From: Ben Yahr [mailto:ben.yahr@gmail.com]
Sent: Monday, May 03, 2010 11:13 PM
To: EBSA, E-ORI - EBSA
Subject: RIN 1210-AB33

Ladies and Gentlemen:

Thank you for giving me an opportunity to provide comments in response to the Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans (RIN 1210-AB33) (the “RFI”). I commend the Department of Labor (DOL) and the Department of the Treasury (Treasury) (collectively, the “Agencies”) for this initiative to learn more about guaranteed lifetime income solutions and for their willingness to consider possible rulemaking to facilitate their use.

Based on my experience as an investment advisor to retirement plans, I have addressed several questions relating to the selection of in-plan lifetime income solutions and the administrative challenges they present.

In addition, I have attached a paper ("Individual Pension Account with Purchasing Power Protection" by Shannon and Yahr) which outlines an in-plan lifetime income solution that I believe satisfies many of the RFI’s objectives. Please let me know if I can be of further assistance.

Regards,
Ben Yahr

RFI Questions:

8. What are the advantages and disadvantages for participants of selecting lifetime income payments through a plan (in-plan option) as opposed to outside a plan (e.g., after a distribution or rollover)?

In-plan solutions have the potential to provide participants with the ability to transfer undesired risks (i.e., investment risk, longevity risk and/or inflation risk) to another entity during the accumulation period. If lifetime income payments are provided outside the plan, the participant will need to bear these risks until they are able to distribute the funds into another investment where they are able to transfer them to another party.

Another potential advantage to an in-plan solution is its potential impact on participant behavior. Many participants do not make any positive elections with respect to their retirement benefits. As such, if the default distribution option for a portion of a participant’s account is an in-plan lifetime income benefit, I think that participants would begin to view that portion of their account as being intended for income purposes and would be less likely to withdraw those assets as a lump sum. Outside the plan solutions necessitate a lump sum distribution into another appropriate vehicle and encourage participants to view their retirement account as a lump sum amount and not as future income payments.

For high net worth investors, out of plan solutions are significantly more flexibility than in plan solutions. Retail annuities can be tailored to fit participants' needs at distribution. However, participants with smaller account balances may find it difficult to access good advice and to find the best product for their needs. For these participants, an in-plan solution may offer better or more appropriate benefits.

Interestingly, in today's market, retail variable annuities with riders that provide a guaranteed lifetime withdrawal benefit appear to offer richer benefits than their institutional counterparts for a comparable cost. This observation is opposite what one would normally expect.

14. What are the impediments to plan sponsors' including lifetime income options in their plans, e.g., 401k or other qualification rules, other federal or state laws, cost, potential liability, concern about counterparty risk, complexity of products, lack of participant demand?

While some in-plan lifetime income solutions are available in the market, plan sponsors have been reluctant to offer these benefits. I think that there are several factors contributing to the lack of use.

- The in-plan income solutions are very complex. As such, these solutions are difficult for plan sponsors, participants and advisors to understand.
- The in-plan solutions are difficult to administer/provide record keeping services. Therefore, solutions to date tend to be bundled with a single insurance company's recordkeeping platform.
- Given the potential record keeping requirements (and existing limitations), it is unclear whether participant benefits will be able to continue when they leave the plan through termination or if the plan sponsor switches providers.
- From a fiduciary standpoint, a plan sponsor could potentially be held liable if some participants lose benefits they paid for because the plan sponsor elects to switch providers.
- Plan sponsors are concerned about the safeguards built into the products/in-plan lifetime income solutions to protect participants from themselves. Most of the guaranteed minimum withdrawal benefit (GMWB) for life product designs are only guaranteed if the participant doesn't withdrawal more than the guaranteed amount. If more is withdrawn, some carriers re-determine the guaranteed amount, which could erode the participant's guaranteed benefit.
- If an in-plan lifetime income solution is implemented, low balance participants that would have historically taken a lump sum distribution would probably remain in the plan and could increase the administrative cost of the plan.

21. Should an individual benefit statement present the participant's accrued benefits as a lifetime income stream of payments in addition to presenting the benefits as an account balance?

Yes. I believe the benefit statement should include the amount of monthly income a participant's current balance may translate to in today's dollars for both a single life annuity and a joint and survivor annuity when the participant reaches his/her normal social security retirement age. In addition, the benefit statement should include the amount of future income

that may be generated with a 1% of salary monthly contribution until the normal retirement age.

This information would allow a participant to observe the amount of income in today's dollars that he/she may be able to generate from the retirement plan (and social security) and to adjust his/her savings rate as necessary to achieve the desired income replacement ratio.

