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Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210
Attention: Lifetime Income RFI
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Room 5205
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

The Pension Rights Center, a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families, has long been concerned with the diminishing availability of lifetime income options in most defined contribution plans. Therefore, we are pleased that the Departments of Labor and Treasury are seeking comments on the serious problems that Americans face in managing their assets to ensure they have a source of income through their retirement.

We have already provided comments in the letter dated May 3, 2010, from the Pension Rights Center and other signatories, which focused on issues of particular resonance and concern to women (hereafter referred to as the Women's Pension Coalition letter).

When Congress enacted comprehensive pension reform in 1974, most Americans fortunate enough to participate in employer-sponsored retirement plans were covered by a defined benefit plan, which paid participants a guaranteed monthly benefit throughout their retirement years. It was impossible to outlive these benefits. Moreover, most sponsors of defined benefit plans periodically improved benefits to minimize the erosive effects of inflation on these benefits. With Social Security, such participants could count on a stream of income that assured that they could maintain their standard of living in retirement.

The last several decades, however, have seen a remarkable change in employer-sponsored plans. Today's workers are far less likely than yesterday's workers to participate in a defined benefit plan. If they participate in a plan at all, it is likely to be a defined contribution plan—probably a self-directed 401(k) plan—where they must choose to participate, decide how much to contribute; manage their investments while they work; and manage their investments and the draw-down while they are retired.

Given the challenges of defined contribution plans, tomorrow's retirees, on average, will have less retirement savings and run a far greater risk of outliving those savings than retirees of the

last generation. Moreover, even defined benefit plans increasingly offer, and plan participants increasingly elect, lump-sum payments in lieu of a guaranteed life benefit. To compound the problem, Americans are living longer, which makes it even harder for an individual to ensure that she does not outlive her assets.

Creating a climate in which more Americans can count on a lifetime stream of income would be a remarkably positive development in retirement policy, with one important caveat: the annuities and other products offered to retirement plan participants should be fairly priced, comprehensible, and reliable. Unfortunately, many annuity products that are available today -- particularly those aimed at individuals with modest retirement accumulations -- offer the twin investment demons of high loading fees and low effective returns. Hence it is important for DOL to examine ways of providing lifetime income products that are aimed at improving the lives of individuals in cost-effective and transparent ways.

As a final preliminary note, we believe that the diminished availability of lifetime income products is a contributing, but not the only, factor to the approaching retirement crisis faced by our nation. Too many Americans simply lack access to employer retirement plans and too many of those who are fortunate to have access to such plans are not able to accumulate sufficient assets to ensure a comfortable retirement. Our nation should be addressing the question of lifetime income in the context of these and other issues. We need to begin the process of drafting a new blueprint for a retirement system that is universal, secure, and adequate.

We have divided our comments into three sections. The first section provides background and context to our remarks. Here we provide some thoughts on the value of guaranteed lifetime payments and some of the various reasons that employees generally do not elect or purchase annuities. We also in this section raise some fundamental contextual questions that we think need to inform answers to some of the specific questions that the Departments have posed in their RFI.

The second section suggests some ideas on how to expand availability of lifetime income options, while at the same time assuring that the lifetime income products are appropriate and reasonably priced. The third section focuses on protections for plan participants and their beneficiaries.

I. Background and Context

This section first answers two of the questions posed in the RFI: what are the advantages and disadvantages of lifetime payout options and what are the reasons that result in most people not taking annuities? The section also provides some thought on the problems of small accounts.

1. Advantages and Disadvantages of Lifetime Payment Options

A lifetime stream of income provides predictability and a certain level of security to retirees and their families. In contrast, the risks of managing a lump-sum amount to provide for a secure retirement are well documented. Retirees receiving a lump sum are faced with several choices, none of them ideal. They must manage the lump sum to last over their lifetimes and yet provide steady income. This means not spending it too quickly or conserving too much. They are also faced with investment choices which they are often ill-prepared to make or buy an annuity in the individual market.

There are of course disadvantages to lifetime options in some situations. Some disadvantages are specific to particular individuals: a person with terminal cancer, or a person for whom it is sensible to pay off high-interest debt at the start of retirement, may be better served by taking a lump-sum payment over a guaranteed lifetime income option.

