOL.)

Since so many financial services firms have fingers in so many different products, it's hard to tell who gets hurt and to what extent. There are partial winners and partial losers. Fidelity and Vanguard are considered immunized because they offer retirement plans and brokerage IRAs.

One way to make 401(k) money stay in 401(k) accounts would be to sell participants annuities and make them customers for life. That's why life insurance companies spent five years pushing for the passage of the SECURE Act, which includes provisions to make it easier for plan sponsors to allow annuities into their investment lineups for participants.

Principal Financial Group's announcement this week (see story in today's issue of *RIJ*) of plans to offer a Pooled Employer Plan (PEP) in 2021 is evidence of the SECURE Act in action. The SECURE Act enabled PEPs, which are 401(k) plans that lots of small and mid-sized employers can join.

Principal's PEP will offer, as an option, Principal's Pension Builder deferred income annuity (DIA). Principal's life insurance company created this annuity five years ago. But the market wasn't as ready then as it is now. An employer joining this PEP will not have to shop around and get bids from different annuity issuers; it can offer Pension Builder.

That's because Principal, as the Pooled Plan Provider (or general contractor of the plan) has partnered with Wilshire, the big defined contribution plan asset manager. Wilshire will serve as the so-called 3(38) investment fiduciary. As such, Wilshire picked Pension Builder to offer as an investment option. National Benefit Services will be the 3(16) administrator of the plan. (If this sounds complicated, it is.)

The PEP provision in the SECURE Act does not explicitly make it easier to bring annuities into plans, but that may be an effect. It may be more compelling than the SECURE Act's "safe harbor," which introduced a not-very-stringent procedure that individual plan sponsors can use to satisfy their fiduciary duties when selecting an annuity provider.

The future of in-plan annuities is likely to involve target date funds. TDFs account for a big percentage of plan assets now. Participants can be defaulted into them. A TDF can be converted to an in-plan annuity option by wrapping a guaranteed lifetime withdrawal benefit around it or tying it to the purchase of a DIA at retirement.

The still-unanswered question is this: Do participants want annuities? Industry-sponsored surveys show that many participants want pension-like income in retirement. But they don't necessarily want to pay for it themselves, and they won't necessarily accept the illiquidity of the contracts. In Pension Builder, participants can liquidate their DIAs, but not without a haircut.

The paradox facing would-be in-plan annuity providers is that the participants who would best benefit from them have the least interest in them. As Michael Finke of The American College pointed out during his presentation at the DCIIA Academic Forum this week, a recent survey showed that people who are college-educated, married, with retirement savings greater than \$250,000, are the least likely to say they would allocate 50% of their 401(k) balance to a guaranteed income stream.

So even if annuities make it into a majority of 401(k) plans as an everyday option, will the optimal client opt into them? Getting the SECURE Act passed, as hard as it was, may have been the easier part.

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