INDIVIDUAL PENSION ACCOUNT WITH PURCHASING POWER PROTECTION

Benjamin J. Yahr[1] and Patrick J. Shannon[2]

EXECUTIVE SUMMARY

Rather than reinventing the wheel, a new investment election could be introduced into the existing defined contribution system in the US, which would satisfy many of the objectives outlined in the Department of Labor's Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans. Rather than reinventing the wheel, the new investment election would allow participants to purchase an inflation adjusted defined benefit inside their existing defined contribution plan and/or IRA. Contributions and fund transfers into this new investment choice would purchase units for this benefit. The unit value would be based on the attained age and gender of the individual, using the value of a deferred immediate annuity payable at the target retirement age using a pre-defined real interest rate. The participant's total number of units will equal the annual inflation adjusted benefit the participant has accrued in today's dollars. Each year, the number of units would be increased by inflation (similar to TIPS). This feature would make it very easy for participants to observe their accrued annual retirement benefit in today's dollars. As a result, their retirement income would be predicable and guaranteed, which would make it easier for participants to plan for their retirement.

Similar to FEGLI, a government sponsored entity (possibly a committee from the PBGC or Social Security Administration) will provide governance of this benefit. This government entity will select an insurance company to be the lead provider of the benefits from an open bid process. Government sponsorship of the program would ensure portability and enable a broad sharing of longevity risk across the insurance companies who wish to participate. The insurance companies will primarily invest in TIPS to hedge the inflation risk.

As part of the transition process, we recommend changing ERISA Section 404(c) to permit (or prescribe) this benefit as a Qualified Default Investment Alternative (QDIA). In addition, to help enable portability and access, we recommend establishing state sponsored defined contribution plans that any employer could elect to use in lieu of sponsoring their own plan. To help encourage participation and efficient pricing, the US government could create a series of TIPS for funding these benefits that have varying times to maturity and a fixed or predetermined real rate of interest. In other words, guarantee the availability of a hedging investment.

While normal variance would be absorbed by the participating insurance companies, the governance structure will define a self-adjusting mechanism to respond to extreme events. If experience is significantly different than the pricing expectations, the target retirement ages by cohort would be recalculated using a predetermined process.

1. INTRODUCTION

Historically, many participants were covered by defined benefit plans, which provided guaranteed lifetime income on top of social security. However, the number of individuals who are covered by defined benefit plans has

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diminished rapidly over the last 20 years, due to the plan cost and employers' desire to eliminate the risk associated with administering these plans. Now, only 20% of the employees are covered by these plans.

Today, the majority of employees are covered under defined contribution plans, which shift all of the investment risk, longevity risk and inflation risk on to the participant. Unfortunately, individuals are not equipped to efficiently manage these risks. Many individuals lack the necessary knowledge or time to make prudent investments. Others suffer from bad decisions such as chasing returns, impulse spending, etc. While target date funds were developed to manage a portfolio of assets for an individual who is planning to retire in a particular year, they do not provide adequate protection for participants who are nearing retirement, as evidenced by the 2008 calendar year returns for the target 2010 funds.

To compound matters, individuals who are not considered "high net worth" investors may find it difficult or impossible to get access to insurance products that create an income stream. Insurance products are complicated and intimidating for the average consumer. Therefore, consumers often rely on the advice from their financial advisor, insurance agent, or broker, who may not have their incentives aligned with the individual. This lack of trust or conflict of interest lessens the likelihood of an individual hedging their longevity risk. There exists a lack of transparency in the annuity market, making it nearly impossible for an average investor to evaluate different annuity products. Longevity hedging securities (annuities) can be very expensive, due to high distribution costs and unnecessary benefits.

Given the state of the US retirement system, it is important to find a solution that:

- Provides guaranteed income to individuals to supplement their social security benefits
- Aligns roles with stakeholder skills
- Can be adopted into the existing retirement system
- Can be implemented in an effective low-cost manner

Rather than reinventing the wheel, a new investment election could be introduced into the existing defined contribution system in the US, which would satisfy many of the objectives outlined in the Department of Labor's Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans. The new investment election would allow participants to purchase an inflation adjusted defined benefit inside their existing defined contribution plan and/or IRA. For the remainder of this paper, we will refer to this new investment option added to a defined contribution plan as an Individual Pension Account with Purchasing Power Protection (IPAwithPPP).

2. Benefit Description

IPAwithPPP mitigates some of the potential moral hazards that plague defined contribution plans. First, the benefit is only available in the form of lifetime income or joint lifetime income; thus, much of the behavior risks (loans, chasing returns, having too much invested in risky investments, etc.) associated with an individual are eliminated. Next, the number of units owned in IPAwithPPP translates directly to the annual retirement benefit in today's dollars at the target retirement age. As a result, it is much easier for a participant to gauge whether they are on track with their retirement savings and take action before it is too late. Third, IPAwithPPP enables employees to transfer inflation risk and longevity risk to insurance companies, entities with the expertise, ability, and desire to assume those risks.

