Annuities Need to Be 401(k) Default

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MarketWatch Blog by Alicia H. Munnell

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United Technologies does it, but does any other major company?

My colleagues and I are beginning to think seriously about embedding annuities in 401(k) plans. 401(k) plans generally offer lump sums, which means that retirees have to decide how much to withdraw each year. They face the risk of either spending too quickly and outliving their resources or spending too conservatively and consuming too little. They also must consider how to invest their savings after retirement. These are all difficult decisions.

Better strategies are possible that will ensure a higher level of lifetime income, reduce the likelihood that people will outlive their resources, and alleviate some of the anxiety associated with post-retirement investing. Workers could use some of their 401(k) assets to purchase an immediate annuity that pays a fixed amount throughout their lives, typically starting at age 65. Or, they could purchase a deferred annuity, which is cheaper and begins payments at a later age like 85. Alternatively, they could use their assets to delay claiming Social Security – essentially purchasing an inflationindexed annuity. Right now, none of these three options is commonly used. And they won't be until lifetime income strategies become the default.

As far as we can determine, United Technologies Corporation is the only Fortune 100 U.S. company that defaults new hires into an investment option that includes a lifetime income approach. Starting at age 48, the default begins to move the participant's assets to the company's Lifetime Income Strategy (LIS) component. The initial transfer is about 4 percent of assets, but the proportion gradually increases until age 60, when the participant's entire 401(k) account balance is allocated to the LIS portfolio.

Plan participants ages 60 and over enter the payout phase when they retire. The assets in a participant's account are used to pay out the income benefit. If the account balance is exhausted, then the insurance company takes over and continues to pay out the income benefit. Plan participants can terminate the annuity at any time, converting their stream of income into a lump sum, with no surrender charge. The plan allows separated employees to keep their assets in the plan and all participants can transfer DC assets accumulated from other employers into their UTC account.

To handle the income guarantee, UTC invites insurance companies each year to bid on the amount that they could provide in annual income out of that year's contributions to the LIS. Once the bids are accepted, the guaranteed income amount from the year's contributions is locked in. This process is repeated each year. The insurer fees are about 7 basis points for those age 48, rising to about 100 basis points by ages 60 and over.

At the end of 2017, the company's DC plan had over 110,000 participants and the LIS, which was introduced as the default for new hires in 2012, had about 31,000 participants. Apparently about one third of employees who were ever enrolled in the LIS have chosen to opt out. (This figure does not include those who opted out before they were enrolled.)

My question for you is whether any other large company has such a default arrangement.