JOURNAL of PENSION BENEFITS

ISSUES IN ADMINISTRATION, DESIGN, FUNDING, AND COMPLIANCE
Volume 33 • Number 1 • Autumn 2025

The Fiduciary Risk of Not Adding Annuities to 401(k) Plans

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The perceived risk of adding annuities to 401(k) plans is high, but the question comes up whether failing to give participants the option of lifetime income at retirement is a fiduciary breach. We describe the arguments on both sides and the assertion that all plan sponsors should consider whether they want to include lifetime income as a matter of plan design.

Legal risk may be the leading reason that plan sponsors do not implement lifetime income solutions in their plans, but there is a flip side to that argument: the risk of not implementing them. The question is provocative in a climate where many plan sponsors focus only on the risk of *adding* lifetime income to a plan.

One does not need to dig deep to find those who are utterly against in-plan annuities and the current

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movement to expand access to participants. Many express the opinion that a plan sponsor should not assume fiduciary risk by introducing a financial product that is not required in the first place.

Even some who acknowledge the value of lifetime income for retirees balk at the idea of implementing them as an option within the plan. For example, Jack Towarnicky has long advocated for the use of a deemed individual retirement account (IRA), also described as a sidecar IRA, that allows the employer to establish the IRA and offer options but is funded through voluntary contributions within the plan. [Jack Towarnicki, *2018 Advisory Council on Employee Welfare and Pension Benefit Plans Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA) – Focus on Decumulation and Rollovers*, written testimony, 18 June, 2018] A strategy funded through voluntary employee contributions outside the plan itself is presumed to allow an employer to offer an annuity to participants without assuming the fiduciary responsibility.

Even though annuities are permissible within a Qualified Default Investment Alternative (QDIA), they are not a standard feature of 401(k) plans, nor are they required as part of a retirement plan. However, one argument for why plan fiduciaries must consider adding an annuity runs along the lines that annuities offer unique benefits to increase security in retirement, namely through the mitigation of longevity risk by transferring this risk to an institution. Put simply, employers that fail to offer an annuity expose employees to longevity risk, which means a lower standard of living because accounts run low or their own adjustments to periodic payments out of fear of outliving savings.

It has been suggested that plan sponsors that neglect the effect of sequence of returns risk are responsible for "a reprehensible breach of the duty of care." [Ron Surz, "Don't Fail to Protect Financial Naïve 401(k) Beneficiaries," *401(k) Specialist*, 28 September, 2021] Similarly, the failure to include annuities as a distribution option could be seen as a failure to consider a plan design feature that provides substantial benefits to participants that they may otherwise not have access to outside the plan.

Not a Fiduciary Risk

To put the question to bed, there is no record of an Employee Retirement Income Security Act (ERISA) attorney, even one friendly to lifetime income, make this argument. Bonnie Treichel of Endeavor Law flatly stated that it would not be a fiduciary risk, but she elaborated that it would be "imprudent not to consider" the option of adding lifetime income. [Bonnie Treichel, Plan Sponsor Council of America National Conference, Las Vegas, spoken comments, May 1, 2025]

Certainly, ERISA does not require that plans offer an annuity as a distribution option in most 401(k) and profit-sharing plans, and they are not yet common in corporate plans. Should that change, the needle could shift to bolster an argument that a plan ought to have had it in the first place.

In the meantime, the fiduciary risk of not offering an annuity remains simply a provocative question. Nevertheless, as Treichel and others state, every plan sponsor ought to develop an informed position on the matter and decide, one way or the other, whether it believes it ought to provide lifetime income.

Participants Believe Target Date Funds Guarantee Retirement Income

As the winds shift on the perceived risk and benefit of lifetime income, sponsors need to acknowledge that participants already believe they have guaranteed income in the form of target date funds. When asked, two-thirds of participants mistakenly believed that target date funds provide guaranteed income in retirement.

The Securities and Exchange Commission (SEC) sponsored a report on consumer understanding of target date funds that found, among other things, that only 36 percent of respondents knew that target date funds do not provide guaranteed income in retirement [siegel+gale, *Investor Testing of Target Date Retirement (TDF) Comprehension and Communications*, PDF presentation for SEC, February 15, 2012, *s71210-58.pdf*]

Results from a 2018 study by AllianceBernstein were consistent with those findings, showing that only 37 percent of participants knew that target date funds do not guarantee meeting income needs in retirement [Warren Cormier, "Investor Confusion About Target-Date Funds Is Alarming," *Investment News*, December 1, 2018]

More recently, an American Century survey finds that, 62 percent believe that target date funds provide income at retirement, which means that 38 percent either understand how they work or do not know at all. [Brian Anderson, "401(k) Participants Express Strong Interest in Guaranteed Lifetime Income," *401(k) Specialist*, October 7, 2024]

To some extent, adding lifetime income to retirement plans simply provides a benefit that many participants believe they already have. Closing the loop on this misbelief may serve the expectations and needs of workers and, more importantly, plan objectives.

The Duty to Participants Is Not Lawsuit Avoidance

To those asserting that sponsors should not tolerate the risk associated with adding a feature that is not otherwise mandated, the sponsor's "duty isn't to avoid getting sued." [Michael Kreps, *Demystifying Retirement Income: The "Why" and the "How" for DC Plans*, Institutional Retirement Income Council in-person meeting, Charlotte, NC, spoken comments, May 22, 2025]

Kreps added that the plan sponsor's "duty is to do what's right for participants" and that the decision to keep annuities out of a plan should come from the position that this is in the best interest of the participants, not out of the concern of getting sued.

Treichel and Kreps agree that all plans should engage in a process of determining the plan's objectives, including whether they want to simply be a savings plan or a retirement plan. As experts on the topic have iterated time and again, the application of a consistent, repeatable, and well-documented process is the cornerstone of fiduciary decisions; lifetime income is no different.

In the end, the question is not whether all employers are obligated to provide lifetime income to workers but whether they have engaged in a process that includes an evaluation of lifetime income. Plan sponsors can and will have many reasons for not including lifetime income, but the answer should come from a continued focus on plan design and participant interests. ■