Most annuities available today do not protect against inflation risk. Complete annuitization may defeat a person's desire to leave something to their children or grandchildren. And in the current marketplace, some annuities are expensive and/or complex and/or risky and thus might not be an ideal or even good product for many people.

But, while there are issues that need to be examined, we also note that annuities can be beneficial for many people. They provide guaranteed and predictable benefits for a retiree's remaining life at a level that a lump sum can exceed or replicate only by taking on high levels of mortality, investment, and personal management risks. The 2008 market collapse provides a graphic illustration of how these risks can result in financial devastation—many retirees had to reduce their income streams or markedly increase the risk that they will outlive their assets.

2. *Reasons Plan Participants Often Decline Annuities Options*

Individuals often prefer lump sum payments to annuities for a variety of reasons, including the following (some of the reasons overlap):

- Failure to appreciate that they may outlive their assets, and the attraction to a lump sum, which may be the largest sum of money ever available to participant;
- Need for large sum of money for an immediate purpose;
- Concern about viability of financial institutions over lifetime;
- High cost of purchasing annuities;
- Confusion about how to select an annuity, particularly given the complexity of many annuity products, and the amount of time and effort needed to select a good annuity product;
- Inability to compare products;
- Lack of education about value of annuities and how they are calculated;
- Tendency to accept option offered by the plan, which in 401(k) plans is generally a single-sum payout;
- Desire to leave a legacy for children/grandchildren;
- Small accounts too small to purchase annuity for reasonable premiums;
- Pressure from financial advisers and investment vendors who would receive fees from lump-sum distributions that they could manage;
- Concern about medical emergencies or other future expenses;
- Ability to exercise control over assets;
- Concern about inflationary erosion of fixed income;
- Some plans do not permit partial annuitization;

II. Ways to Increase Use of Lifetime Income Options

Because there are many explanations for why participants in qualified plans often end up without the benefit of guaranteed lifetime income from their retirement savings, there is no single policy innovation that will, in isolation, result in the type of dramatic upswing in selection of lifetime income options that most retirement policy thinkers believe is optimal.

Rather, it is our view that a multi-faceted approach is required, including experimentation to determine which policy innovations might work best. In this section, we provide ideas—some of

which can be accomplished by regulation, some through legislation, and some through government and private sector partnering—that might increase participant usage of lifetime income options for their retirement savings in qualified plans.

1. *Require all defined contribution plans to offer lifetime income options as an election for participants.*

We support this requirement for the reasons suggested in the Women’s Pension Coalition letter. We note, as well, that a plan offering an annuity option will also serve an informational function: it will alert participants that annuities are an option that should be considered and the offering of a lifetime income option might carry with it an endorsement effect.

A lifetime income option should offer participants the opportunity to take a portion of their account balances in a lifetime income form, which would allow participants who are wary of an either/or election to have greater flexibility. It would permit individuals to set aside a certain amount of money for emergencies, large discretionary expenditures, or bequests for their children. Providing such a partial annuitization option would also accommodate individuals who are considering the resources of a spouse or other member of the household when making decisions about income needs in retirement.

The basic lifetime income option should be simple and transparent and subject to the joint-and-survivor rules applicable to pension plans.

Requiring profit-sharing, 401(k), and stock bonus plans to offer a lifetime income option would require legislation.

2. *Default Annuity Option.*

The Retirement Security Project has recommended defaulting participants into a trial annuity, which would be revocable within a certain period. The proposal rests on the premise that the tendency towards inertia and procrastination in most people will result in many participants defaulting into an annuity option, which will give them a chance to experience the benefits of guaranteed annual payments. At the end of the specified period, they can opt out and take a lump-sum distribution, if they are not persuaded of the value of the annuity.

This is a serious idea and worth experimenting with, although it may not enjoy the same positive participant response that some plans have experienced with automatic enrollment 401(k) plans (which are premised on the same assumptions about inertia).