The IPAwithPPP would fit right on top of Tier I social insurance. The total benefit would be communicated to participants in the form of guaranteed annual income in today's dollars. As such, it will be simple for a participant to determine the percent of their existing income they will be able to replace when they retire.

One significant difference from Tier I social insurance is the equity between income levels. Low-middle and middle-class workers will be able to replace a significant portion of their income, when combined with Social Security.

2.1. What is the benefit?

A new investment election would be introduced into the existing defined contribution system in the US. The new investment election would allow participants to purchase an inflation adjusted defined benefit inside their existing defined contribution plan and/or IRA.

2.2. How will it work?

Contributions and fund transfers would purchase units for this benefit. The unit value would be based on the attained age and gender of the individual, using the value of a deferred immediate annuity payable at a specified age using a pre-defined real interest rate. The participant's total number of units will equal the annual inflation adjusted benefit the participant has accrued in today's dollars. Each year, the number of units would be increased by inflation (similar to TIPS). Please refer to the appendix for a numerical example.

When the participant reaches the specified retirement age, the default option for a married participant would be a joint and 50% survivor life annuity, using an actuarially based adjustment factor. This level of income would be included on all statements in addition to the single life annuity income amount. This feature would make it very easy for participants to observe their accrued annual retirement benefit in today's dollars. As a result, their retirement income would be predicable and guaranteed, which would make it easier for participants to plan for their retirement.

If the participant dies prior to the specified retirement age, the participant's accumulated balance would be transferred to the participant's spouse at the spouse's applicable unit value. Other than the death benefit and retirement income, no other benefits would be available.

2.3. Who sponsors the benefit?

The IPAwithPPP will be integrated into the current private retirement system available in the US. It operates similar to a mutual fund, which can be an investment option available in both defined contribution plans and IRAs.

2.4. How will the benefit be communicated to participants?

Employers will still play a big role in terms of access and education. The qualified default investment alternative could become the IPAwithPPP. This benefit solves a number of the moral hazard issues which plague the current DC system in the US. However, participants need to understand that the money deposited into this option is not available for loans, lump-sum distribution, hardship withdrawals, etc. The sole purpose of the IPAwithPPP is to provide supplementary retirement benefits on top of Social Security.

An effective communication mechanism may be to integrate the communication of a participant's social security benefit and their IPAwithPPP benefit. This coordinated communication could either be provided by the Social Security Administration two months prior to a participant's birthday or by the insurance company or recordkeeper administering the IPAwithPPP benefits, by linking into the SSA database. Education materials could also be available on-line for participants.

3. GOVERNANCE STRUCTURE

3.1. Define governance roles

A government sponsored entity will provide governance of the IPAwithPPP benefit. This government entity will select an insurance company to be the lead provider of the benefits from an open bid process. The government entity (or possibly lead insurer under prescribed guidelines) will then solicit other insurance companies that meet strict qualification guidelines to join the pool. Any insurance company that the government entity invites and is willing to accept the terms of the pool may join the group of insurance companies insuring the benefit. The government entity will also be responsible for regular spot checking of the creditworthiness of the companies in the pool, periodic review of the appropriateness of the investments supporting the IPAwithPPP benefits, and independent analysis of the reserve adequacy of the pool, as performed by the lead insurer.

In an effort to promote efficiency, employers could elect to offer a state sponsored defined contribution plan, which would transfer all responsibility for the retirement plan to the sponsoring state. States' roles would be similar to their role in sponsoring a 529 plan. Each state could choose a plan design from one of several prototype safe harbor plans. Then, the state would assume fiduciary responsibility for the plan, including the selection of investment options, a custodian, and a recordkeeper. In addition, the state would be responsible for all related compliance testing and government reporting. If the employer selected a state/plan design that required employer contributions, then the employer would be responsible to make those contributions. In return for being relieved of the responsibilities and expenses of sponsoring a retirement plan, employers who choose to offer the benefits through the state sponsored plans would have reduced flexibility in selecting/customizing their retirement plans.

3.2. Formation of Pool

A pool will be formed to facilitate the sharing of this risk. Companies will be approached to join the pool and asked whether they wish to bid on becoming the lead administrator and/or insurer. The board of directors described in section 3.3 will be responsible for choosing the lead administrator and the lead insurer. It is not obligatory that these two roles are filled by the same company.

Risk sharers will need to meet designated capital and surplus requirements. In order to remain a risk taker, these or updated requirements will need to be perpetually satisfied. The initial shares will be allocated in a way similar to the allocation of reinsurance limits on catastrophe programs. Each company will submit terms and limits that they would accept. Then, the final terms would be determined such that the capacity would exceed the total expected amount of annual contributions into the IPAwithPPP benefit. The shares would be allocated to each company based on their limits. In future pool years, current pool members could increase or decrease their shares at the prevailing terms. If there was insufficient interest from existing pool members, the pool could open up to new membership. If the pool wants to change the terms, then the initial process would be conducted again.

