

## 401(k) advisers don't see annuities as income solution

Memories of insurance failures prompt search for alternative strategies

**By Darla Mercado**

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While retirement industry leaders last week pressed officials from the Labor and Treasury departments to make it easier to include annuities in 401(k) plans, many investment firms and advisers said they aren't pinning their hopes on the annuity proposal and are looking for income solutions that don't involve insurance.

"I think the annuity industry will do an excellent job in providing solutions around the problem, but there's only a finite amount of insurance that can be written," said James Breen, director of fiduciary services at Horizon Investments LLC. "There are an awful lot of people who are interested now in this problem and developing innovative ways of solving it."


Last week, government officials met with executives speaking on the behalf of plan sponsors, insurers, retirement plan providers and asset management firms. Insurers pushed for the expansion of "safe harbor" rules to cover plan sponsors who select annuities. This would protect employers from fiduciary liability with respect to carriers' future financial condition, provided the plan sponsors met certain requirements when selecting that carrier.

"If I had to guess, there will be some safe harbor for the inclusion of an income option, but I don't think it'll be mandated," said Jason C. Roberts, an attorney with Reish & Reicher. "I don't think the DOL will get in and force small plans that are bundled and underserved, or make it harder for fiduciaries to manage that."

But while financial advisers who work with retirement plans are aware of the push toward in-plan annuities, they also remember the past failures of insurers. For example, First Executive Life Insurance Co., which was once a provider of guaranteed-income contracts to retirement plans, went belly up in 1991.

"That memory is fresh for many plan administrators: Why would you want to jump back into the arms of an insurance company?" said Michael J. Francis, president of Francis Investment Counsel LLC.

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To avoid such a scenario, some advisers are looking for income solutions that don't require an insurance product.

Horizon Investments, for instance, has created its Lifetime Income Strategy with Principal Protection. The product, designed by Horizon's senior investment strategist and Mr. Breen's father, William Breen, allocates three years of a participant's spending requirement in a fixed-income portfolio and allocates the remainder of the retirement portfolio in equities.

As each financial quarter passes, if the return on equities is positive, the client can liquidate a portion of the equity portfolio and invest it in the fixed-income portfolio. If returns are negative, the client does nothing at first. If the returns remain negative for an extended period, the principal-protection model kicks in, reallocating some of the equity portfolio to fixed income to protect the principal.

Participants start the strategy just as they exit the 401(k) plan, the younger Mr. Breen said. The firm is working with third-party advisers to implement the strategy. "There are several things driving interest: a tough market that's been frightening to many investors and a real hunger for having a solution that will work through difficult times," he said.

Thornburg Investment Management Inc. has also developed a participant-focused strategy that involves creating three portfolios: one for immediate needs that invests in money markets, a second portfolio that goes two to five years out and invests in intermediate-term-bond funds and dividend-yielding stocks, and a longer-term portfolio that invests only in equities.

Similarly, Tamarac Inc. has reported that the independent advisers with which it's been working have been using ladders of Treasury inflation-protected securities or certificates of deposit.

"We've seen firms do this with just a few of their top large accounts, but this has also been implemented downstream to mom-and-pop account sizes," said Clive Matthew Springer, president and founder of Tamarac.

The underlying investment process isn't terribly different between the non-annuity process and the annuity products, noted Lou Harvey, founder of Dalbar Inc. "The last time we looked at it, you lose about a third of what you could make or what the income would be if you used a guarantee — and that's over the lifetime of the participant," he added.

Advisers have been largely ambivalent about the possibility of working with annuities in plans. Some don't expect to implement them if the safe harbor is granted to plan sponsors.

"I'm waiting for the products to mature a bit," said Brant Griffin, partner at North Pier Fiduciary Management LLC. "You could be doing a disservice by putting annuities in the plan or by just complying with what participants demand," he added.

Instead of considering annuities in plans, Mr. Griffin reduces risk by diversifying fixed-income exposure. "We advise them on their stable-value-investment choices and diversify into international bonds or high-yield bonds," he said.

The Oppenheimer International Bond Fund and the Pimco High Yield Fund are a couple of the options he's weighed.

Nevertheless, others acknowledge that despite the careful planning advisers may implement at

both the plan and participant levels, only a guarantee can protect against a major market decline.

“You can create fixed-income and total-return funds that look similar to annuitized products, but if you don't have an insurance component, you can't guarantee against principal erosion,” said Matthew D. Hutcheson, an Employee Retirement Income Security Act fiduciary and retirement plan consultant. “It's one of those things where I'd hate to see people get overconfident that they can do something comparable to what insurers can do without the insurance backing.”

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