Employers moved to automatic enrollment primarily for three reasons: it was good for employees, it helped satisfy section 401(k) non-discrimination rules, and it did not impose costs or burdens on them. With default annuity options, the first of these reasons is present, but there is no tax benefit to the employer and there may be additional costs—direct and indirect—to the employer in a default option.

Moreover, employees are likely to reflect at retirement on how they wish to take their benefits, and, if they prefer a lump-sum payment, they will elect it despite the default option. In any event, we concur with the Coalition’s recommendation that, before lifetime income payments become the default option for all plans—whether on a trial basis or not, plans first be required to offer lifetime income as an optional form of benefit and then that experience should be studied.

3. *Increasing the safety of annuities.*

Although we discuss this in greater detail in Section III of these comments, participants are more likely to choose a lifetime income option if they know that their income will not be disrupted by the financial insolvency of the insurer offering the income product. Security can be provided either by ensuring the adequacy and coverage of state insurance guarantee funds or by a guarantee by the Pension Benefit Guaranty Corporation.

4. *Tax incentives to moderate- and lower-income individuals to annuitize.*

There have been numerous proposals over the last decade to encourage people to annuitize by offering them individual tax incentives. These proposals generally would create a limited exclusion from income for annuity payments. In some of the proposals, the exclusion would apply from the first dollar of annuity payment up to a cap; in other proposals, the exclusion would apply to a percentage of the annuity payment, up to a cap. Some proposals, but not all of them, would not extend tax benefits for people whose total taxable income exceeded a designated threshold; some proposals, but again not all of them, would offer tax benefits to people who purchased annuities with their own funds directly from insurance companies.

These proposals are problematic. First, the value of the benefit is dependent on a taxpayer's marginal rates, so the incentive would be relatively weak for moderate- and low-income plan participants, who in our view should be the primary targets for such individual tax incentives.

Second, we should expect that an exclusion from income would induce some wealthy individuals to annuitize simply to capture the tax benefits, even though they would extract only limited benefit from the annuity's longevity protection. We might also expect the insurance industry to devote resources to creating products that are heavy on investment and light on insurance to attract this population.

While we do not favor income exclusions as an incentive to annuitize, we believe that the use of tax credits to encourage low- and moderate-income individuals who purchase annuities is an idea worth consideration. The value of a tax credit does not correlate with marginal tax rates, so tax credits would provide stronger incentives for lower- and middle-income individuals. Moreover, insurance companies generally charge more to annuitize relatively small amounts, since there are many fixed costs that do not vary with the size of the amount being annuitized. Limiting tax credits to low- and moderate-income individuals thus can be seen as a means of normalizing the costs of annuitizing large and small account balances.

5. *Issue USA retirement bonds as an investment option for defined contribution plans.*

The federal government currently issues, among other forms of debt, inflation bonds. It might be plausible for the government to combine those bonds with an annuity feature, which might be provided either directly by the government or through a portion of insurance companies that would purchase some of the mortality risk. A participant in a section 401(k) plan could purchase such bonds as investments.

One of the reasons this might be an attractive approach is that younger employees are less likely to have good information about whether life expectancy, so they might be more willing to pre-commit to an annuity payout than an older individual, who will be deciding between an immediate lump sum payout or an annuity. It might also be possible for a default investment to direct some assets to such bonds (or to similar deferred annuity products issued by private

insurers). The bonds might have a pre-retirement death feature, or perhaps a cash-out feature with an appropriate penalty. They might also be subsidized to make them more attractive to purchasers.

6. *Retirement rollovers from defined contribution plans to defined benefit plans.*

When an employee works for an employer that sponsors a defined benefit plan, it can be efficient for the employer to offer an employee the option of rolling over defined contribution accounts to the defined benefit plan, where it could be paid by the defined benefit plan in an annuity form. We are not certain whether any employers currently offer this option, but we believe that some might if there were guidance dealing with issues ranging from section 415, the nondiscrimination rules, and from PBGC on the insured status of benefits purchased from a defined benefit plan with rollover funds.

