



Plan Sponsors Have Multiple Options for Creating Income Streams for Participants

Annuities should be considered, and the type to offer in a DC plan depends on several factors.

Reported by [LEE BARNEY](#) | Art by TIM PEACOCK

ANNUITIES HAVE A PLACE in defined contribution (DC) retirement plans, and sources say [should the SECURE Act get passed](#) and provide additional safe harbor clarification to sponsors, more sponsors are likely to warm up to the idea of offering annuities and guaranteed income choices to their participants.

“The greatest innovations in annuities are taking place among fixed annuities, and developing regulations to catch up to this innovation so that [they can be default investments](#) will be the next frontier in retirement plans,” says Doug McIntosh, vice president of investments at Prudential Retirement. “If we want to move the needle for deserving American workers, we have to offer fixed annuities as the default, and we know the strongest force in defined contribution plans is participant inertia. This is something to keep an eye on from both a product and regulatory perspective.”

“Any product that can help provide a reliable stream of income would be valuable,” agrees Dana Hildebrandt, director of investments at Willis Towers Watson. “But an important part of annuities being offered is adoption. Plan sponsors have more options today than they did 18 months ago. The key is getting them educated about these options.”

Paul Richman, chief government and political affairs officer at the Insured Retirement Institute, is optimistic that the SECURE Act could be a game changer when it comes to sponsors’ confidence in offering annuities in their plans. While the [Department of Labor has offered safe harbor](#) to sponsors to offer annuities, those safe harbors “still include liabilities in terms of requiring sponsors to look at the financial capability of the provider of guaranteed income at the time of selection as well as the cost,” Richman says. “The problem is that employers, particularly small employers, don’t have that expertise. The bill provides clarification to say that sponsors can rely on the judgement of state insurance regulators, which are consistently auditing, examining and regulating the insurers, and one of the key things they are looking for is their financial strength.”

Richman says the SECURE Act would make a “significant difference because it would reduce [plan sponsors’] current liabilities, which are tremendous. Annuities are the only solutions that protect people from outliving their savings. We think that providing this clarification will reduce sponsors’ reluctance to consider annuities for their plan menus.”

In fact, sponsors are already showing interest in annuities, Hildebrandt says. Willis Towers Watson surveyed plan sponsors about lifetime income offerings in September and [found an increased interest](#) in lifetime income solutions, including balanced funds tied to an annuity, she says. “The interesting and exciting part about this for us is there are so many more products on the market today that incorporate an income component for a qualified plan,” Hildebrandt says. “The peer universe is getting much larger, making it more palatable for sponsors to offer annuities, and anything that helps participants create a stream of income is a win.”

For sponsors looking to offer annuities, the first question they should ask themselves is whether they want to offer a fixed or a variable annuity, says Bob Melia, executive director of the Institutional Retirement Income Council. “An employer with a defined benefit plan that was



Both variable and fixed annuities have pros and cons, McIntosh says. “What is wonderful about fixed annuities is that they deliver a predictable stream of income, and dollar for dollar, at the time of purchase they will almost always deliver more income than a variable annuity,” he says. “The reason for that is when you purchase a fixed annuity, you are yielding control over the underlying assets to the backer of that product. I could live to 105 and still be paid. The flip side is that with a variable product, you have potential upside and always have access to the underlying assets during the accumulation phase, which can be useful if you face unexpected needs.”

Fixed annuities pay the same amount each month, while variable annuities pay an amount that depends on the investment performance of the investments held by the particular annuity.

It is also important for companies to analyze their human capital and their longevity in the workforce, he adds. “A firm comprised of architects and engineers who can work late into their lives, who offer a high level of human capital and are well sought after, has workers who can take on more equity risk and would probably do better with a variable annuity,” Melia says. “A company whose work is physically demanding has employees who might retire early, and they might be better served with a fixed annuity so that they have retirement security throughout their lives.”

Companies that have a mixed workforce might want to offer a couple of retirement income solutions, some guaranteed, Melia adds.

Like McIntosh, Melia thinks insurers will develop more iterations of fixed annuities, and he also believes they are a better investment. “My personal view is that as long as the 10-year Treasury rate reaches 2% or higher, fixed annuities will have a real, attractive appeal, and that is where you are going to see new innovations in the marketplace,” Melia says.

Prudential also sees merit in [nonguaranteed, spend-down funds](#) that allow people to retain access to the underlying assets, which are invested in public securities. They work like balanced funds, McIntosh says. “If the underlying assets outperform, the investor will have a little bit more income. But if they underperform, the investor will have to cut back on spending.”

Prudential also expects more asset managers will offer managed accounts [that offer participants customized draw-down strategies](#), and that blend both guaranteed and non-guaranteed solutions, McIntosh says.

The Insured Retirement Institute also expects more sponsors to offer “annuities with a guaranteed lifetime withdrawal benefit where the plan participant retains control of the money, as well as structured annuities that provide participants with the potential for a higher return with a crediting rate linked to a market index, as well as protection against market loss,” says Frank O’Connor, vice president of research.

Tags

[annuities in defined contribution plans](#), [Retirement Income](#)

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