Good Day at BlackRock

By Kerry Pechter *Tue, Nov 2, 2010*

BlackRock will use the SPARK Institute's new IT standards to deliver the LifePath in-plan income solution--a deferred income annuity in a target-date fund of funds. "That's a very important step in the evolution of these products in the marketplace," said BlackRock's Chip Castille (above).

One of the obstacles to adding income-oriented investment options to defined contribution plans—options that would give 401(k) participants some of the benefits of a traditional pension plan—has been an absence of recordkeeping standards.

Until recently, recordkeepers had to develop different software for every income product on the market. If one of their plan sponsor clients decided to change recordkeepers or change income products, new software would be needed. To avoid that headache, sponsors avoided income options.

That hurdle has largely been cleared. A task force of IT specialists and managers from 30 interested (and competing) asset managers and retirement plan service providers like BlackRock, The Hartford, Prudential and others, working through the retirement plan services trade organization, the SPARK Institute, have over the past year created industry-wide standards that codify the system requirements for income products.

Where Babel reigned, there's now a common language, and where there were multiple proprietary administrative designs, there's now an open architecture. And "that's a very important step in the evolution of these products in the marketplace," said Chip Castille, head of BlackRock's defined contribution business.

"It makes perfect sense for DC plans to become a source of retirement income," he told RIJ. "And this provides a set of core functionalities that recordkeepers, asset managers and plan sponsors need to deliver income efficiently in a DC plan. This open standard paves the way for income options in DC plans."

"This is intended to be a game changer," agreed Larry Goldbrum, general counsel of the SPARK Institute. "For customer-facing recordkeepers to make income products available, we needed a group of standards. It also helps solve the portability problem." That is, plan sponsors can change recordkeepers with less cost and hassle.

"Our goal was to create a uniform set of standards to be used by recordkeepers and product providers for the various lifetime income solutions that are being rolled out," said Kelly Hewes, director of product management for The Hartford's Retirement Plans Group. "That was our marching orders, to get out standards. Whether the product had a fixed or variable design, recordkeepers could plug these standards in."

The Hartford created an in-plan income option in 2006 but has never taken it live, Hewes said. She noted that, industry-wide, there are "about eight in-plan options active and four to seven more in development."

The rise of in-plan guaranteed income options also allows insurance companies to participate in the $4 trillion defined contribution market.

Some of the best-known products are Prudential's IncomeFlex, MetLife's Personal Pension Builder, Great-West's SecureFoundation, Genworth's ClearCourse and John Hancock's GIFL. More recently, Mutual of Omaha and Diversified Investment Advisers have introduced options. The products include deferred income annuities as well as variable annuities with guaranteed lifetime withdrawal (GLWB) or guaranteed minimum income benefits (GMIB), usually combined with target date funds.

It's too early to celebrate a new era in DC plans, however.

Jamie Kalamarides, senior vice president of Retirement Strategies & Solutions for Prudential Retirement, whose company offers a stand-alone living benefit that guarantees lifetime payouts from target date funds, said, "It's like creating an MP3 standard. It allows providers to have a standard way of communicating with recordkeepers. It's a necessary but not a sufficient condition" for making more plan sponsors willing to adding annuity or annuity-like options to their plans.

Other critical steps include Department of Labor clarification of its guidelines for acceptable participant education and advice practices and passage of proposed legislation around reporting the performance or projected outcomes of income options on participant statements. Most importantly, providers want a more specific "safe harbor" that identifies a method for choosing an annuity provider that will exempt plan sponsors from responsibility for a provider's failure to fulfill its obligations.

SponsorMatch Becomes LifePath

The fruits of the standards appeared almost immediately, when BlackRock and SunGard announced a software partnership, based on the standards, that would make it easier for plan sponsors to adopt BlackRock's LifePath Retirement Income Program, which puts a deferred income annuity inside one of BlackRock's existing LifePath target date funds.

LifePath Retirement Income was first introduced in late 2007 as SponsorMatch. It allowed plan participants to direct their personal 401(k) contributions into target date funds provided by asset manager BlackRock (created when Merrill Lynch spun off its proprietary mutual funds; Barclays Global Investors and iShares are now part of it) and directed their sponsor's matching contribution into ladders of deferred income annuities provided by MetLife.

That product, introduced just before the financial crisis, made little headway in the market. Castille was reluctant to say how many plan sponsors adopted it or how many assets it attracted, if any. At some point, with no public announcement, the name SponsorMatch and the idea of dedicating the match to the income annuity were abandoned.

In its current form, Castille said, the LifePath program invites participants to invest in age-appropriate target date funds. The TDF fund manager will direct part of the contributions into underlying mutual funds and part into the annual purchase of a deferred income annuity. When the participant retires, and the target date fund reaches “maturity,” 53% of the fund assets will be invested in a fixed annuity, Castille said.

Since target date funds are Qualified Default Investment Alternatives, he said, plan participants can be defaulted into the product when they join the plan. When they leave the plan or retire, participants can either take the income or opt for a lump sum equal to the “fair value” of their account, based on their contributions and interest rates. Since the annuity is part of the TDF, Castille said, “We believe it meets QDIA standards.”

Establishing standards “wasn’t difficult from a computer programming standpoint,” said Goldbrum. It mainly involved defining the types of data that various income products will require from plan participants, providers and sponsors.

“But at the beginning stage of the initiative I thought there was no way we’ll get this done because there were so many different service models,” he said. “It was hard to imagine how we would get our arms around everything and get one set of standards that everyone could live with. But we did it.”

Industry observers welcome the development. “The SPARK standards… remove one of the biggest obstacles to bringing DB into DC plans,” said Garth Bernard, CEO of Sharper Financial Group and a long-time advocate of income annuities.

“No one could administer [an income product] except the product provider on its own proprietary platforms—which by definition is not a shining example of an open market. SPARK in effect cleared the junk out of a stopped sink,” he added. “Now there is an opportunity for unbridled innovation in the DB-in-DC arena.”

There are still unresolved questions, however. The standards increase portability for plan sponsors, but not necessarily for participants. For instance, a participant who owns a plan’s LifePath fund can’t keep contributing to it when he leaves that plan, and he can’t roll it into an IRA because it’s part of a collective investment trust (CIT). To consolidate it with another tax-deferred account, he’d have to cash out of it.

Like the 401(k) system itself, the in-plan income options themselves are likely to work better for some participants than others. They’ll probably work best for highly compensated employees who spend many years in a single plan and who can afford to make five-figure contributions each year. They won’t work as well for average workers who change jobs several times during their careers. In short, they bring back some of DB’s advantages, but also some of its flaws.