It’s Back: The Hartford’s In-Plan Income Annuity

By Editor Test *Thu, Oct 20, 2011*

With United Technologies' recent adoption of an in-plan annuity, it now appears more likely that guaranteed income will eventually become commonplace in the defined contribution space. The Hartford, after a false start, has jumped back in that game.

The Hartford has introduced a new version of its Hartford Lifetime Income (HLI), a deferred income annuity option for defined contribution plan participants that was first introduced before the 2008-2009 financial crisis but wasn’t adopted by any retirement plans.

The product allows participants to buy $10 increments of retirement income, with the cost of each increment dependent on the age of the participant and prevailing interest rates at the time of purchase. The contributions go into Hartford’s general account.

As for the timing of the reintroduction, “Recordkeepers are becoming more interested in income. We’re seeing income options requested more frequently in RFPs [requests for proposals] and income is showing up more often in our conversations with clients,” said Pat Harris, The Hartford actuary who designed the product.

The Hartford is currently proposing HLI to new 401(k) recordkeeping and investment clients in the small to mid-sized plan market, and will offer it to existing recordkeeping clients next year. It intends to start accepting contributions on January 1, 2012. The Hartford’s recordkeeping system is on the “RICC” (Retirement Income Information Clearing and Calculation System) middleware platform created by DST Systems, which gives plan sponsors flexibility to change recordkeepers.

This is a somewhat different approach than HLI’s first marketing effort, which found no takers. “Our DCIO [Defined Contribution Investment-Only] income product did not get traction in the large corporate market as these companies generally have not been early adopters for guaranteed income options. The experience did help us mold our new product for the bundled 401(k) market,” said David Potter, a company spokesman.

The investment option is also included at no additional cost in the Fiduciary Assure program, an optional, third-party co-fiduciary service provided by Mesirow Financial.

Encouraging plan sponsors to add lifetime income options to defined contribution plans has been a priority of the Department of Labor in recent years, and the government’s interest dovetails with the insurance industry’s interest in entering the $4 trillion DC market as well as the interest among DC asset managers in continuing to manage client assets even after they leave a plan or retire.

A split still exists between proponents of “in-plan” and “out-of-plan” income options. With the in-plan type, income guarantees are applied to plan assets while the money is still in the DC plan. United Technologies’ jumbo plan, for instance, adopted the AllianceBernstein in-plan stand-alone-living-benefit product, which is backed by three insurance companies, two weeks ago.

With the "out-of-plan" options, the participant rolls assets out of the plan and into an IRA before buying an annuity. The Profit-Sharing Council of America favors the simplicity of this approach, and it has a relationship with the Hueler Income Solutions platform, where retired 401(k) participants and others can roll plan assets into a single-premium immediate annuity at institutional prices.

All of the in-plan annuities allow participants to change their minds and liquidate their contributions to the income option during the accumulation stage. Contributions to the plan have cash value and are not life-contingent.

Under the first iteration of The Hartford Lifetime Income, the cash-out value was calculated by taking the current share price of $10 of monthly lifetime income at age 65 (adjusted for the age of the participant and current interest rates), multiplying it by the number of shares the participant had already bought, and taking 96% of that. The death benefit, however, was equal to the amount contributed to the annuity by the participant.

Under the just-announced version of Lifetime Income, there's no flat 4% reduction in the value of the share price, which is updated daily for each participant, reflecting his or her age and current interest rates. "If you decide that you don't want the guarantee, you receive the stated value of the account," Harris said. "The cost of the ability to cash out is included in the pricing." In addition, the death benefit and the cash-out value are now the same.

"The change we made was to have the death benefit now equal the cash-out value instead of the annuity-like cash refund amount. In the prior product, the death benefit amount was not as readily available," said David Potter, a company spokesman.

The daily price of an income share moves in the opposite direction of interest rates, but in the same direction as the age of the participant. The cash-out value can fall if interest rates rise or rise if interest rates fall, said Chris O'Neill of Mesirow Financial, who has reviewed the new version of the Hartford product. But there's a cap—the cash-out value can't exceed the value of contributions accumulated at a 3% annual interest rate.

"The income shares are portable, which means that a plan participant can retain the shares and the guaranteed income they provide if he or she changes employers, or the plan sponsor changes providers or recordkeepers," The Hartford said in a statement.

O'Neill thinks the tweaking of The Hartford product is linked to the recent development of recordkeeping standards for in-plan annuities. "This is consistent with the SPARK Institute data standards initiative to establish what data fields recordkeepers need to provide," he told RIJ.

"It's in keeping with an industry-wide move to let the participant see a definite cash value. But there are still no standards for reporting in terms of a current balance and equivalent income. It's incumbent on each product provider to provide the cash-out value in their own way."

On the question of how the presentation of the cash-out value might impact participant behavior, O'Neill said, "In the absence of an explicit fee for moving out of the product, if the participants can look at their cash-out value and appreciate how much future income they'd be giving up, then it could be a disincentive to moving money out of the annuity."

Mutual of Omaha offers an in-plan deferred income annuity that works a bit differently from The Hartford's. Each monthly contribution to the Mutual of Omaha product is assigned a fixed, five-year accumulation rate. Contributions buy lifetime income units and build an account balance that's fully liquid until annuitization. A withdrawal from the account reduces the amount of guaranteed income on a pro rata basis. (See the Institutional Retirement Income Council's website for information on many of the available in-plan options.)

At retirement, the Mutual of Omaha client receives whichever payout is higher—the one guaranteed under the terms of the in-plan product or the one that can be obtained by applying the current account value (adjusted for withdrawals, if any) to the purchase of a single-premium immediate annuity at prevailing rates.

How plan participants will actually use such products remains to be seen. Just as defined benefit plan participants currently do, defined contribution plan participants who contribute to an in-plan annuity like the ones offered by The Hartford and Mutual of Omaha will inevitably compare the guaranteed income stream to the cash-out value at retirement and try to decide which is more valuable to them at the time.

Product manufacturers hope that plan sponsors and plan advisors will educate participants about the insurance value of the annuity, and make sure they don't shortsightedly discount the hard-to-quantify protection that it can give them from longevity risk. Without liquidity, in-plan annuities would obviously never get started. With liquidity, however, many of the purchasing decisions probably won't last. A clear behavioral trend may not reveal itself for years, or even decades.