

HOW IN-PLAN ANNUITIES ENABLE PARTICIPANTS TO TURN SAVINGS INTO INCOME

BY TAMIKO TOLAND AND MICHAEL FINKE

When employers decide how to help retirement plan participants turn savings into income, no one solution is a clear winner, but annuities are the only means to provide guaranteed income within a defined contribution (DC) plan. However, annuities are not commonly available as distribution options and expanding participant access to lifetime income is an important avenue to increasing retirement security. We examine the differences in existing and potential future product designs for providing lifetime income in retirement plan defaults in our recent paper for the International Review of Financial Consumers, “Using Defaults to Enhance Adoption of Lifetime Income in Defined Contribution Plans.”¹

While the DC system has come a long way in improving investment outcomes during accumulation, it still falls short in helping participants secure lifetime income in retirement. Among economists, annuities are considered the optimal design for turning savings into retirement income because they allow individuals to pool the risk of an unknown lifespan. Compared to unprotected decumulation, longevity risk pooling through annuities results in higher optimal spending without the risk of outliving savings. Adding annuities to qualified default investment alternatives (QDIAs) is the most promising way to help workers gain access to high quality products that provide lifetime income security.

Existing annuity designs can be differentiated between those that offer liquidity and those that offer traditional annuitization. Consumer aversion to traditional annuitization (the “annuity puzzle”) led insurers to create the guaranteed lifetime withdrawal benefit (GLWB), which gives

people flexibility in guaranteed income without the permanence of annuitization. Though this innovation was developed for the retail market, the same thinking has driven the development of in-plan annuities that use GLWBs that provide an alternative to annuitization. In addition to helping participants overcome the irrevocability and illiquidity of annuitization, GLWBs offer practical benefits to plan sponsors and QDIA manufacturers.

However, annuitization offers participants benefits that need to be considered by plan sponsors. Annuitization may provide a higher income per dollar of retirement savings and avoids the risk of misuse by less sophisticated participants. A balanced comparison must consider both participant preferences and the needs of the plan sponsor. Among consumers, some value the dependability of a pension-like stream of guaranteed income above all else. Others prefer the optionality of liquidity.

1. <https://sciendo.com/article/10.2478/irfc-2024-0006>

Further, 81% of plan participants consider annuities or other protected-income products in 401(k) or 403(b) plans to be “very or somewhat helpful,” according to the 2024 PRIP Study.² Like consumers, plan sponsors must weigh their own preferences for risk tolerance, administrative capabilities, and fiduciary concerns.

That’s why choice—specifically, the ability to choose between annuitization and GLWBs—is critical. Neither solution is objectively superior, and an ecosystem that supports both approaches will offer the choice necessary to suit the needs of different plan sponsors.

DEFAULTS DRIVE THE INCOME BUS

The rapid growth of target date funds has taught us the power of retirement savings defaults. Today, 68% of employees save in QDIAs.³ Those who remain in the QDIA tend to be less financially sophisticated and benefit from a professionally managed automated portfolio that rebalances toward an age-appropriate risk glidepath as an employee nears retirement.⁴

However, current defaults focus almost exclusively on wealth accumulation. They help participants build a nest egg, but they do little to ensure that nest egg provides a sustainable income stream after retirement.

There’s an opportunity to extend the power of defaults into retirement by integrating lifetime income features. Fortunately, it’s already possible to include annuities into QDIAs, either by integrating them into (or wrapped around) a target date fund or by offering them as an option to participants before or at retirement. Annuities that are incorporated into the QDIA must be liquid and allow participants to shift to another investment before retirement.

ANNUITIZATION: EFFICIENT BUT INFLEXIBLE

Traditional annuities convert retirement savings into a guaranteed stream of income that lasts a lifetime. This model closely mirrors the security of a defined

benefit pension and allows retirees to spend with greater confidence.

From an economic standpoint, annuitization offers efficiency by providing an automatic lifetime stream of income. Annuitization is also simple and requires little employee input to manage over time. But annuitization comes with trade-offs. Once annuitized, funds are typically inaccessible. That lack of liquidity is a major barrier for many participants—and a key reason why annuitization isn’t more common in DC plans.

For plan sponsors, offering annuitization through in-plan solutions raises concerns about the permanence of the decision and the traditionally low uptake of these products. Furthermore, annuitized assets are no longer administered within the plan, which could be a drawback for plan sponsors that seek to keep retiree assets within their plans.

GLWB: FLEXIBILITY WITH PROTECTION

Guaranteed Lifetime Withdrawal Benefits (GLWBs) provide an alternative approach. They allow participants to draw income from their retirement account while keeping the account balance liquid. If the account depletes, the insurance kicks in and continues the income stream for life. When there are fees applied to the annuity balance for the benefit, they may be more accurately viewed as an insurance premium to cover the cost of longevity risk protection. These in turn provide the funds needed to pay for the income of those who live long enough to spend down their annuity balance.

