

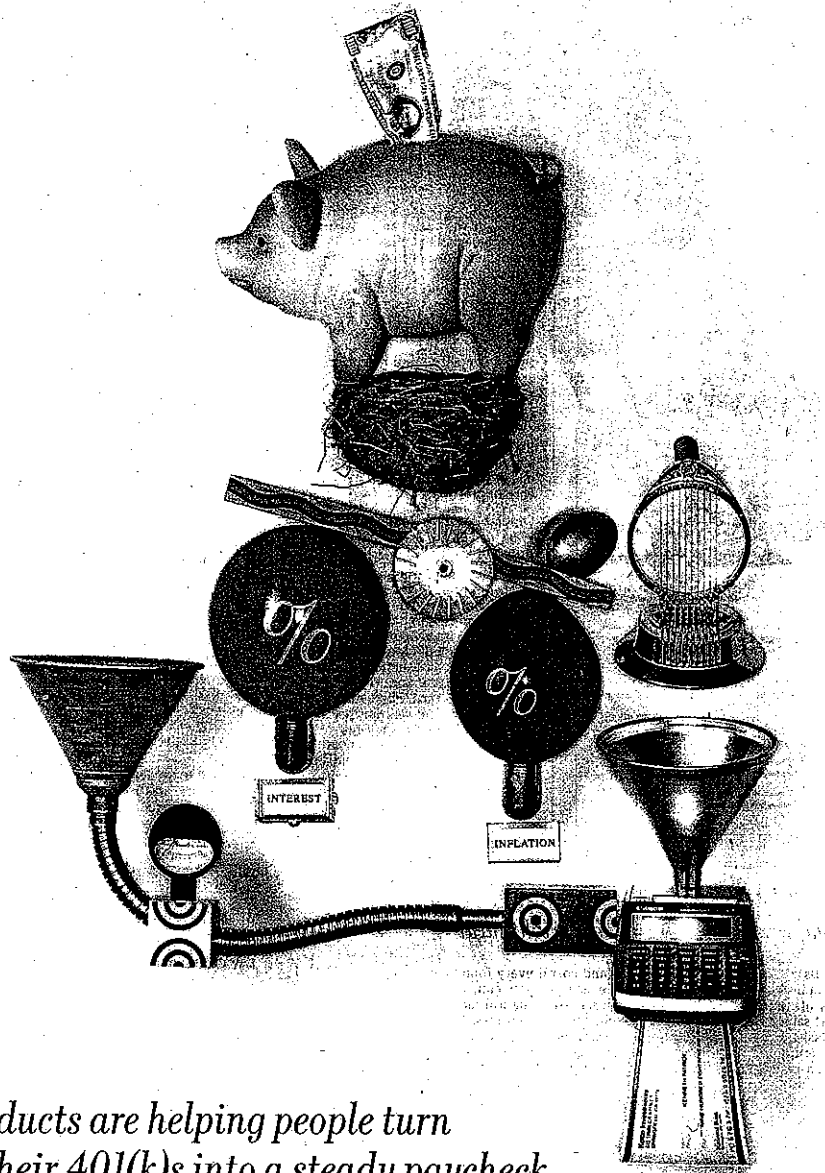
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Do-It-Yourself Pensions



New products are helping people turn part of their 401(k)s into a steady paycheck in retirement. Here's how they work—and what to watch for.

By Kelly Greene

IT'S ONE OF THE BIGGEST financial challenges people face upon entering retirement: How do you tap your nest egg to create a regular paycheck for life?

The financial-services industry is rushing to provide some answers.

A number of companies are introducing products that for the first time allow workers to invest in annuities through their 401(k)s, the heart of many Americans' retirement savings. A

401(k), for the most part, is easy to understand and set up. But it doesn't offer a simple mechanism for creating a steady income in retirement. Annuities, by contrast, have long offered a way to generate a paycheck in later life but tend to be complicated, expensive and a general pain in the neck to shop for.

The new products, in theory, offer the best of both worlds. Though currently offered at only a few dozen companies, the 401(k) option gives employees the ability to direct a portion of their 401(k) investment each month toward purchas-

ing an annuity. Doing so can be cheaper than buying an annuity on the retail market (say, through an insurance agent or financial planner).

The reason for all this activity is simple: At a time when increasing numbers of companies are doing away with traditional defined-benefit plans, many people nearing retirement still long for a pension that can't run out. At the same time, some would-be retirees recognize that the traditional strategy when leaving the office—rolling over a 401(k) into an individual retire-

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ment account and trying to manage a nest egg on one's own—is often a recipe for trouble.