The administrator would be responsible for all record keeping and banking. All interested companies will submit to a bid process for the committee to choose the administrator. An administrative agreement between the pool members and the administrator will determine the rules under which this pool will operate.

3.3. Checks and balances

The board of directors of the government sponsored entity that provides oversight to the IPAwithPPP benefits will contain a combination of professional, government and industry representatives. The board members will be appointed by congress (or other responsible government agency) and have pre-specified terms (maybe 3 or 5 years).

Every five years, the government sponsored entity that oversees the IPAwithPPP benefit will conduct an open bid process to select/re-confirm the lead insurer. This open bid process will ensure that the program continues to offer competitive benefits to participants while providing a sufficient amount to time to permit the lead insurer to amortize any acquisition costs. The public accounting firm who will serve as the auditor will also be selected every five years.

Each year, a public accounting firm will audit the IPAwithPPP benefits. They will be responsible to verify that the lead insurer and other pool members are following the agreed upon guidelines. In addition, they will verify that participant benefits are being credited accurately, that reserves are complete, accurate, and in accordance with generally accepted accounting procedures, and that the benefits are properly paid. The audit engagement would be similar to work conducted for insurance companies and mutual funds.

Rating agencies will monitor the insurance companies' risk management practices and solvency. Insurance companies who choose to engage in risky practices (i.e. forgoing hedges for potentially increased profit) could potentially be downgraded. Most insurance companies desire to keep a certain level of ratings and will make decisions in an attempt to maintain their desired rating. Ratings are easily observable for the government sponsoring entity as well as the public.

State regulators will also play an important role as each state's insurance department monitors the statutory solvency of the insurance companies domiciled in its state. If an issue exists in one of the insurance companies that is part of the pool, the state regulator would step in to monitor the remediation. At this early stage, the pool could recapture the business placed with this insurance company based on a pre-defined formula. This way, if a solvency/liquidity issue occurs in one of the companies in the pool, the liabilities attributable to the IPAwithPPP benefit could be transferred in an orderly process. Since a process would be in place to transfer IPAwithPPP liabilities back to the pool in the event of financial distress, the IPAwithPPP benefit would not be subject to state life and health guarantee association coverage.

3.4. Self Adjusting Mechanism

It is important to note that normal variance will be absorbed by the insurance companies electing to participate in offering these benefits. Profits and losses within certain bounds will flow to their bottom line and their shareholders. If an extreme event moves the funding status of the benefits outside of the normal variance, the governance structure will allow for a process to change the target retirement age. The definition of an extreme event could be in terms of standard deviation (e.g., experience that translates to 6 times the normal standard deviation or more) or in terms of a CTE (e.g., an event that leads to a CTE of 99%). Since a small change in the retirement age will have a big impact on the level of funding (see the American Academy of Actuaries August 2008 briefing statement where they advocated increasing the normal retirement age for an example of the impact of a small change in retirement age), the self-adjusting mechanism will keep the funding within balance, even in extreme situations.

When changes to the target retirement age are necessary, the governance structure will balance the time horizon of the cohorts who are retired and about to retire with the intergenerational subsidy that may be occurring. We believe it is desirable to keep the retirement age and benefit levels relatively constant for people in or close to retirement. We would also want to preserve the purchasing power of the units that participants had accumulated. As a result, any positive or negative deviations outside of the normal levels of variance would change the retirement ages of the cohorts with a longer time horizon (i.e., younger people with more than 10 years to retirement).

4. Stakeholder Roles

4.1. Society

Society will need to encourage employers/plans to establish IPAwithPPP as the qualified default investment alternative (QDIA). For most individuals, this investment option would be more prudent than a target retirement fund. Society could either mandate the adoption of the IPAwithPPP as the QDIA or create a strong incentive by modifying the fiduciary safe harbor that the Pension Protection Act created.

Similar to FEGLI, a government sponsored entity (possibly a committee from the PBGC or Social Security Administration) will provide governance of this benefit. This government entity will select an insurance company to be the lead provider of the benefits from an open bid process. The government entity (or possibly lead insurer under prescribed guidelines) will then solicit other insurance companies that meet strict qualification guidelines to join the pool. Any insurance company that the government entity invites and is willing to accept the terms established by the lead insurer may join the group of insurance companies insuring the benefit. The government entity will also be responsible for regular spot checking of the creditworthiness of the companies in the pool, period review of the appropriateness of the investments supporting the IPAwithPPP benefits, and independent analysis of the reserve adequacy of the pool, as performed by the lead insurer.