7. *Enhancing the value of lifetime income products, particularly for lower- and moderate-income participants.*

There currently is a limited insurance market for lifetime income products for individuals with low account balances. We would favor legislation that would permit the PBGC to create low-fee annuity vehicles, at least for individuals with low account balances. We also think that it is worth discussing the creation of national insurance exchanges, in which insurance companies would offer relatively uniform products to enable participants to comparison shop. Such an exchange might include a consumer expert panel that would approve products offered on such exchange.

8. *Education on the value of lifetime income options.*

Education during working years and at the time of retirement will help participants make the choices that are right for them. Participants need background information about the risks of managing money in retirement; longevity risk, health risks and investment risks, including fees. At the same time, the purchase of an annuity involves a consideration of fees and often a choice among types of annuities.

Participant education should include guidance on annuity options and fees, as well as the risks associated with managing lump-sum distributions. EBSA could provide an informational booklet on decisions at retirement with definitions and descriptions of various options, as well as factors to consider when making a decision. EBSA also could issue guidance for employers who wish to provide education programs.

Many participants do not have a sophisticated understanding of how an annuity is calculated. Providing this information during the working years would help participants become familiar with the concept of an annuity.

Here, the individual benefit statement could be used to educate participants by including an estimate of the annuity that could be purchased with the current account balance and an explanation of how the estimate was calculated. Estimates should be kept simple without complicated calculations so they can be easily understood by participants. The agencies could specify by regulation how to calculate an annuity estimate, and the agencies could provide interest rate and longevity tables to be used in the calculation.

The Pension Rights Center thus supports the Lifetime Income Disclosure Act, S.2832, introduced by Senators Jeff Bingaman, Johnny Isakson, and Herb Kohl, which would require

plans to give participants annual estimates of how much the money in their accounts would buy in lifetime monthly payments beginning at normal retirement age.

III. Protecting Participants

Participants face numerous risks when they invest some or all of their assets in a lifetime income product. They face the risk of high initial fees and low effective investment returns; they face the risk of buying an inappropriate product; they face the risk of insurer insolvency. Providing protection against such risks is important in its own right—ERISA is a statute informed by consumer protection issues—but also because participants are more likely to consider such products if they understand what they are purchasing and are confident of its safety.

In this section, we discuss what we consider are the essential components of consumer protection: ensuring the safety of the lifetime income products; the role of the fiduciary in selecting such products; and disclosure to the participant.

1. Safety of Annuity Products

There are two basic approaches to providing safe lifetime income products: relying on fiduciaries, subject to their ERISA duties, to make prudent annuity selections; or providing reliable back-up guarantees for such products. Given that the failure of an insurance provider would be catastrophic for retirees who are receiving fixed income, we believe that the actual back-up guarantees are essential. Even the most careful fiduciary may choose a lifetime income product whose issuer later suffers severe financial stress. The losses to the participants are no less devastating because the fiduciary was careful and attentive when it initially selected the issuer. This is one of the occasions when insurance, not simply prudence in selection, is essential. This would, of course, require legislation.

Currently state insurance guarantee funds provide insurance for the products of failed insurers. The eligibility for and extent of the guarantees, and the health of the guarantee funds, vary from state to state and, even when the guarantees are adequate, there can be a lengthy period before the state fund begins payment. The current system, while workable in many states, is not fully adequate when considered on a national scale.

There are different paths for providing effective insurance protection: federal protection, through the PBGC or another federal guarantee corporation; setting minimum federal standards for state guarantee funds; or a hybrid, both setting minimum standards for state guarantee funds combined with a federal guarantee of such funds.

A legislative effort to create strong guarantees would require resolution of numerous difficult policy issues, including the appropriate relationship between federal and state jurisdiction in the regulation of retirement plan annuity contracts, but such guarantees are in our view not only essential for building consumer confidence in lifetime income products, but also for avoiding potential catastrophic consequence for some retirees.

2. Fiduciary Considerations.

A fiduciary must comply with ERISA's fiduciary standards when selecting an annuity provider. The Department of Labor has provided guidance for fiduciaries selecting annuities and a safe harbor for fiduciaries selecting an annuity contract as a means of benefit distribution. The fiduciary's paramount concern under both the guidance and safe harbor is the safety of the

annuity contract. The RFI specifically asks whether that safe harbor is adequate and how it might be modified to increase its usage without compromising participant interests.