Because of the liquidity, it’s relatively simple for an annuity with a GLWB to fit into the standard investment model that plan sponsors are already used to. A fixed annuity with a GLWB can be treated as a (steadily declining) fixed-income component in a participant’s portfolio. A GLWB can also be attached to a target date or balanced portfolio. Substituting full annuitization for bonds requires increasing the equity allocation of the remaining funds to account for the consideration of the guaranteed income as a fixed-income asset. This makes a GLWB attractive to plan sponsors who want

2. <https://www.protectedincome.org/prip-2024/>

3. <https://www.ici.org/system/files/2024-05/2024-factbook.pdf>

4. Goda, Gopi S., Matthew R. Levy, Colleen F. Manchester, Aaron Sojourner, and Joshua Tasoff. 2020.

“Who Is a Passive Saver Under Opt-In and Auto-Enrollment?” *Journal of Economic Behavior and Organization* 173: 301–21.

Lifetime Income	Facts	Options
Annuitization	• Exchange savings for guaranteed lifetime income • Income payments are administered outside of the plan • Death benefit options allow heirs to receive payments • Investment Policy Statement (IPS) may or may not need to allow annuities as a distribution option depending on the solution	• Payments for one person or a couple • Payouts can begin immediately or in the future • Annuitization can happen as a distribution from the plan or after rollover into an IRA
GLWB	• Withdraw from savings for income and guarantee payments begin when the account depletes • Savings remain accessible, declining with withdrawals • IPS does not need to allow annuities as a distribution option	• May be used with fixed or variable annuities • Excess withdrawals reduce the income guarantee • Various design factors influence the guarantee amount and increase potential • GLWB assets can remain within the plan or roll into an IRA

to incorporate lifetime income without fundamentally changing their investment architecture.

The flexibility of GLWBs makes them particularly appealing to participants who value access to funds in retirement. But they also introduce complexity. Participants must understand how to activate the income guarantee, and poor decisions—such as withdrawing too much too soon—can reduce or eliminate the benefit.

This last issue is a potential fiduciary consideration for plan sponsors, as they act as a fiduciary even deep into retirement for those who may be more vulnerable to cognitive decline and elder abuse.

PLAN SPONSORS NEED THE FREEDOM TO CHOOSE

The key takeaway from our research is this: policy should support both forms of lifetime income to encourage greater adoption. Plan sponsors may have a preference based on business decisions for a certain structural choice, such as keeping assets within the plan. Fiduciary reasons may drive the choice to use one form of lifetime income or the other.

Neither annuitization nor the GLWB offers an obviously superior fiduciary choice; instead, much of this is driven by the specific product design and participant experience. What matters is that sponsors have the flexibility to select the solution that aligns with their participants' preferences, financial behavior, and retirement goals.

POLICY SUPPORT CAN ENABLE MORE DESIGN OPTIONS

To support this flexibility, policy and regulatory frameworks must consider multiple lifetime income designs. Safe harbor protections under the SECURE Act were a step in the right direction, but concerns remain about insurer credit risk, fiduciary exposure, and participant understanding.

We propose that policymakers consider additional tools—such as a government-sponsored commutation program—that would allow participants to access a portion of their annuitized wealth in the event of insurer downgrade or other qualifying events.⁵ This would ease sponsor concerns about irrevocability while preserving the integrity of the income guarantee.

5. <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2024-qdia-finke-written-statement-07-08.pdf>

Such policies would support the use of annuitization and address certain objections that plan sponsors have around annuitization.

CONCLUSION: A BETTER FUTURE THROUGH CHOICE

As the DC system continues to evolve, the focus must shift from simply building wealth to delivering income. Participants need help turning their savings into a reliable retirement paycheck. But how that paycheck is delivered should not be dictated by a single product model.

There is no universally “best” way to provide lifetime income. Annuitization and GLWBs both offer unique benefits and challenges. By allowing plan sponsors to choose between them based on their own preferences, we can improve retirement outcomes for more participants.

As with many puzzles, we believe that there’s more than one solution to the “annuity puzzle” and we need to continue to innovate ways of providing the protections that plan sponsors want—for themselves and their participants—to support greater retirement security for all.

AUTHORS

Tamiko Toland is an Education Fellow with the Retirement Income Institute and a leading industry expert on annuities. Her thought leadership focuses on simplifying the complex topic of lifetime income, both within the retail and retirement plan markets. She leverages decades of experience for strategic initiatives and businesses through her consulting practice and as founder of the 401(k) Annuity Hub and co-founder of IncomePath.

For more than two decades, Tamiko has tracked trends and key issues on retirement income, addressing all audiences. She has held leadership roles at TIAA, Strategic Insight, and Cannex Financial Exchanges, the annuity data and analytics firm.

Tamiko’s introduction to annuities began as a trade reporter for Annuity Market News. She regularly shares her perspectives for the news media and speaks at industry and client conferences and webinars.

Michael Finke, PhD, CFP®, is professor of wealth management, WMCP program director, director of the Granum Center for Financial Security, and Frank M. Engle Chair of Economic Security at the American College of Financial Services. He is also a Research Fellow with the Alliance’s Retirement Income Institute.