Rather than relying solely on employers to provide access and have to bear the administrative costs of running a defined contribution or defined benefit plan, we recommend establishing state sponsored defined contribution plans that any employer could elect to use in lieu of sponsoring their own plan. States' roles would be similar to their role in sponsoring a 529 plan. Each state could choose a plan design from one of several prototype safe harbor plans. The state would assume fiduciary responsibility for the plan, including the selection of investment options, a custodian, and a recordkeeper. In addition, the state would be responsible for all related compliance testing and government reporting. Another potential advantage of the state sponsored plans is that they would provide a recordkeeping facility to ensure portability of the IPAwithPPP benefit for terminated workers.

This approach could enable small employers to offer retirement benefits without worrying about taking on fiduciary risk, financial risk and compliance risk. If the employer selected a state/plan design that required employer contributions, then the employer would be responsible to make those contributions. In return for being relieved of the responsibilities and expenses of sponsoring a retirement plan, employers who choose to offer the benefits through the state sponsored plans would have reduced flexibility in selecting/customizing their retirement plans. Since the state offered plans would be optional, small employers who wish to set up a more complex plan designs to enable the owners to maximize their contributions would be able to continue these plan designs.

4.2. Individuals

Employees are still responsible for saving for their individual retirement. However, IPAwithPPP helps mitigate some of the potential moral hazards that plague defined contribution plans. First, the benefit is only available in the form of lifetime income or joint lifetime; thus, much of the behavior risks (loans, chasing returns, having too much invested in risky investments, etc.) associated with an individual are eliminated. Next, the number of units owned in IPAwithPPP translates directly to the annual retirement benefit in today's dollars at the target retirement age. As a result, it is much easier for a participant to gauge whether they are on track with their retirement savings and take action before it is too late. Third, IPAwithPPP enables employees to transfer inflation risk and longevity risk to insurance companies, entities with the expertise, ability, and desire to assume that risk.

While normal variance would be absorbed by the participating insurance companies, the governance structure will define a self-adjusting mechanism to respond to extreme events. If experience is significantly different than the pricing expectations, the target retirement ages by cohort would be recalculated using a predetermined process. To

the extent a funding shortfall exists, the retirement age of younger participants may be adjusted to restore balance in the system.

4.3. Employers

Employers have historically provided access to retirement plans and a communication channel to educate employees on various aspects of retirement planning. Under IPAwithPPP, we envision that employers would continue to encourage workers to save for retirement and provide them with educational resources related to retirement planning.. For employers who wish to provide a more attractive employee benefit, they would still have the ability to make non-elective, matching or discretionary employer contributions, as they can do under the current defined contribution plans. Employers will also have the ability to transfer all responsibility for the retirement plan to state sponsored entities, as discussed in Section 4.1. Employers who currently do not sponsor retirement plans may decide to begin offering retirement benefits by using the state sponsored plans.

4.4. Markets

4.4.1. Insurance Companies

Insurance companies will assume inflation risk and longevity risk. They will retain the longevity risk and hedge the inflation risk by purchasing TIPS. Insurance companies will also provide a death benefit to transfer a participant's accumulated balance (i.e., # of units times the unit value) to a participant's spouse in the event of a participant's death prior to retirement.

The lead insurer will take the expense risk of administering the pool.

4.4.2. Hedging Instruments

The insurance companies will primarily purchase TIPS to hedge the inflation risk. A small portion of the portfolio may be invested in corporate bonds or other investments to help increase the spread/lower the cost of the benefits. While the program could certainly work today, the efficiency of the program could be greatly improved if the government is willing to make a special series of TIPS available for the purpose of providing IPAwithPPP benefits. The key item is for the government to agree to supply TIPS of varying durations with a specific real rate of return. This will allow insurance companies to price deferred immediate annuities with a known real interest rate. As a result, the insurance companies will be able to determine the unit value at each age with certainty and the number of units a participant has accumulated will correspond to his/her annual benefit in today's dollars. We believe there may be secondary benefit of allowing the government to "to refinance" part of the current debt held by foreign entities while supporting a program aimed at shoring up retirement saving for the middle class. Having a regular purchaser of US debt securities may help to stabilize the US currency and possibly lead to lower inflation on imported commodities.

4.4.3. Recordkeepers

Recordkeepers will be responsible for tracking the number of units that participants have purchased, communicating this information to participants, making payments to retired participants, answering participant phone calls, administering death claims, etc. While the IPAwithPPP benefit will look similar to a mutual fund on their existing platform, the recordkeeper will need to be able to identify the participant's age and gender to ensure that they are using the proper unit values. They will also need to be able to identify a participant's marital status on the death of the participant and at retirement, which could be accomplished through claim forms.

5. Administrative Costs

The administrative costs and risk charges will be covered by the spread between the real interest rates earned by the insurance companies and the real interest rates assumed in the development of the unit values.

