In-Plan Income, the Mutual of Omaha Way

By Editor Test *Tue, Sep 21, 2010*

Mutual of Omaha, in a program led by retirement plans product leader Tim Bormann, offers a deferred income annuity option called the Lifetime Guaranteed Income Account to small and micro plan sponsors.

Executives from Mutual of Omaha didn't participate in the Department of Labor hearings on "in-plan" or 401(k) annuities in Washington last week. That's not because they weren't interested, but because they've been too busy implementing the kind of plan that the hearings envisioned.

Starting last March, Mutual of Omaha Retirement Services quietly began offering some of its 5,000 institutional clients, most of whom are sponsors of small and "micro" retirement plans, a voluntary deferred income annuity option called the Lifetime Guaranteed Income Account (LGIA).

So far, says Tim Bormann, Mutual of Omaha's retirement plans product line director, about 80% of the new plan sponsors who've been offered the option have agreed to make it available to plan participants. United of Omaha Life underwrites the product.

"We're addressing many of the concerns voiced by plan sponsors following the recent market downturn," Bormann said in a published statement last spring. "We're removing the ambiguity from retirement savings and reducing risk. With the Lifetime Guaranteed Income Account, a participant's retirement income will be known, shown and guaranteed."

The program bears certain similarities to SponsorMatch, the program launched by MetLife in 2009 that combines a deferred income annuity, funded by the employer match, with a participant-directed investment account, funded by the employee's contribution. And it's not unlike The Hartford's Personal Retirement Manager "two-cylinder" deferred variable annuity.

By encouraging the purchase of future income credits, and reporting account balances as both as a lump sum and as a rate of retirement income, programs like MetLife's or Mutual of Omaha's accustoms a participant to regarding his or her 401(k) as a source of retirement income rather than as an investment account.

By locking in future income, such a program also maximizes the time value of money and spreads interest rate risk over many years or even decades. From a behavioral standpoint, it will presumably help diminish a participant's natural resistance to parting with a large lump sum all at once at retirement.

One outside observer thinks the plan reflects progress for the entire field.

"As I understand the product, since the units are purchased on a per paycheck basis, the participants are also essentially dollar-cost-averaging interest rates, and, to a lesser extent, mortality," said Jay DeVivo, founder of String Financial LLC, a provider of 401(k) participant advice and managed accounts.

"Once this generation of products becomes established and consumers become better educated on concepts such as mortality credits, I'm hopeful that products like ALDAs (Advanced Life Deferred Annuities) that are less flexible but have greater income producing leverage can flourish."

How the LGIA works

As Bormann explained to RIJ, the process works like this: the 50 investment options under a Mutual of Omaha institutional plan include a Guaranteed Account and the LGIA. Contributions to either account earn a fixed rate that floats from month to month, but every contribution or matching contribution that's directed to the LGIA—by employer or employee—purchases an increment of future guaranteed income and earns 50 basis points less (as payment for the guarantee).

In 2010, the rate on the Guaranteed Account has ranged from 1.5% to 2.5%. The value of future income is calculated based on an assumed interest rate of 4% and a retirement age of 65. Regarding gender issues, a unisex mortality table is used and the annuity purchases do not trigger Qualified Joint and Survivor Annuity requirements.

"The LGIA actually has two components. There's the account balance that's growing at the credited interest rate, and there's a second guarantee that says, 'If you put in, say, $5,000 a year, I can tell you exactly how much income you'll get when you're 65,'" Bormann said. "The underlying investments in the two accounts are identical. The difference is that the credited interest rate is 50 basis points lower on the guaranteed side."

The program allows plan sponsors to offer something tantamount to a defined benefit plan. "We've had plan sponsors ask, 'Why don't I just function like a pension plan, since you're basically providing a guaranteed amount.' One strategy we think will be attractive is the concept of offering the LGIA for employer contributions and let them offer a quasi-defined benefit plan," Bormann said.

In designing the program, Mutual of Omaha anticipated the usual objections to in-plan annuities. For instance, participants can change their minds and move money from the LGIA to another investment option within the plan and back again, with a minimum of 60 days between round trips. In the meantime, however, they lose the guarantee—and the time that their future income could have been growing.

Contributions to the LGIA go into the general account at United of Omaha Life, but the insurer maintains adequate liquidity to allow transfers out of the account. (The cost of maintaining the liquidity is factored into the rate credited to the GA and LGIA accounts.)

At retirement, participants can take a lump sum or buy an income annuity, on whatever payout terms that United of Omaha offers. They can also roll their lump sum into an IRA and purchase an income annuity at The Hueler Companies' Income Solutions platform. (Mutual of Omaha, along with about a dozen other insurers, distributes its income annuities through the Hueler's competitive bidding platform.)

If a participant leaves the plan before retirement—as, presumably, many will do—they can preserve their income guarantees when they leave by rolling their LGIA into an IRA. If the plan sponsor decides to change providers and discontinue its relationship with Mutual of Omaha, the LGIA can stay with the plan as a "frozen option," Bormann said, meaning that it no longer accepts contributions.

As for the typical plan sponsor's greatest anxiety—that the in-plan annuity provider they choose will someday go out of business, fail to fulfill its obligations and trigger a raft of lawsuits and claims against the sponsor—Mutual of Omaha relies its long history, its survival of the financial crisis without significant damange, and the high level of participant control built into its program, to reassure potential sponsors.

Expressing today's savings as tomorrow's income

One of the public policy initiatives discussed at last week's Department of Labor and Department of Treasury hearings on in-plan options was the introduction of 401(k) account statements that display each participant's accumulated savings as both a lump sum and a future monthly income.

Mutual of Omaha's program does that. On their quarterly statements, and at each plan's website, participants can see their accumulated savings expressed both as a lump sum and as the monthly income stream that they've already purchased through the LGIA.

During the hearings in Washington, several plan providers expressed uncertainty about how to express future income—whether to base the figure on the amount already saved or to create projections and estimates based on assumptions about future contributions and rates of return. Some asked the Department of Labor to write guidelines for expressing future income in a fiduciary or compliant manner.

There is some concern that younger participants might be discouraged by the relatively small amounts of monthly income that their past contributions have purchased. Mutual of Omaha has chosen the more conservative route and provided only income that has been purchased, while offering participants an online calculator to test a variety of strategies and assumptions.

"One of the failings of the [retirement] industry is that we've focused on the account balance, rather than on how much income the participant will get at retirement," Bormann said. "We're trying to get them focused away from the account balance."

Jay DeVivo agrees. "I think it is important to reorient participants away from a 'magic number' they should have accumulated by retirement and toward retirement income, particularly guaranteed retirement income," he said.

"I think the risk of outliving one's assets has been so broadly reported and discussed, along with the demise of the pension, that it is no longer an industry talking point, but a risk widely recognized by individual investors. Since the vast majority of retirement savings is done through an employer-sponsored plan—upwards of 80% of IRA assets originate from a DC plan as well—in-plan products and guarantees are going to become the rule rather than the exception."