We have two general comments about the application of ERISA's fiduciary rules and then offer some specific suggestions about how to revise the safe harbor to make it both more useful to fiduciaries and more protective of participants.

General Comments

1. Until the issue of guarantees for retirement annuities is addressed legislatively, the issue of annuity safety must be the first consideration for a fiduciary.
2. An equally important fiduciary concern, and one that currently is not clearly reflected in Department of Labor guidance, is product suitability. There are many annuity and other lifetime income products—and there will almost certainly be new products in the future--that may not be “safe” and fairly priced but nevertheless may be unsuitable to the typical participant.

Some of these products would expose retirees to risk that they might not understand and might not be equipped to handle. Thus, we believe that the Department should work on guidance to ensure that plan fiduciaries consider product suitability and provide disclosure and other necessary information, education and advice to assist participants in choosing appropriate products for their needs.

Regulatory Safe Harbor

The current regulatory safe harbor that applies to fiduciary annuity selection is process-based. For an annuity to fit the safe harbor, the fiduciary must engage in an objective, careful, and thorough process to select an annuity, with a substantive focus on the issuer's ability to satisfy future annuity payments and the relationship between the annuity's cost and the annuity's benefits (including administrative services) to the participant. (Other DOL guidance provides the factual considerations in determining an issuer's claims-paying ability and directs the fiduciary to also consider the quality of state guaranty programs.)

We have two concerns with the safe harbor. The first concern is that the safe harbor is essentially a statement of what the ERISA prudence and exclusive benefit rules already require of a fiduciary in terms of process, without providing concrete examples of annuities whose selection would satisfy ERISA standards. The second concern is that the safe harbor does not focus sufficiently on suitability of a particular annuity product for the typical plan participant.

We urge the Department of Labor to redesign the safe harbor to reflect these concerns. Specifically, we would suggest that the safe harbor cover single-life annuities for unmarried participants and joint-and-survivor annuities for married participants. The safe harbor might also cover a limited number of easy-to-understand variations on these basic annuities as alternatives (for example, a trial annuity, end-of-life annuity, or an annuity with a limited right to reach a percentage of the principal). We do not believe that a safe harbor should apply to annuity vehicles that expose participants to substantial investment risk.

For small employers, the ability to determine claims-paying ability in accordance with the current regulatory safe harbor is not realistic—it imposes too much cost unless small-plan fiduciaries have access to reasonably priced expert advice. We note that it may not be cost-effective to have every fiduciary go through an independent and rigorous process to re-determine what we would hope would be a relatively stable conclusion about claims-paying ability and credit-worthiness.

Thus, we believe that in designing a safe harbor, the Department should consider innovative means to help fiduciaries assess claims-paying ability and creditworthiness of insurers (and the extent and coverage of applicable state guarantees) on a cost-effective basis. Perhaps the Department could create an independent expert panel that would, from time to time, provide information to assist fiduciaries in evaluating particular insurers.

3. Disclosure

Most participants in defined contribution plans are not familiar with annuities. In addition to general background information on annuities, participants should have information on the specific annuity products available from the plan. This information should be written in a direct and simple manner to be easily understood by participants, thus enabling them to choose among the various plan options at retirement.

Required disclosures should include:

- A description of the type of annuity and what it means, such as single life annuity or variable annuity;
- The calculations used to determine the monthly amount;
- Definitions and descriptions of the features of the annuity, such as death benefits.
- All fees, including fees applied when the annuity is purchased and any fees applied throughout the years of payment;
 - Any one-time fees triggered by an annuitants' request, such as fees for changing investments, should be disclosed at the time of annuity purchase.
- Investment risks;
- Participants at retirement who are deciding either between two or more annuity options or between a lump-sum payment and an annuity should be given the calculation of the exact amount of monthly income the annuity will provide.
 - If the amount could vary due to changing interest rates or other factors, then that should be clearly explained.

These disclosures should be written and provided according to the current Department of Labor rules for plan disclosures.

If you have any questions about these comments, please contact Karen Friedman, Executive Vice President and Policy Director, at 202-296-3776.

Respectfully submitted,

Pension Rights Center