
Principal Adds 'In-Plan' Deferred Income Annuity Option

By Kerry Pechter *Fri, Oct 23, 2015*

Participants in Principal Financial defined contribution plans will be able to buy deferred income annuities a little at a time or in a lump sum just before retirement.

Principal Financial, the full-service provider of 35,000 mostly small to mid-sized defined contribution (DC) retirement plans, this week introduced a flexible-premium, unisex-priced deferred income annuity (DIA) as a stand-alone investment option for plan participants.

Called Pension Builder, the new institutional DIA is now being offered to plan sponsors for participant contributions next March, according to Principal. Contributions to the DIA purchase a set amount of guaranteed income for life, backed by Principal's general fund. Contributions aren't irrevocable; participants can transfer their contributions out of Principal Pension Builder and surrender the annuity, subject to certain restrictions and a potential surrender charge.

"We see two purchasing scenarios," said Jerry Patterson, senior vice president of retirement and investor services. "One scenario might involve a lump sum purchase of the DIA by, for instance, a 58-year-old who's retiring in two years. The other scenario might involve someone aged 50 or even younger, who purchases a chunk of income with each contribution."

As of June 30, 2015, Principal plans included some 4.2 million participants with more than \$156 billion in assets. In the individual annuity market, Principal posted variable annuity sales of about \$542 million (ranked #20) and fixed annuity sales of about \$930 million (ranked #16) in the first half of 2015, according to the LIMRA Secure Retirement Institute.

For the past decade, large life insurers have tried in various ways to bring the essence of a defined benefit plan—guaranteed lifetime income—to DC plans. In 2004, MetLife introduced the Personal Pension Builder, which was similar to Principal Pension Builder. It was that marketed to participants in retirement plans administered by Bank of America/Merrill Lynch.

A variety of income delivery structures have been developed and/or brought to market. Prudential, Empower, and John Hancock offer guaranteed lifetime withdrawal benefit wrappers around their proprietary target date funds. Participants in Vanguard-administered plans can easily roll 401(k) balances to an immediate or deferred income annuity at the

Hueler "Income Solutions" web platform.

Alliance Bernstein and three insurers offer a DIA option as a sleeve inside a target date fund. Voya has a similar option in its plans. Last May, MetLife introduced Retirement Income Insurance, which allows participants in 10,000 MetLife plans to buy an institutionally priced MetLife QLAC (Qualified Longevity Annuity Contract) at the point of retirement but without a rollover. MassMutual has a program that allows participants to buy retirement income in \$10 per month increments.

Patterson said that Principal decided to offer a stand-alone DIA because it was "simpler" than the VA/GLWB. "I'm very familiar with that benefit [the GLWB] in the advisor-driven world, and there's a lot of complexity in those designs. When the DIA emerged, we saw that it's easy for people to get their heads around. We sell the GLWB in the retail world, but we would have a hard time deploying it in the institutional world," he told *RIJ*.

"The next step after a stand-alone DIA," Patterson told *RIJ*, "would be to integrate the DIA with a TDF offering. Principal is a large purveyor of TDFs, and we're developing toward a TDF solution next year. Participants could be defaulted into that, and they could opt out if they want to."

While many employers have shown an interest in in-plan deferred annuities, the market has been slow to develop. Certainly the financial crisis and low interest rates (which mean high prices for annuities) haven't helped. But there's also a regulatory hurdle. Employers are hesitant to maintain lifelong ties to former employees and they're afraid that they might end up liable for annuity payments if the annuity issuer went broke. The Obama Administration has been an advocate of turning the DC into a true income vehicle. The Treasury Department last year announced that a qualified DIA called a QLAC could be offered as a default option when included in a TDF.

"Washington, plan sponsors, providers, and participants increasingly agree on the objective of greater retirement security and the role of DIAs as means of securing greater income," said Mark Fortier, director and co-head of the DC business at NISA Investment Advisors. At Alliance Bernstein, he served as the architect for an in-plan annuity option in a TDF at United Technologies. "The strategic question is how to weave the DIA into the fabric of a DC participant's lifecycle and reframe savings as an outcome—in the form of retirement income they can't outlive."

In-plan deferred annuities could also help solve one of the key behavioral obstacles to

buying annuities. "It's much easier to move small amounts of money over time rather than lump sums all at once," said Jody Strakosch, a Minneapolis-based retirement consultant, board member of the Defined Contribution Institutional Investment Association.

"You also need to display the amount of future income that has been purchased." As for the lack of demand for annuities from plan participants, Strakosch said, "Participants don't know to ask for something that's not there yet. Was anyone demanding an iPhone before Steve Jobs invented it?" said Strakosch, a former MetLife executive who ran an innovative DIA program for 401(k) participants, now called LifePath Retirement Income, in concert with BlackRock (then BGI) prior to the financial crisis.

When DIAs are offered in retirement plans, they're priced differently from retail DIAs. Institutional products are, in theory, cheaper than retail, because they don't involve the cost of a selling agent. Annuities in ERISA plans must use gender-neutral ("unisex") pricing, which makes them cheaper for women and more expensive for men than retail annuities, where the price accounts for the shorter average life expectancies of men. A big benefit of the flexible premium DIA is that plan participants could "dollar cost average" into their annuity, thus diversifying their interest rate risk—and letting them benefit if interest rates rise.

With Principal Pension Builder, participants can transfer up to 50% of their plan account balances (minus outstanding loans) and direct up to 50% of contributions to the DIA. The minimum contribution is \$10 per transfer. The higher the prevailing interest rate and the younger the participant at the time of each contribution, the more future income each contribution will buy. Regarding portability, as long as at least \$5,000 has been contributed to the DIA, employees who leave the plan "can retain their guaranteed income through a deferred annuity certificate," a Principal spokesperson said.

In calculating future income, Principal assumes that participants will elect a single life annuity with a 10-year period certain and will start income at age 65. In practice, however, participants have flexibility. They can choose from a variety of annuity forms, including life-only, joint and survivor, and cost-of-living-adjusted, for instance. Income must begin no earlier than age 59½ and no later than April 1 following the date the client reaches age 70½.

If the participant dies before the income date begins, the sum of the contributions to Principal Pension Builder minus any previous distributions or surrenders or applicable surrender charges is distributed to beneficiaries, like any other retirement account at death.

A spousal beneficiary may instead elect to receive the guaranteed income payments as an annuity based on his or her own age.

“We’ve been getting lots of positive feedback from plan sponsors on it,” Patterson told RIJ. “But until the rubber actually meets the road, you never know.”

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