PENSION BENEFIT STATEMENTS SHOULD ALSO ILLUSTRATE INFLATION-ADJUSTED ANNUITIES

by

Jonathan Barry Forman[1]
Alfred P. Murrah Professor of Law
University of Oklahoma
College of Law
300 Timberdell Road
Norman, OK 73019
United States of America
jforman@ou.edu
http://www.law.ou.edu/profs/forman.shtml
(405) 325-4779

Comments on the

Employee Benefits Security Administration
Advance notice of proposed rulemaking on Pension Benefit Statements[2]

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I am submitting these comments in my individual capacity as the Alfred P. Murrah Professor at the University of Oklahoma College of Law. At the outset, I wholeheartedly agree that the Department of Labor should issue regulations that would require a participant's accrued benefits to be expressed on her pension benefit statement as an estimated lifetime stream of payments, in addition to being presented as an account balance. However, instead of using the normal retirement age under the plan for lifetime income illustrations, I believe that these illustrations should use the participant's Social Security full retirement age. Moreover, in addition to these standard lifetime income illustrations, pension benefit statements should also illustrate the income streams that would result if the retiree instead purchased an inflation-adjusted annuity.

I. Longevity Risk

Longevity risk—the risk of outliving one's retirement savings—is probably the greatest risk facing current and future retirees. As life expectancy increases, accumulated retirement

[1] Alfred P. Murrah Professor of Law, University of Oklahoma; B.A. 1973, Northwestern University; M.A. (Psychology) 1975, University of Iowa; J.D. 1978, University of Michigan; M.A. (Economics) 1983, George Washington University; Professor in Residence at the Internal Revenue Service Office of Chief Counsel, Washington, DC for the 2009-2010 academic year; Member of the Board of Trustees of the Oklahoma Public Employees Retirement System, 2003-2011.

[2] Employee Benefits Security Administration, *Pension Benefit Statements*, 78(89) Federal Register 26,727 (May 8, 2013).

savings in individual accounts will need to finance longer retirements. A 65-year-old woman already has an even chance of living past age 86, while a 65-year-old man already has an even chance of living past age 84.[3] The joint life expectancy of a 65-year-old couple is even more remarkable. There is a 50-percent chance that at least one 65-year-old spouse will live to age 91, and there is a 25-percent chance that at least one will live to 95.[4] That means married couples can easily have 25 or 30 years in retirement.

These longer lives and longer retirements increase the risk that many retirees will outlive their resources.[5] Accordingly, the government should encourage Americans to retire later and take their benefits in the form of inflation-adjusted annuities.[6] Pertinent here, pension benefit statements should use the participant's Social Security full retirement age and should provide illustrations of inflation-adjusted annuities, in addition to standard lifetime income streams.

II. Use the Participant's Social Security Full Retirement Age

ERISA generally defines "normal retirement age" as the earlier of the time specified in the plan or age 65.[7] Meanwhile, Social Security's full retirement age has already increased to age 66 and is headed toward age 67.[8] As Americans are living longer, many will need to retire later, and having pension benefit statements use the participant's Social Security full retirement age will help encourage Americans to increase their savings by working longer and retiring later.[9]

III. Provide Illustrations of Inflation-adjusted Annuities

Traditional lifetime annuities provide a powerful hedge against longevity risk. For example, for a 65-year-old man who purchased a $100,000 immediate, level-payment annuity

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[3] BOARD OF TRUSTEES, FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, 2013 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS 93 (tbl. V.A4) (2013), http://www.ssa.gov/oact/tr/2012/tr2012.pdf (cohort life expectancy, intermediate assumptions, life expectancy for a 65-year-old female in 2012—21.4 years, for a 65-year-old male—19.1 years).

[4] Fred Reish, *Living "Room"? The problem with living too long*, PLAN SPONSOR (August 2011), http://www.plansponsor.com/MagazineArticle.aspx?id=6442481375.

[5] *See*, *e.g.*, Jack VanDerhei, *All or Nothing? An Expanded Perspective on Retirement Readiness*, 33(11) EMPLOYEE BENEFIT RESEARCH INSTITUTE NOTES 1, 11 (2012), http://www.ebri.org/publications/notes/index.cfm?fa=notesDisp&content_id=5131 (estimating that 44% of Baby-Boomer and Gen-Xer households are at risk of running short of money in retirement and that 19.4% are projected to have less than 80% of what they will need).

[6] *See*, *e.g.*, Jonathan Barry Forman, *Optimal Distribution Rules for Defined Contribution Plans: What Can the United States and Australia Learn from Other Countries?*, 2012 NEW YORK UNIVERSITY REVIEW OF EMPLOYEE BENEFITS AND COMPENSATION 3-1 to 3-41.

[7] ERISA § 3(24), 29 U.S.C. § 1002(24).

[8] Social Security Administration, *Retirement Planner: Full Retirement Age* (May 30, 2012), http://www.socialsecurity.gov/retire2/retirechart.htm.

[9] Of note, one study found that working just one more year can increase annual income 9% overall and by as much as 16% for low-income workers. Barbara Butrica, Karen E. Smith & C. Eugene Steuerle, *Working for a Good Retirement* 28 fig. 2 (Urban Institute, Retirement Project Discussion Paper No. 06-03, 2006), http://www.urban.org/UploadedPDF/311333_good_retirement.pdf.

without inflation protection in December of 2012, the annual payout would be around $6,336 or 6.34% of the annuity's purchase price.[10] With inflation-adjusted annuities, annual payouts start lower but can end up higher. For example, if our hypothetical 65-year-old man instead chose an annuity stream with a three-percent escalator, the annual payout in the first year would be just $4,548 in the first year, but it would increase in later years.[11]

While Social Security benefits are adjusted for inflation, relatively few private pensions or annuities have cost-of-living adjustments. But inflation-adjusted pensions and annuities are exactly what American retirees will need to preserve the value of their benefits as the years go by. Plan participants also need to understand how post-retirement inflation can diminish the real value of their benefits, and they need to be educated about their life expectancies.

Accordingly, in addition to providing illustrations of the income streams that they can expect to receive from standard lifetime annuities, pension benefit statements should also provide illustrations of inflation-adjusted annuities (e.g., by showing the income streams that would be result from purchasing annuities with a three-percent escalator).

Respectfully submitted,

Jonathan Barry Forman ("Jon")
Alfred P. Murrah Professor of Law
University of Oklahoma College of Law
300 Timberdell Road
Norman, Oklahoma 73019
(405) 325-4779
fax (405) 325-0389
jforman@ou.edu
http://www.law.ou.edu/faculty/forman.shtml
OU LAW

[10] *Immediate Annuities Update*, 28(1) ANNUITY SHOPPER 28 tbl. 5 (January 2013), http://www.annuityshopper.com/archives/2013-Jan-Annuity-Shopper.pdf ($6,336 = $528 × 12). As women tend to live longer than men, the annual payout for a 65-year-old woman who elected an immediate, level-payment annuity in December of 2012 would be just $5,880 or 5.88% of the annuity's purchase price ($5,880 = $490 × 12). *Id.*

[11] *Id.* ($4,548 = $379 × 12).