The administrative costs for IPAwithPPP fall into several categories: governance, recordkeeping, and insurance. The most significant of these expenses will be the insurance cost, which we believe would be around 50bp and would be absorbed by the spread between the real rate TIPS earn and the rate credited to participants. This insurance cost will cover the risk charge, profit margin and expenses incurred by the insurance companies participating in the pool. The lead insurance company will receive slightly more of the expense charge to offset their extra expenses in administering the pool. Similar to a mutual fund back-office, they would be responsible to determine the number of units outstanding, the unit value of each and communicate this information to each custodian/recordkeeper. In addition, they would be responsible to produce reports on the funds received and send/receive money from each of the pool members. The insurance companies will also need to either provide recordkeeping of these benefits or provide a modest amount of revenue sharing to offset the recordkeeper's expenses associated with administering this benefit. Also included in this insurance cost is the amount needed for the death benefit of married participants.

The cost of governance should be modest in light of the expected scale of this benefit. It will likely consist of the salaries of the governing board members and independent auditor fees. In total, this should be less than a few million dollars per year.

Recordkeepers may need to enhance their systems to enable them to identify and track a participant's age and gender, which are key items in determining the unit value of a participant's benefits. Since the system changes will likely be a one-time enhancement, they can be amortized over many years.

6. Transition Issues

6.1. Legislative Changes

6.1.1. Changes to ERISA Section 404(c)

While not a necessary constraint for success, the government could encourage this benefit as the qualified default investment alternative. However, at a minimum, several changes will need to be made to ERISA Section 404(c) to permit the use of the IPAwithPPP benefit by plan fiduciaries. Specifically, since the IPAwithPPP would not permit the transfer of funds out of the benefit (money allocated to this fund are purchasing a deferred immediate annuity), the rules governing transfers in and out of the core funds and low risk funds will need to be modified to permit the use of the IPAwithPPP benefit. Also, it may make sense to allow a plan to simply offer the IPAwithPPP benefit as the only option. In this case, the requirement to allow participants to choose between three or more alternatives would need to be modified. It may also be desirable to modify the legislation to permit plans to allocate employer contributions to the IPAwithPPP benefit instead of allowing participant investment control over these contributions.

6.1.2. Beneficiary Changes

Under current rules, a participant's funds are passed along to their spouse or beneficiaries upon their death. These rules would need to be slightly altered for funds that are deposited into the IPAwithPPP benefit. If a participant in IPAwithPPP dies before they reach retirement age, any funds in the IPAwithPPP account will flow into their spouse's account if they are married or be forfeited if they do not have a living spouse at the time of the participant's death. In this way, those who die prematurely will provide funds for those participants who live longer than their life expectancy.

6.1.3. Federal Insurance Regulation

Because of the nature of the IPAwithPPP benefit and the desire to have it be added as an investment option in the current structure of the defined contribution system, this specific insurance benefit should be regulated by federal statutes instead of the 50 individual state rules. State regulation is important and will definitely be one of the checks and balances to ensure that moral hazard is held in check. However, the desire to have a uniform set of benefits enacted uniformly across states (both initially and in the future as experience may warrant) is critical. If this uniformity was not the case, a participant in one state may be subject to a very different deal than a participant in another state, which would make administration very complicated and undermine public confidence in the solution.

6.1.4. Eligibility and Vesting Rules for Employer Contributions

Because of the nature of IPAwithPPP benefits (they are effectively a deferred immediate annuity) and the availability of state sponsored plans, rules would become very complicated if vesting schedules are permitted on employer contributions. As such, rules should be changed so that employer contributions vest immediately. Employers who wish to limit contributions for short-term employees could establish a waiting period before participants become eligible for employer contributions.

6.2. State Sponsored Plans

Current IRS rules for groups that can provide retirement benefits would need to be expanded/modified to permit employers to join state sponsored defined contribution plans. Rather than relying solely on employers to provide access and have to bear the administrative costs of running a defined contribution or defined benefit plan, we recommend establishing state sponsored defined contribution plans that any employer could elect to use in lieu of sponsoring their own plan. States roles would be similar to their role in sponsoring a 529 plan. Each state could choose a plan design from one of several prototype safe harbor plans. The state would assume fiduciary responsibility for the plan, including the selection of investment options, a custodian, and a recordkeeper. In addition, the state would be responsible for all related compliance testing and government reporting. The state plans would also provide recordkeeping services to facilitate portability of the IPAwithPPP benefit for terminated workers.

6.3. New Series of TIPS

To help encourage participation and efficient pricing, the US government could create a series of TIPS for funding these benefits that have varying times to maturity and a fixed or predetermined real rate of interest. In other words, guarantee the availability of a hedging investment. Additional details are discussed in Section 4.4.2.