Chad Lown, a 29-year-old technical-support manager, signed up for a 401(k) annuity when Paychex Inc., an employee-benefits administrator in Rochester, N.Y., started offering the option in May. "I love the idea of having guaranteed income for life and knowing that, worst-case scenario, you're getting a paycheck when you retire," he says. "My father worked for Kodak, and he's always had that pension. It takes away a lot of the stress knowing you're going to have this money."

Many financial planners recommend putting as much as 25% of your total nest egg in an annuity—or enough to pay basic living costs, such as utility bills. With a fixed annuity inside your 401(k), you might consider investing the same percentage that you previously put into bonds and other fixed-income products, since fixed annuities use the same types of investments.

For all their apparent benefits, though, the new products aren't a panacea. While purchase fees are lower than for annuities purchased at retail, the annual expenses can be double those of other 401(k) investments. An annuity within a 401(k) could be awkward to manage if you job-hop. And the products' guarantees of a paycheck down the road are only as sound as the finances of the insurance companies providing them (though state funds generally provide limited coverage when insurers become insolvent).

Still, retirement-plan managers and benefits consultants say growing numbers of workers will have access to such products in the next few years—and should begin learning about their options.

"Ten years from now, every 401(k) plan in the country will have a [product] like this in its lineup," predicts Thomas Witt, the retirement-fund manager for H.E. Butt Grocery Co. in San Antonio, who says he is "kicking the tires" of several new products that provide a monthly check in retirement.

Here's a look at the opportunities—and the drawbacks—of 401(k) annuity investing:

A GUARANTEE—BUT AT WHAT PRICE?

Insurers sell two main types of annuities: fixed and variable. Fixed annuities are either immediate, which means a lump-sum payment is made up front in return for set payments over a specified period or for life; or they are deferred, meaning they are purchased either with a single payment, or with installments, invested over time before the payments start. Fixed annuities offered in 401(k)s generally are deferred, with your money mainly invested in bonds and other fixed-income securities. Variable annuities, also either immediate or deferred, are typically invested in a portfolio with a sizeable chunk of equities, meaning their

years old and, starting this month, you begin contributing \$100 a month to **Hartford Financial Group Inc.'s Lifetime Income** fixed annuity. (The program sells shares that guarantee \$10 a month in income starting at age 65.) At age 65, after contributing \$18,000, you would have about 20 shares, which would yield a monthly paycheck for life of \$200. If you had contributed \$300 a month, the monthly payment at age 65 would be about \$600. Contributing \$500 a month while working would yield \$1,000 a

be willing to do the work to find them. And it can be very tough to comparison-shop for annuities because the returns quoted by the vendors are calculated after fees, which vary from company to company.

It's best to find an independent, certified financial planner who doesn't work on a commission basis to help you shop. Mark Cortazzo, a certified financial planner in Parsippany, N.J., has found annuities for his clients with higher guaranteed payments than those provided by some 401(k) prod-

Asking About Annuities

Here are some resources to help you decide whether you should invest in annuities, and if so, how:

immediateannuities.com

■ Provides instant quotes for monthly payouts from immediate fixed annuities.

longevityalliance.com

■ Provides an explanation of different types of annuities and sends quotes for immediate annuities by email or telephone.

incomesolutions.com/annuityfaq.asp

■ Answers nuts-and-bolts questions about immediate fixed annuities, including questions about taxes. (You can't use the online shopping service unless your employer has paid a fee.)

sec.gov/investor/pubs/varannity.htm

■ "Variable Annuities: What You Should Know," a publication on the Securities and Exchange Commission's Web site that outlines the pros and cons of variable annuities.

naic.org/documents/consumer_alert_annuities_senior_citizens.htm

■ "Consumer Alert" on annuities and older investors from the National Association of Insurance Commissioners that describes types of annuities, ways to figure out whether annuities are right for you, strategies for understanding the product you are buying and a warning about deceptive sales practices.

month at 65.

Inflation is an issue as well. It could decimate the spending power of the monthly retirement income you paid so much to guarantee. That \$910 a month you've amassed with MetLife's product, for example, would be worth roughly \$670 a decade from now, assuming an annual 3% inflation rate. Some products are adding inflation-protection features—but they can reduce the initial monthly income provided by as much as 30%.

Variable

Like fixed annuities, variable annuities in 401(k) plans typically guarantee a specific retirement income. But variable annuities hold out the additional promise of an occasional increase in payments, which could help you keep up with inflation. That said, these products can be even tougher to understand.

