Do In-Plan Annuities Have a Future?

By Kerry Pechter *Thu, Jan 14, 2016*

The latest evidence of the opinions of plan sponsors and plan providers on this topic comes to us via the "2015 Survey of Defined Contribution Viewpoints," produced by Rocaton Investment Advisors. The article contains a link to the survey results.

If anything could breathe new life (and sales) into the annuity industry during a period of stubborn headwinds (the affluent are living longer and a low interest rates are here to stay) it would be the introduction of annuitization options in retirement plans.

In-plan annuities make perfect sense. Minimal distribution costs and institutional pricing could raise annuity payout rates. Participants could get used to the idea of buying future income gradually, and benefit from decades of tax-deferred compounding and interest rate diversification.

While it's true that defined contribution plans were never designed to create income, and aren't easy to re-purpose, they've inherited the job that defined benefit pensions used to do. DB pensions have found new life as fodder for pension risk transfer deals, but the creativity in that space is largely destructive of institutional income strategies.

But such a revolution can't happen—not on a broad scale, outside jumbo plans—without a revolution in the minds of plan sponsors. And plan sponsors have conflicted feelings about annuities. The latest evidence of their views comes to us via the "**2015 Survey of Defined Contribution Viewpoints**," produced by Rocaton Investment Advisors.

[Editor's note: This week's announcement by MetLife that it would spin off some of its insurance subsidiaries might make plan sponsors even more skittish about the stability of in-plan annuity sellers. See today's RIJ **article** on MetLife.]

The Rocaton report would seem to offer encouragement to annuity advocates. When asked to name "the one thing" they would like to change about their plan or plans in general, "include a retirement income solution" was the most popular answer (given by 24% of 100 sponsors and 28% of 199 providers).

Further questioning showed, however, that enthusiasm for in-plan income options is bigger on the sell-side than the buy-side. Only 39% of plan sponsors mentioned "considering a retirement income solution" to be one of their three priorities for 2016. But 62% of the plan providers mentioned "retirement income solutions" when asked what new products they'd like to develop.

The authors of the study remarked at the high rate of interest in DC income. They found it to be inconsistent with "the lukewarm use and reaction to retirement income solutions in other questions" in the survey. But the resolution to that inconsistency could be found in sponsors' answers to the question: "Which retirement income options do you offer?"

Three out of four plan sponsors said they offer "educational or planning tools focused specifically on retirement income." One in four sponsors said they offer participants access to a managed account program with a focus on non-guaranteed income—the most popular of which is Financial Engines' Income-Plus program for retirees.

So, we can't assume that plan sponsors who express an interest in retirement income would use in-plan annuities. About one in six plan sponsors (17%) said they offer participants access to immediate or deferred income annuities through an "annuity window" outside the plan—an apparent reference to Hueler's Income Solutions platform, which is available, for instance, to members of Vanguard's plans.

When asked which retirement income options they might consider adding to their plans or consider appropriate for DC plans, 71% of plan sponsors and providers referred to "education or planning tools." Just over 40% of plan sponsors mentioned an "asset allocation option with a guaranteed income or annuity component." That may have been a reference to the Qualified Longevity Annuity Contracts that the U.S. Treasury Department approved for use within target date funds in defined contribution plans.

For several years, plan sponsors have hinted that they might be amenable to in-plan annuities if the Department of Labor offered a fiduciary "safe harbor." This could be an annuity product or annuity selection process that employers could follow without fear of ever having to pay their employees in case the annuity provider failed and the employees' state guaranty programs also failed.

But insurers should probably not hang much hope on the chance that this will happen. The Department of Labor already offers a safe harbor of sorts—"the best available annuity" language in Interpretive Bulletin 95-1–and has not expressed great interest in going farther.

In short, the Rocaton report doesn't offer any indication that, despite their assertion that the retirement security of their employees is important to them, plan sponsors in general want to bring annuities per se into their plans. Some of the largest 401(k) plans, especially those whose sponsors provided a DB pension in the past and would like to replicate the income benefit without the liability (like United Technologies), may be the most likely to want to work directly with an insurer. Others, not as much.

One could speculate that the state-sponsored mandatory defined contribution plans that are under construction in California, Connecticut and a few other states might, depending on how they evolve, decide to offer in-plan guaranteed income options to their participants at some point. As non-profits, they might not require the same incentives or protections that private plan sponsors and providers need.

At present, annuity issuers can gain exposure to the 401(k) participant market through the Hueler Income Solutions “annuity window.” So far a number of insurers do offer immediate and deferred income annuities through that platform, but others anecdotally haven’t done so because it might compete with and perhaps under-price their retail distribution channels.