Why most 401(k)s don’t offer in-plan annuities

By Editorial Staff *Thu, Oct 5, 2017*

Technically, the 401(k) is a profit-sharing plan, not a pension plan. Under federal law, only pension plans need to offer in-plan retirement income options. A new TIAA whitepaper explains.

Many decumulation mavens would like to see inexpensive, gender-neutral annuities added to 401(k) investment lineups, even though most plan sponsors don’t want them. But do most people know why most401(k) plans–the most prevalent retirement savings plan in America–don’t offer any income option?

A new **white paper** from TIAA called “Closing the Guarantee Gap” answers that question.

The 401(k) concept appeared in the 1980s as a type of profit-sharing plan, not as a pension plan, the paper explains. Since the Employee Retirement Income Security Act, or ERISA, requires only pension plans to offer income options, 401(k)s didn’t have to.

Then, in the early 1990s, the Department of Labor, in response to an annuity provider default, tightened regulation of annuities in retirement plans. Rather than regulate providers more closely, it put the burden for choosing a safe annuity provider on plan fiduciaries, making them more annuity-shy.

Until the turn of the century, money purchase plans, which are pensions and did offer annuities, competed with 401(k)s. But in 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) “equalized the deduction limit for money purchase plans and 401(k) profit-sharing plans at 25% of compensation. Almost immediately, corporate employers abandoned money purchase plans for 401(k) profit-sharing plans,” said the TIAA white paper.

The 401(k) rapidly emerged as America’s primary retirement savings vehicle. But because these plans are, technically, profit-sharing plans and not pensions per se, labor law doesn’t require them to include in-plan annuity options. In fact, as noted above, the DOL has made plan sponsors more wary of them.

In the white paper, TIAA identifies three major weaknesses in the U.S. retirement system:

- Coverage Gap. Not enough Americans have access to a workplace retirement plan;
- Savings Gap. Even if they have access to a retirement plan, many Americans aren’t saving enough; and
- Guarantee Gap. Few plans provide resources such as annuities to guarantee savings will last throughout retirement.

To solve the Guarantee Gap, TIAA recommends the following actions:

- Simplify the safe harbor for employers selecting an annuity provider
  2. Increase the portability of annuity contracts
  3. Broaden the qualified default investment alternative (QDIA) regulations so that annuities can

become default investments
4. Provide retirement savings plan participants with an annual lifetime income disclosure statement
5. Give participants more access to flexible income distribution options
6. Provide favorable tax treatment for annuity income in retirement