The features generally work like this: Your variable annuity is invested in a portfolio of stocks and bonds, chosen either by the insurer or yourself. At some point each year, typically your birthday, the insurer gauges your portfolio's market value. If it has grown, the insurer bumps up your payment. If it has fallen, the insurer can lower the payment, but not beneath the initially guaranteed minimum.

For instance, with **Genworth Financial Inc.'s ClearCourse** variable annuity, a 45-year-old worker who invested \$100,000

ucts, along with more investment options that could provide a better shot at getting the guaranteed income bumped up. But he and his staff spend about 2,000 hours a year culling through products to get those results, he says.

FLEXIBILITY: On the plus side, it's easier to move contributions out of annuities and into mutual funds inside your 401(k) than it would be with annuities you hold on your own. (You simply give your plan custodian a new allocation for your investments.) But if you ditch your 401(k) annuity for a different type of investment, you will have wasted the money paid in add-on fees.

Contributing to an annuity within your 401(k) "only makes sense if you plan to hold onto it and use it as protection," says Moshe Milevsky, an associate professor of finance at York University in Toronto who has studied the products. "This is not just another [exchange-traded fund] to trade in and out of."

JOB SECURITY: If you expect to change jobs, a 401(k) annuity could be a hassle, mainly because there might not be an equivalent option in a different employer's 401(k) plan. You have the right to leave a balance worth at least \$5,000 in your former employer's defined-contribution plan, and many employers let you leave your assets in the plan in retirement, says David Wray, president of the Profit Sharing/401(k) Council of America in Chicago. But you should find out specifically what could become of your annuity. If you have saved less than \$5,000, your investment could be converted to cash and rolled into an individual retirement account, he says.

Preserving a Nest Egg

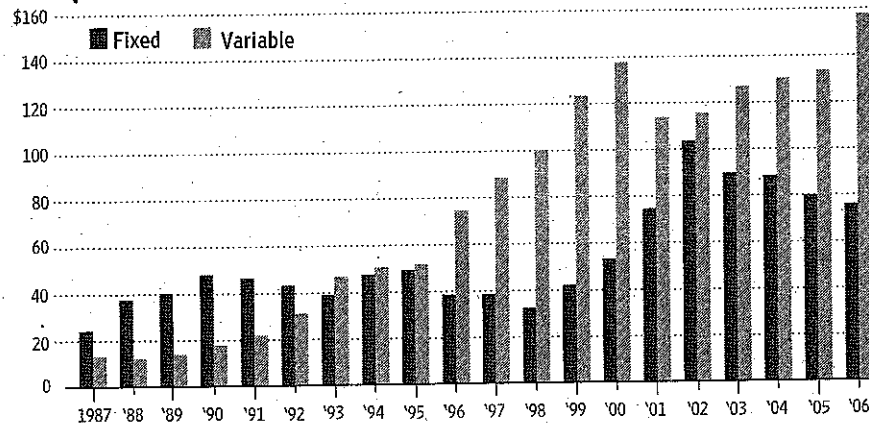
Marketing annuities through 401(k)s is just one part of the insurance industry's efforts to play a larger role in, and profit from, consumers' preparations for retirement. While sales of fixed annuities have tailed off in recent years, sales of variable annuities are climbing, in part

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Preserving a Nest Egg

Marketing annuities through 401(k)s is just one part of the insurance industry's efforts to play a larger role in, and profit from, consumers' preparations for retirement. While sales of fixed annuities have tailed off in recent years, sales of variable annuities are climbing, in part because of products with guaranteed benefits.

Total sales, in billions of dollars



Sources: NAVA, the Association for Insured Retirement Solutions; Morningstar Inc.; LIMRA International

value and income-payment level can vary based on those investments' performance.

Taxes for deferred annuities (including those in 401(k)s) generally are not owed until the payments are made. Those payments generally are taxed at ordinary income rates.

Although both fixed and variable annuities are available in 401(k)s, so far most employers offer only one or the other. So it's important to know the relative advantages or disadvantages of both.

Fixed

With fixed annuities inside 401(k)s, interest rates and your age at the time you invest affect the size of your eventual payments. Investing early increases the payout because your money is invested longer. Higher interest rates at the time of the investment also boost payouts because the insurer earns higher returns, and those returns are reflected in lower annuity purchase rates.

Purchasing fixed annuities inside your 401(k) can hold some advantages by taking advantage of dollar-cost averaging. "If you retire when interest rates are low, then the cost of [buying] an annuity [at retail] is high. But if you buy a little bit each year [in a 401(k)], you average out the risk," says Robyn Credico, national director of Watson Wyatt Worldwide's defined-contribution consulting practice in Arlington, Va.

