Retirement Income
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Cannex puts 401(k) annuities to the test

By Kerry Pechter *Sun, Feb 2, 2025*

'Insurance companies should all be thinking carefully about this," said Ramsey Clark, CEO of ALEXIncome, with respect to the nascent 401(k) annuity market. 'They need to understand that this is a Once-in-a-Generation opportunity to establish themselves in the 401(k) space.'

Lots of new 401(k) annuity products are being pitched to plan sponsors and their advisors these days. There are in-plan and out-of-plan annuities, deferred and immediate annuities, as well as variable, fixed, and fixed indexed annuities. It's hard to make sense of their differences.

Cannex, the annuity data and analysis firm, recently made the selection process a bit more rational. It conducted that compared and contrasted five different ways that 401(k) participants might convert their savings to income in retirement.

The **research** was sponsored by ALEXIncome, a fintech startup that *RIJ* first **wrote about** in March 2024. Led by CEO Ramsey Smith and partner and head-of-product Graham Clark, ALEXIncome aims to create a platform from which asset managers, life insurers and other plan service providers can launch new products into that space.

Five income options

The Cannex study hypothesized a plan participant, 40 years old in 2023 and with plan savings of $100,000 in a target date fund (TDF). This imaginary participant intends to add $10,000 (increased by 3% each year) to the TDF each year for the next 25 years, and to retire at age 65.

The study then imagines five different paths—each representing one of the most common methods for drawing down 401(k) in retirement—that the participant might take:

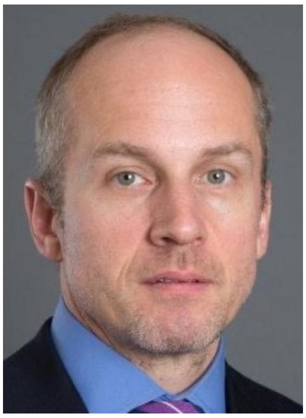
- An *annuitization strategy* where, at age 65, the participant would take the fixed income portion of the TDF (50% of the total TDF value) and buy a *single premium immediate annuity* (SPIA) with it.
- An *annuitization strategy* in which a participant in a *hybrid TDF* would, from age 40 to age 65, contribute to a *fixed-rate deferred annuity* sleeve inside the TDF at age 40 instead of contributing to bond funds. At age 65, the new retiree would convert the deferred annuity to a SPIA.
- A *systematic withdrawal strategy*, where the participant would determine an amount equal to 4% of the final balance of the TDF and spend that amount (adjusting it

upward each year by 2%) starting at age 65.

- A strategy where participants would stop contributing to the bond funds in their TDFs at age 50. Instead, they would contribute to a deferred *fixed indexed annuity contract with a guaranteed lifetime withdrawal benefit rider*. At age 65, the retired participant would start taking withdrawals according to the terms of the rider.
- A strategy where the participant, starting at age 50, pays a fee of 1% per year of the value of the TDF to wrap *a guaranteed lifetime withdrawal benefit rider* around it. The rider establishes a *benefit base* that guarantees the participant a minimum monthly income starting at age 65 without requiring the participant to annuitize the contract.

These strategies were put through 1,000 randomized Monte Carlo simulations of future market conditions to see which one delivered the most income (including income from both the annuity and from the participant's investments) to the participant in retirement. All else being equal, the ALEXIncome came out ahead on several metrics.

Proof-of-concept analysis



Graham Clark

"This was a proof-of-concept analysis," said Clark, noting that ALEXIncome sponsored the study but didn't control the results. "It stacked the proto-type of ALEXIncome's hybrid-TDF against four established, well-known alternative income solutions.

"The question was," Clark said, "'Can we deliver the same level of income, or higher levels, when compared to existing alternatives?' The simple answer is yes. In creating a hybrid defined benefit/defined contribution model within a 401(k), ALEXIncome performs favorably relative to each of the other prevailing options."

Most people don't use SPIAs in retirement—SPIAs have always had much lower annual sales than deferred annuities, and owners of deferred annuities rarely annuitize them—because keeping their life savings liquid and readily available is so important to them.

But many academic studies have shown that one way to generate more retirement income from a limited amount of resources is to divide one's savings between the purchase of an illiquid fixed income annuity and a portfolio of mutual funds.

The 4% rule, by comparison, gives retirees more control over their money but it leaves a retiree's risk of running low on money in old age fairly high. Living benefits, such as guaranteed lifetime withdrawal benefits, provide both guaranteed income and liquidity, but tend to produce less annual income from the same amount of savings as SPIAs.

Both Smith and Clark have Wall Street experience with FIAs. They have found that the costs of the index strategies and the derivatives associated with building FIAs tend to reduce their performance, as does the 1% fee associated with guaranteed lifetime income benefit riders on both FIAs and variable annuities.

Ramsey Smith

"People ask, 'What makes you different?'" Smith told *RIJ*. "We're more interested in creating a benchmark than in differentiation. We want to find a standard that launches the industry in the direction it should take, and that solves a problem for people, rather than to try to come up with a different bell and whistle."

Smith is urging annuity issuers to jump on the 401(k) opportunity. "Insurance companies should all be thinking carefully about this," he said. "They need to understand that this is a Once-in-a-Generation opportunity to establish themselves in the 401(k) space. I don't see any other [distribution] channel that presents as clear a path to re-establishing a footprint in the greenest of green fields or the bluest of blue sky opportunities."

Clark thinks 401(k)s could eventually become the largest annuity distribution channels, but only if the life insurers collaborate on it. “If you had full penetration of the 401(k) market, with 15–20% of total account values in annuities, that would equal the size of the retail annuity market today,” he told *RIJ*. “But you’ll need everyone’s capacity to do it.”