ADVISOR PLANNING STRATEGIES | ADVISOR NEWS

New Lifetime Annuities in 401(k) Plans Could Cut Advisors Out of the Picture

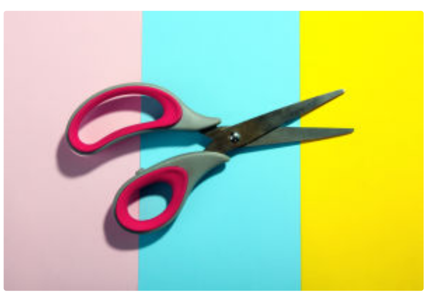
BARRON'S

By **Lewis Braham**

Updated Dec. 29, 2021 2:43 pm ET / Original Dec. 29, 2021 2:42 pm ET

One of the primary reasons many retirees seek out financial advice is to convert their savings into a steady stream of income that can support their current lifestyles for the rest of their days.

That's why, to some advisors, the news this November that State Street Global Advisors launched a deferred lifetime income annuity within the University of California's retirement plan could seem unsettling. That retirement plan has $35 billion in assets that advisors might not be able to manage if its 300,000 participants decide to keep their money in the plan's annuity after they retire.



The 2019 passage of the Secure Act encouraged annuity additions by reducing 401(k) plan sponsors' potential legal liability for partnering with an annuity provider.
Alexandr Bazhanov/Dreamstime

Deferred-income annuities are insurance contracts in which the buyer gives an insurer a lump sum in exchange for guaranteed lifetime income that begins at a later date. The new retirement plan annuities are attached to target-date asset-allocation funds, which invest a portion of investors' assets in annuity contracts as the plan participant approaches retirement age.

State Street is not alone. This October, investment powerhouse BlackRock announced that five larger retirement plan sponsors, including the Tennessee Valley Authority and Advance Auto Parts , had signed up for its LifePath Paycheck product as their plans' default investment option for employees. Unlike State Street's, BlackRock's product can begin paying income as soon as employees retire. Other retirement-plan-focused financial groups, such as Income America and the National Professional Planning Group, have made similar announcements.

This shift is happening now because of the 2019 passage of the Secure Act, which encouraged annuity additions by reducing 401(k) plan sponsors' potential legal liability for partnering with an annuity provider.

Income America's 5ForLife guaranteed lifetime-annuity product already has seven retirement plan sponsors signed up since its April 2021 launch. This is impressive especially as retirement plan sponsors have historically been slow to make any changes and Income America is a newly formed consortium of financial groups—among them fund managers American Century Investments and Wilmington Trust, insurers Lincoln Financial Group and Nationwide, and investment consultant Wilshire. "The interest [in 5ForLife] is off the charts," says Matt Wolniewicz, Income America's president.

It's no surprise to advisors that retirement plan sponsors, record-keepers and asset managers want to keep collecting fees from employees in their plans even after they retire. "I think the entire point of [annuities in plans] is that the 401(k) industry doesn't like rollovers," says advisor Chris Chen of Insight Financial Strategists in Newton, Mass. "A lot of the stuff that has happened recently in plans, including the ability now to do annuities inside a 401(k), are essentially the results of lobbying from the insurance industry."

Indeed, Open Secrets—a nonprofit that tracks money in politics—published a list of lobbyists that supported the Secure Act that reads like a who's who of insurance industry heavyweights: Prudential, New York Life, Aegon, Pacific Mutual, MetLife, Nationwide, TIAA, and Lincoln National. Fidelity Investments, the largest 401(k) provider, is also on the list.

Investor appeal. Retirement plan annuities might seem attractive to many investors. Historically, advisors haven't always done right by clients when it comes to selling annuities, charging upfront commissions as high as 7% to buy them. That would be on top of the annuities' underlying fees.

"There's a definite cost advantage," says Nick Nefouse, BlackRock's head of retirement solutions and its new LifePath annuity products. "We are not charging any sort of commission, and [LifePath's] liquidity during the accumulation period is not available in the market." Nefouse is referring to the fact that investors have faced significant surrender fees to sell out of traditional variable and other kinds of annuities that brokers have sold before they enter the income or annuity phase. LifePath's target-date funds can be redeemed without any charge or liquidity concern prior to annuitization.

There's also the fact that large money managers can negotiate better-than-retail pricing for investors from insurers for the annuitized income guarantees. State Street employs an open bidding process for insurers that can change on an annual basis.

"What we will do as the fiduciary is go out to the institutional insurance market and do the due diligence based on credit quality and other factors to determine an approved slate of insurers," says David Ireland, State Street's head of global defined contribution. "Then on an annual basis, those approved insurers have the opportunity to bid on the annuity contract. The winning bidder in most cases has the lowest fee structure." For the University of California, "we saw pricing differences of over 10% across the available insurers," he adds. "It's meaningful income to the end individual [investor]."

Fee-only options. Fee-only advisors who don't sell products for commissions can also shop around for the best annuity prices for their clients. "In the past people like me, when we thought that a client needed an annuity, we would tell them, 'This is the kind of annuity you should get, and here is someone I know who will treat you OK, but he'll charge you a commission,'" says Chen. But in recent years, "you've had an increasing number of insurance companies that have added fee-only annuities that are basically their normal annuities repackaged without a commission." He points to DPL Financial Partners commission-free annuities as an example.

Other advisors wonder about the need for annuities that don't actually pay that much income in a near zero-interest rate environment. "While guaranteed income can be helpful, it usually comes with a fairly low embedded rate of return, particularly in today's low interest rate environment," says advisor Elliott Appel of Kindness Financial Planning in Madison, Wis. "In most situations, an annuity is going to offer a lower rate of return, at least compared to historical returns of a balanced stock and bond portfolio."

That's true. But if 401(k) sponsors convince employees to stay in retirement plan annuities, that's less client money advisors will have to put in those balanced funds—and less income for advisors, too.