6.4. Recordkeeper Technology

One significant implementation issue is the ability of recordkeepers to identify the age and gender of participants. If the government encourages the development of IPAwithPPP, we believe that existing recordkeepers will make the necessary enhancements. In addition, entrepreneurs may be enticed into this marketplace with new technology that enables them to administer existing benefits along with the IPAwithPPP benefits.

6.5. Investment Advisor Resistance

It will be difficult for investment advisors to be paid an asset based fee when the IPAwithPPP benefit exists in a defined contribution offering. As such, a move to a flat fee arrangement may be necessary. Then, the investment advisor will need to work with the employer or participant to determine how to structure compensation such that the investment advisor receives the same compensation regardless of which investment choices a participant makes.

7. Conclusion

The IPAwithPPP, a new investment option offered within the existing defined contribution system in the US, would satisfy many of the the objectives outlined in the Department of Labor's Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans. This investment election would allow participants to purchase an inflation adjusted defined benefit inside their existing defined contribution plan and/or IRA. As we discussed, this benefit will provide guaranteed inflation adjusted income to individuals to supplement their social security benefits, align roles with stakeholder skills, and can be adopted into the existing retirement system in an effective low-cost manner.

8. Biographies

BENJAMIN J. YAHR has worked in the financial services industry since 1993. In August, 2006, he joined the 1934 Group, an independent financial services firm that is part of the M-Financial Group. Ben heads up the firm's wealth management services, which include investment advisory services for individuals, endowments, foundations and qualified plans, retirement income planning, and holistic financial planning. Prior to joining the 1934 group, he held a variety of traditional actuarial positions in two insurance companies and a consulting firm. Ben is a Fellow of the Society of Actuaries and a member of the American Academy of Actuaries and holds a Chartered Financial Analyst designation.

PATRICK J. SHANNON has worked in the insurance industry since 1985. In June, 2009, he joined CV Starr. Pat is responsible for all actuarial functions for the Accident and Health operation. Prior to joining CV Starr, he held a variety of traditional actuarial positions at CIGNA and Towers Perrin. Pat is a Fellow of the Society of Actuaries and a member of the American Academy of Actuaries.

9. APPENDIX: A NUMERICAL EXAMPLE

Assumptions:

- Mortality: 80% of the Annuity 2000 mortality table with mortality improvement of 1.0% per year.
- Real Return assumed in unit values: 1.0%
- Specified Retirement Age for IPAwithPPP: 70
- Sample Individual
    - Age: 40 year
    - Gender: Male
    - Salary (in 2010 dollars): $40,000
    - Percent of salary contributed to retirement plan: 10.0%
    - Social Security Benefit at age 70: $22,152 (estimated using the quick calculator on the Social Security website

For this sample person, Social Security would replace approximately 55.4% of his pre-retirement income. If all of his retirement plan contributions beginning today were allocated to the IPAwithPPP benefit, he would replace an additional 18.6% of his income. Therefore, when the IPAwithPPP is combined with social security, the individual in this example would have replaced 74.0% of his pre-retirement income on an inflation adjusted basis.

The unit values for the IPAwithPPP benefit equals the cost of purchasing $1 of inflation adjusted income per year that begins at the specified retirement age for the program. Using the assumptions above for the specified retirement age, mortality and real return, the unit values for a male retiring in 2040 have been calculated in Table 1.

Table 1
Unit Values for a Male Retiring in 2040

Year	Age	Unit Value	Year	Age	Unit Value	Year	Age	Unit Value
2010	40	13.62	2020	50	15.24	2030	60	17.35
2011	41	13.77	2021	51	15.43	2031	61	17.60
2012	42	13.92	2022	52	15.62	2032	62	17.85
2013	43	14.07	2023	53	15.81	2033	63	18.12
2014	44	14.22	2024	54	16.01	2034	64	18.39
2015	45	14.38	2025	55	16.22	2035	65	18.68
2016	46	14.55	2026	56	16.43	2036	66	18.99
2017	47	14.71	2027	57	16.65	2037	67	19.31
2018	48	14.89	2028	58	16.88	2038	68	19.64
2019	49	15.06	2029	59	17.11	2039	69	20.00

Note: The unit values represent the present value of an annuity of $1 of inflation adjusted income per year beginning at age 70.

Table 2 shows an example of the accumulation of units of IPAwithPPP for the sample individual we outlined above. As you can see, in 2040, the IPAwithPPP benefit will replace 18.6% (=7434/40000) of his pre-retirement income.

