Obama May Urge Plan Sponsors To Include Annuities In 401(k) Offerings
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Fixed annuities appear to be one solution to what is often a major shortcoming of 401(k) plans: unpredictable payouts. This type of annuity is like a traditional pension in that it distributes a set amount every month — and in a time of economic uncertainty, people are drawn to any investment vehicle that can provide stability.

No surprise, then, that in the aftermath of the stock market meltdown, many investors who saw their retirement nest eggs decimated flocked to fixed annuities: Sales jumped from $72.8 billion in 2007 to just over $109 billion in both 2008 and 2009, although demand slackened in the fourth quarter of last year as the stock market gained momentum, according to LIMRA International, an insurance company trade association headquartered in Windsor, Connecticut.

Demand may soon pick up again, thanks to a boost from the White House Middle Class Task Force, which calls for "promoting the availability of annuities and other forms of guaranteed lifetime income." The Department of Labor and the Treasury Department asked for industry comment by May 3.

Not all of the input was expected to be positive. "Annuity is a bad word in our culture," says Pamela Hess, director of retirement research at Hewitt Associates, a Lincolnshire, Illinois–based benefits consultant. "It's like giving away your nest egg to an insurance company, giving up control."

Other perceived disadvantages stand out. With a typical fixed immediate annuity, buyers are locked in to the interest rate that prevails at the time of purchase — which is a benefit if rates subsequently decline, but a drawback if they increase. Moreover, plan sponsors and annuitants must consider the likely future financial stability of the insurer, no slight concern in the aftermath of the U.S. government's $182 billion bailout of American International Group. The back-office work can be a nightmare if an employer switches recordkeepers, and employees might have to cash out of an annuity early if they change jobs. Finally, there is the issue of cost: Commissions, fees and other charges vary widely and can range from 1 percent to 10 percent of the total contract, according to industry reports.

It's unclear what legislative changes, if any, will result from the Obama administration's seeming embrace of annuities. Some observers speculate that tax breaks may be offered for annuity payouts, or that retirement plan sponsors may be allowed to automatically enroll employees in annuities on a trial basis unless they opt out. But the attention focused on annuities is spurring interest, and insurers have been developing new products to meet growing demand.

A few providers are offering so-called laddered annuities, in which a participant buys a mini-annuity with each 401(k) contribution; the applicable interest rate each time is pegged to the prevailing rate, so a participant who makes a contribution every two weeks would have 26 mini-annuities at year-end. MetLife, which markets such a product in conjunction with Bank of America Merrill Lynch, has about two dozen plan-sponsor clients, up from 15 in late 2005.

Putnam Investments hopes to introduce a variation with a personal touch: Participants would be able to buy one annuity a year, with the interest rate based on the rate prevailing on their birthday.

Investment managers are pitching other types of guaranteed-income options. Prudential's IncomeFlex Target product ensures retirees a lifetime annual payout equal to 5 percent of the market value of their holding at its highest point. Jamie Kalamarides, Prudential's senior vice president of Retirement Solutions, says 10 percent of Pru's 401(k) clients have signed up.

Although these new products solve some problems, like locked-in interest rates, they raise others, such as recordkeeping hassles for mini-annuities. And they can cost 35 to 130 basis points more than traditional fixed annuities.

"At the 50,000-foot level, it sounds nice," says William Kalten, a benefits lawyer at the consulting firm Towers Watson in New York. "When you get into the weeds, it gets complicated."