For example, a 65-year-old man who bought a \$100,000 immediate fixed annuity from MetLife Inc., New York, in June would get \$700 a month for life. But if he or she had invested \$10,000 a year for the past decade in MetLife's Personal Pension Builder, available in more than two dozen 401(k) plans so far that are managed by Merrill Lynch & Co. Inc., the retiree would get monthly payments of \$910. (This is theoretical; Personal Pension Builder wasn't available until 2005, and employees in participating plans are just now learning about it.)

In another example, let's say you're 50

in 1985 (theoretically) and retired at the end of 2005 would have received payouts totaling \$26,718 in the first year of retirement. The lowest payout, if the portfolio had been flat, or tanked, could have been \$15,536 a year. These guarantees come at a price—ClearCourse charges 0.85% of assets each year plus investment-management costs.

Prudential Financial Inc.'s Prudential IncomeFlex product works much the same way, but it gives you a choice of five proprietary mutual funds, ranging from conservative to aggressive, in which to invest. And the newest variable annuity for 401(k)s, Lincoln National Corp.'s i4Life Advantage, markets itself as offering upside potential and the ability to make cash withdrawals. But there's also a downside: Your guaranteed income could drop to 75% of your initial minimum if your investments do badly.

THE RETAIL ROUTE

Even if your employer adds an annuity to your 401(k), don't ignore the offerings in the retail market. Few products within the financial-services industry are changing faster—and for the better—than annuities. Insurers have created dozens in the past few years, and the competition means there are viable alternatives you can find on your own. Some insurers, for example, are working on annuities that could be used to pay for long-term care, says Mike DeGeorge, general counsel for NAVA Inc., a variable-annuity trade group.

Here are things to consider when comparing a retail annuity with one offered in your 401(k):

COST: An annuity purchased within a 401(k) can cost half as much in fees as an annuity you buy on your own since there are no insurance-agent commissions involved. Plus, there are no surrender charges—penalties that retail products often slap on investors who want out early.

Some retail annuities can outperform those within 401(k) plans. But you have to

of the Profit Sharing/401(k) Council of America in Chicago. But you should find out specifically what could become of your annuity. If you have saved less than \$5,000, your investment could be converted to cash and rolled into an individual retirement account, he says.

SHOPPING YOUR ROLLOVER

If it all seems too complicated, you could simply wait until you retire—and then buy a fixed, immediate annuity with a chunk of your IRA rollover. In the meantime, your 401(k) plan may have added a way to help you do that, too. Large employers including International Business Machines Corp. are signing up for services that make comparison-shopping for annuities easier for retirees.

Minneapolis-based Hueler Cos. has developed a Web-based service, Income Solutions (incomesolutions.com), which retrieves quotes for fixed, immediate annuities. The company's president, Kelli Hustad Hueler, says the service scores discounts of 3.5% to 5% off retail prices and provides apple-to-apple comparisons. In October, Fidelity Investments launched a similar service for participants in the 401(k) plans it administers (though its employer clients have to opt into it).

Similar services are popping up for individual retirees as well, including longevity-alliance.com, the Web site of Longevity Alliance, of Washington, D.C., which was launched in 2005 by a former AARP executive in part to offer annuity counseling and comparison shopping.

You also can hire a financial adviser specifically to help you shift investments into immediate annuities during retirement. For example, MassMutual Financial Group, of Springfield, Mass., has created a retirement management account through which you set a target income, and then gradually convert the account's assets from mutual funds into a fixed immediate annuity, with the goal of keeping pace with inflation.

Still, there's one potential drawback to the wait-and-see approach: If life expectancies continue to rise, annuity payments—which would then have to be stretched across longer lifetimes—would be reduced.

"You don't want to wait to buy an annuity until Merck discovers the drug that keeps us alive five more years," Dr. Milevsky says. ■

MORE AT WSJ.COM

PODCAST: What do you need to know before you go shopping for a variable annuity with guaranteed payments? Find out as Wall Street Journal reporter Kelly Greene interviews Mark Cortazzo, a certified financial planner and senior partner with Macro Consulting Group. You can listen to the discussion at WSJ.com/Podcasts.

VIDEO: Get an insider's look at life on a long-range bicycle tour. Cycling fan Holly Edwards talks about her adventures on the open road, including an odyssey up the Mississippi River, and how they've changed her life. You can see the interview at WSJ.com/Video.

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