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Does Your 401(k) Have an Annuity?

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Annuities, once confusing to many, even suspect to some, are showing new life.

As more people worry about the finances of retirement, the concept of a guaranteed income stream for life, once available to many U.S. workers through employer pension payments, looks like a vital component of their portfolios.

"The people we hear from express a desire for an income stream protected from market volatility, which can be addressed through some types of annuities," said Charlie Nelson, president of retirement services for Great-West Life. "People don't want to be caught, as many were in 2008, with 401(k) losses that cause them to work another five years."

A May 2012 survey of 500 large U.S. employers found that 16 percent already offer their employees a 401(k) option for a retirement income stream, rather than just a lump sum. Another 22 percent plan to offer their workers such an option this year, the survey found.

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In addition, more than 90 percent of workers in their 20s, 30s and 40s want access to guaranteed income through their 401(k)s, according to a 2012 study by The Hartford.

Some of the big insurance and mutual fund companies that offer 401(k) and IRA accounts are on board (Prudential, UBS, Vanguard and Fidelity), as are big plan administrators (Mercer, Hartford, Aon Hewitt and Great-West.)

Employers interested in staying competitive in the job market will need to offer these products in their plans, said Nelson, whose firm administers nearly 19,000 401(k) plans for 2 million workers with $75 billion in assets.

The interest in annuities comes decades after employers began phasing out defined benefit plans that guaranteed lifetime income for workers, replacing them with defined contribution plans, which allow workers to set aside pre-tax income in a savings plan, typically in the form of a 401(k). Many companies also contribute funds to those plans.

Of the $9.7 trillion in private pension assets at the end of 2009, only 22 percent remained in defined benefit plans, while 24 percent were invested in defined contribution plans and 44 percent in IRAs, according to Federal Reserve data.

Between 1975 and 2007, the number of defined benefit plan participants fell by a third to 19 million, while the number in defined contribution plans jumped six-fold to 67 million, according to the Department of Labor.

That's already taken a toll on retiree's nest eggs.

"With fewer pensions, there's been a gradual erosion of income from our retirement system," said Mark Iwry, deputy assistant secretary for retirement and health policy at the U.S. Department of Treasury. "Without imposing anything or forcing anyone, I'd like to see us put pensions back into the private sector retirement system as a very substantial option."

The federal government is trying to help make that happen. In 2012, the IRS made it easier for savers to convert a portion of their 401(k) savings to an annuity product.

The goal is to encourage people to buy an annuity sooner than later.

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Retirees worried about making their money last could always take their 401(k) lump sum distribution and purchase an annuity, but few do it.

In 2008, only about 1 percent of adults over 65 reported receiving income from a private annuity, said Phyllis Borzi, assistant secretary of Labor for employee benefit, in her 2010 Senate testimony.

The growing interest in annuities may be a sign that consumers are overcoming long-held confusion - and in some cases fear - about what experts admit is a complicated product.

"There are a variety of behavioral inhibitions that get in the way of annuity choice," said Iwry.

Some people are worried about dying too soon. With classic annuity risk pools, the people who die early subsidize those who don't. Similarly, in many cases, when the participant dies there are no benefits for survivors, which puts off potential buyers.

Others rejected annuities because they were concerned inflation would eat away returns over the course of many years, while also preventing them from putting more money into a bull market.

At the same time, annuities have been faulted for being too complex for the average person to understand, with excessive fees. There are steep withdrawal penalties.

Not all annuities, however, work that way, said Iwry, and the market is moving quickly to address consumer complaints and reservations.

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New products can offer death benefits, withdrawals, participation in equity returns and other features. A "deferred" or "longevity" annuity doesn't begin making payments until age 85, or whenever the buyer thinks he'll run out of other savings.

"The word 'annuity' has some scary connotations for some individuals," admitted Nelson, of Great West. "But annuities exist in all shapes, sizes flavors and colors. Broad generalizations do make some participants -- and some plan sponsors -- shy away. But I'm actually pretty optimistic this will change."

Not all plan administrators share that optimism.

We're hearing buzz in the marketplace about guaranteed income streams but not a lot of action," said Brian Pietrangelo, managing director of retirement investment services for Charles Schwab. "What we see is if they [people] don't understand, they don't act."

For those interested in researching financial products that offer a lifetime income stream, there's no shortage of advice. Ratings agencies grade and rank companies offering the products.

"Go with people who have very solid credit ratings," said Ted Beck, executive director of the National Endowment for Financial Education. "This is not the time to shop on the Internet for the cheapest rate."

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