Table 2
IPAwithPPP Illustration assuming no inflation

				# of Units of IPAwithPPP			
Year	Age	Salary	Contribution	Beginning Balance	Purchased	Credited	Ending Balance
2010	40	$40,000	$4,000	0	294	0	294
2011	41	$40,000	$4,000	294	291	0	584
2012	42	$40,000	$4,000	584	287	0	872
2013	43	$40,000	$4,000	872	284	0	1,156
2014	44	$40,000	$4,000	1,156	281	0	1,437
2015	45	$40,000	$4,000	1,437	278	0	1,715
2016	46	$40,000	$4,000	1,715	275	0	1,990
2017	47	$40,000	$4,000	1,990	272	0	2,262
2018	48	$40,000	$4,000	2,262	269	0	2,531
2019	49	$40,000	$4,000	2,531	266	0	2,796
2020	50	$40,000	$4,000	2,796	262	0	3,059
2021	51	$40,000	$4,000	3,059	259	0	3,318
2022	52	$40,000	$4,000	3,318	256	0	3,574
2023	53	$40,000	$4,000	3,574	253	0	3,827
2024	54	$40,000	$4,000	3,827	250	0	4,077
2025	55	$40,000	$4,000	4,077	247	0	4,324
2026	56	$40,000	$4,000	4,324	243	0	4,567
2027	57	$40,000	$4,000	4,567	240	0	4,807
2028	58	$40,000	$4,000	4,807	237	0	5,044
2029	59	$40,000	$4,000	5,044	234	0	5,278
2030	60	$40,000	$4,000	5,278	231	0	5,508
2031	61	$40,000	$4,000	5,508	227	0	5,736
2032	62	$40,000	$4,000	5,736	224	0	5,960
2033	63	$40,000	$4,000	5,960	221	0	6,181
2034	64	$40,000	$4,000	6,181	217	0	6,398
2035	65	$40,000	$4,000	6,398	214	0	6,612
2036	66	$40,000	$4,000	6,612	211	0	6,823
2037	67	$40,000	$4,000	6,823	207	0	7,030
2038	68	$40,000	$4,000	7,030	204	0	7,234
2039	69	$40,000	$4,000	7,234	200	0	7,434

Note: Each unit represents $1 of inflation adjusted income beginning in year 2040 (age 70).

Table 3 extends the prior example by showing the mechanics of what happens when inflation exists. In this example, we will assume inflation is 3%. As you can see, in 2040, the IPAwithPPP benefit will still replace 18.6% (=17518/94263) of his pre-retirement income, since all else is equal other than the inflation assumption. Similar to TIPS, the number of units added (labeled as "credited" in Table 3) to a participants balance will equal the starting balance times the rate of inflation in the prior year. By increasing units in this manner, the # of Units of IPAwithPPP will always represent the annual amount of income a participant will receive in today's dollars.

Table 3
IPAwithPPP Illustration assuming 3% Inflation

				# of Units of IPAwithPPP			
Year	Age	Salary	Contribution	Beginning Balance	Purchased	Credited	Ending Balance
2010	40	$40,000	$4,000	0	294	0	294
2011	41	$41,200	$4,120	294	299	9	602
2012	42	$42,436	$4,244	602	305	18	925
2013	43	$43,709	$4,371	925	311	28	1,263
2014	44	$45,020	$4,502	1,263	317	38	1,618
2015	45	$46,371	$4,637	1,618	322	49	1,988
2016	46	$47,762	$4,776	1,988	328	60	2,376
2017	47	$49,195	$4,919	2,376	334	71	2,782
2018	48	$50,671	$5,067	2,782	340	83	3,206
2019	49	$52,191	$5,219	3,206	347	96	3,649
2020	50	$53,757	$5,376	3,649	353	109	4,111
2021	51	$55,369	$5,537	4,111	359	123	4,593
2022	52	$57,030	$5,703	4,593	365	138	5,096
2023	53	$58,741	$5,874	5,096	371	153	5,620
2024	54	$60,504	$6,050	5,620	378	169	6,167
2025	55	$62,319	$6,232	6,167	384	185	6,736
2026	56	$64,188	$6,419	6,736	391	202	7,329
2027	57	$66,114	$6,611	7,329	397	220	7,945
2028	58	$68,097	$6,810	7,945	403	238	8,587
2029	59	$70,140	$7,014	8,587	410	258	9,255
2030	60	$72,244	$7,224	9,255	416	278	9,949
2031	61	$74,412	$7,441	9,949	423	298	10,670
2032	62	$76,644	$7,664	10,670	429	320	11,420
2033	63	$78,943	$7,894	11,420	436	343	12,198
2034	64	$81,312	$8,131	12,198	442	366	13,006
2035	65	$83,751	$8,375	13,006	448	390	13,844
2036	66	$86,264	$8,626	13,844	454	415	14,714
2037	67	$88,852	$8,885	14,714	460	441	15,616
2038	68	$91,517	$9,152	15,616	466	468	16,550
2039	69	$94,263	$9,426	16,550	471	497	17,518

Note: Each unit represents $1 of inflation adjusted income beginning in year 2040 (age 70).