Plan Experts Like Annuities

By Kerry Pechter *Thu, Oct 21, 2010*

In a workshop at this week's ASPPA annual meeting in Washington, D.C., few third-party administrators believed that the average couple will be able to afford the retirement they dream of. Many people, they said (including themselves), will need annuities.

Only five or six hands wavered upward during a workshop on retirement income at the ASPPA conference Tuesday when the roomful of third-party qualified plan administrators was asked if participants in their plans were likely to buy annuities.

But a pale forest of arms rose in unison when the speaker asked the 150 or so TPAs packed into the windowless hotel meeting room if *they* would buy an annuity with their tax-deferred savings.

That's barely "anecdotal" evidence, as researchers say. But it suggested that members of the American Society of Pension Professionals and Actuaries—the ERISA wonks who will help decide whether qualified plans adopt lifetime income options—understand the utility of guaranteed products on a very personal level.

The ASPPA annual conference drew over a thousand TPAs, attorneys and actuaries to Washington, D.C. earlier this week. In addition to general sessions headlined by conservative columnist George Will and Department of Labor official Phyllis Borzi, there were 70 workshops. Only a handful of them dealt with lifetime income.

For logical reasons. Most TPAs are too busy directing and recording the traffic flow of contributions, investments, fees, loans and distributions in their plan correctly, filing Form 5500s on time, keeping the plan compliant and avoiding participant lawsuits, to think much about retirement income storm that's still on the horizon.

On the other hand, the retirement crisis is already bedeviling them. It pressures them to reduce fees so that nest eggs can grow bigger, to choose less risky target date funds so that nest eggs don't fall victim to sequence risks and to start learning about in-plan income options.

It also pressures them to implement auto-enrollment so that governments don't inherit a cohort of elderly mendicants, and to provide decumulation education to complacent participants without driving up costs. Increasingly, it's forcing them to look up from their spreadsheets and legal codes and respond to a long-range threat.

Three income workshops

Of the three workshops on retirement income issues, one was called Retirement: "The New Normal," Nevin Adams, editor of PlanSponsor magazine, revealed a few alarming statistics showing that plan sponsors are awakening very slowly the retirement income dilemma.

For instance, in a poll conducted at a recent PlanSponsor conference, only 10% of attendees had an income replacement ratio in mind, only 28% said they thought their plan participants would be able to retire comfortably, fewer younger workers are saving for retirement today than were 10 years ago, and the adoption rate of auto-enrollment mechanisms by plan sponsors has slowed to a trickle because sponsors want to limit matching contributions.

Michael E. Callahan, the host of a workshop on retirement risks and a workshop on "Lifetime Income for DC Participants," was unable to attend the conference. Callahan, former president of Pentec, Inc., a 401(k) consulting firm, is now the president of Edu4Retirement, a Southington, CT, startup participant education company formed last July.

Callahan's slides were available, however, and were delivered by others. The slides on lifetime income didn't focus on in-plan income options. Rather, they presented Callahan's retirement income planning process, which is admittedly derived from the "build a floor, then create upside" philosophy endorsed by the Retirement Income Industry Association and described in the RIIA's "Body of Knowledge" for its new designation, the Retirement Management Analyst.

As presented by Peter Swisher, a pension consultant at Unified Trust Company, Lexington, KY, Callahan believes that anyone who can afford not to spend more than 4.5% of their savings each year in retirement doesn't need an annuity besides Social Security. But anyone who will need to draw down seven percent or more per year, he said, will need to put virtually all of their money in bonds or annuities.

Only people with more money than they need to pay their living expenses can afford to take risks with their money, the presentation suggested. Many money managers tell their clients that they need to invest in equities throughout retirement as an inflation hedge, and many investors go up in risk out of necessity. Highly unwise, in Swisher's opinion.

Three buckets

In one example, Swisher described a low-risk, three-bucket income strategy for a retired couple with $600,000 in assets (not including home equity) and a need for $24,000 a year in addition to Social Security. The strategy called for the investment of $231,000 in bonds in the first bucket for 10 years of income, $179,000 in stocks and bonds for 10 years of growth before conversion to income, and the rest to be used for the purchase of an annuity at age 85, if needed. Until then, it would sit in diversified investments.

Although Swisher said he finds single-premium immediate annuities valuable, he recommended against purchasing one at age 65, before the mortality credits gain value, and not in the current interest rate environment, when the yields on SPIAs are so low.

It was clear that participants need more information about turning their savings into income. But education costs money, and it's not clear who should pay for it. Especially stubborn is the problem that only a minority of participants, particularly those who are older and have higher balances, are interested in learning to plan.

The participants who are most at risk for poverty in retirement aren't saving enough, are borrowing from their accounts, are spending their assets when they change jobs, and, in many cases, don't have the background needed to fully understand the risks and solutions that they face.

Brochures with pictures of slim, silver-haired retirees relaxing in white Adirondack chairs at the end of a pier beside a blue lake only turn them off, said George J. Taylor, a plan advisor from Muncy, PA. "They regard that type of future as unattainable," he said. "It just turns them off.