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Defined Contribution

Lifetime income options flood uncertain 401(k) market

Managers offering a tidal wave of new DC offerings that include annuities

By Robert Steyer

Despite sponsor resistance, participant reluctance and regulatory uncertainty, lifetime income options for DC plans continue to hit the market.

Last month, officials at Financial Engines Inc., said the firm had begun offering a lifetime income option to defined contribution plans through its managed account business. In November, AllianceBernstein LP unveiled a series of target-date funds with an embedded annuity component for DC plans. In February 2010, Great-West Retirement Services announced a lifetime income option offered through a group of target-date and balanced mutual funds.

Each effort represents an attempt at one-upmanship on existing players that offer annuities embedded in 401(k) plans.

New York-based AllianceBernstein is promoting its annuity product as being backed by three insurers rather than the single-insurer coverage offered by competitors. DC consultants say single-insurer risk is one reason large sponsors have been cool to annuities within 401(k) plans.

Financial Engines and Great-West are promoting non-annuity strategies as offering greater flexibility and simplicity for participants and fewer headaches for plan executives.

Because the Financial Engines product, called Income+, doesn't require buying an annuity within the DC plan, "the plan sponsor is not subject to any of the fiduciary requirements associated with purchasing in-plan annuities nor are there any administrative issues associated with interfacing with an insurance provider," said Robyn Credico, Arlington, Va.-based senior consultant and defined contribution practice leader for North America at Towers Watson & Co. Ms. Credico said her firm doesn't endorse a specific lifetime income option.

Alison Borland, retirement strategy leader at Aon Hewitt, said executives spent a year talking with clients and Financial Engines about how best to deliver Income+ and to deal with administrative issues. Aon Hewitt, Lincolnshire, Ill., began offering the product on its platform in late 2010, and it has offered Financial Engines' managed account business since 2004.

"Sponsors like the fact that there's no insurance (component) in-plan," she said. "They are concerned about the long time viability of insurers, and they have concerns about the uncertainties of fiduciary duties."

Adding that "different sponsors have different needs," she said Aon Hewitt also offers an annuity-based product from Prudential Retirement that is linked to target-date funds in DC plans.

'Makes sense'

"The managed account solution makes sense for a certain subset of the marketplace, but there's room for many solutions," said Drew Carrington, a Chicago-based managing director and head of defined contribution and retirement solutions for UBS Global Asset Management. "There will not be a single solution appropriate for all sponsors or participants."

The latest product launches come at a time when most large sponsors remain on the sidelines, citing concerns over administrative, legal and regulatory issues while waiting for the departments of Labor and Treasury to issue regulations. The departments are sifting through nearly 800 public comments filed last year as well as testimony at hearings held in September. Gloria Della, a spokeswoman for the DOL, said there is no timetable for issuing proposed regulations.

"Waiting for the perfect solution complete with full regulatory blessing is a little bit of a red herring," said Mr. Carrington. "If we all waited for the perfect car, we'd still be riding horses."

Charles Nelson, president of Greenwood Village, Colo.-based Great-West Retirement, said his firm developed a lifetime income product for DC plans in response to concerns from clients who cited the market trauma of 2008 as a reason for wanting something with a guaranteed income stream.

"We felt there was no need to wait" for government regulators, he said. Great-West started designing its product, Maxim SecureFoundation, in January 2009 and launched it in April 2010.

Mr. Nelson said 597 sponsors have made it available and another 400 sponsors are making it available. The largest client is the $406 million Alabama Deferred Compensation Plan. The product can be offered inside or outside of managed accounts, Mr. Nelson said.

It took Financial Engines about three years to develop Income+, which is an extension of its managed account business, said Jeffrey Maggioncalda, CEO and president of the Palo Alto, Calif., firm. Financial Engines has signed a handful of sponsors, but he identified only the $834.4 million 401(k) plan for Baylor Health Care System, Dallas.

The product gives participants flexibility to choose the timing and amount of monthly payouts or to suspend payouts. They can cancel participation without paying a fee or penalty, and they can purchase an annuity outside of the 401(k) plan.

"Employers don't want a lot of hassles and they don't want to change their investment lineup," Mr. Maggioncalda said. "We think we have avoided the issues that have slowed others."

His comment about "others" was a reference to firms offering annuity-based products, whose acceptance by sponsors remains mixed.

AllianceBernstein still lacks a confirmed client. "We continue to be in advanced discussions with multiple large companies," said Mark Fortier, head of product and partner strategy for AllianceBernstein Defined Contribution Investments.

In January, Genworth Financial Inc. suspended sales of its ClearCourse annuity-in-a-401(k) product as well as sales of new retail variable annuities and group variable annuities. "We think that our continuing businesses represent a better strategic position for us and have decided to focus our resources on strengthening those product lines," Tom Topinka, a Genworth spokesman said in an e-mailed response to questions. Launched in 2006, ClearCourse attracted only about 40 clients.

"The terms and conditions of existing ClearCourse contracts have not changed," Mr. Topinka wrote. "We will continue to provide service and support to all existing ClearCourse clients."

Still no sponsors

Barclays Global Investors introduced an annuity-based target-date product in October 2007. BGI later was acquired by BlackRock Inc., and the product's name recently was changed to LifePath Retirement Income from SponsorMatch. As of November, the product still hadn't attracted sponsors. When asked for an update in late January, BlackRock spokesman Brian Beades declined to comment.

Bank of America Merrill Lynch continues to offer a Metropolitan Life Insurance Co. product called Personal Pension Builder to existing clients, said Matthew Card, a Boston-based spokesman, in an e-mailed response to questions. The annuity product, launched in 2004 by a then-independent Merrill Lynch, "has not been adopted heavily by our plan sponsor clients," he wrote. "We are currently developing new solutions in this area." He declined to provide details.

However, Prudential Retirement, a unit of Prudential Financial Inc., Newark, N.J., has experienced a surge for its IncomeFlex annuity-in-401(k) products. Prudential had approximately 200 sponsors using IncomeFlex in early July, but that number jumped to 4,786 by year-end.

Much of that gain was due to a June agreement with ICMA Retirement Corp., Washington, which offers retirement services and products to public sector employees. ICMA-RC provides Prudential's IncomeFlex through the organization's VantageTrust Retirement IncomeAdvantage Fund.

Prudential introduced IncomeFlex in 2006 as a stand-alone option, and it created IncomeFlex Target in 2009 for target-date funds. Prudential only sells the target-date version now, representing the vast majority of sales. "The marketplace wanted this around a target-date structure," said Jamie Kalamarides, senior vice president at Prudential Retirement.

The median DC asset size for an IncomeFlex client is more than $25 million, the average asset size is more than $80 million and the largest, Prudential Financial Inc., has DC assets of over $5.6 billion, he said. "We continue to target mid- to large plan sponsors on our full service DC platform," said Mr. Kalamarides, who declined to identify other clients.

Providers that plan to offer non-annuity products and sponsors that purchase them say they do so for simplicity or flexibility.

"We looked long and hard at annuities," said Donn Hess, managing director and head of product development at J.P. Morgan Retirement Services in Kansas City, Mo., which expects to place Financial Engines' Income+ on its record-keeping platform during the third quarter. "We are fans of annuities but we see challenges making them work in a 401(k). A lot of people don't understand annuities."

The Baylor Health Care System will make Income+ available in March, said Keith Holtz, senior vice president and chief human relations officer, adding that Baylor has been using Financial Engines' online advice service since 2002 and its managed account business since 2008.

"We like the flexibility for retirees," said Mr. Holtz, adding that Baylor didn't look at other companies' lifetime income options. "They are not locked into an annuity. As an employer, I like to leave the choice of an annuity up to the employee." ■