INITIATIVE ON FINANCIAL SECURITY
THE ASPEN INSTITUTE

Department of Labor: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

Comments from Pamela Perun, Ph.D., Policy Director to The Aspen Institute Initiative on Financial Security

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The Initiative on Financial Security at the Aspen Institute (Aspen IFS) commends the Department of Labor and the Department of the Treasury for soliciting comments regarding lifetime income options for participants and beneficiaries in retirement plans. The mission of Aspen IFS is to promote sound public policy that enables all Americans, especially low- and moderate-income Americans, to build financial security that lasts a lifetime. As President Obama has stated, "Americans who work hard their entire lives have earned the right to retire with dignity and security. That's the promise that each of us wants to be realized within our own families, and it's a promise we must keep for all American families." A dignified and fulfilling life in retirement rests on financial security – financial security that matches longevity and enables seniors to contribute joy, wisdom and other resources to their families rather than burden them financially.

This comment project marks the first step towards a national policy on preserving income from savings throughout retirement. Framing the nation's first private annuity policy that supplements Social Security – the universal, baseline annuity for all Americans – will be a difficult and complex task and should be undertaken only with extreme caution. What the government blesses as policy will affect millions of Americans and billions of investment dollars. It could alter the structure of our private savings system significantly and dramatically affect the operation and organization of the financial services industry. Aspen IFS believes that critical work of analysis and debate must be undertaken before the nation embarks upon a broad-based, expansive policy on lifelong security.

It would be tragic if, as a nation, we fail to learn from some of the significant policy failures in 401(k) plans over the last twenty years. Many believe that they originate in what Aspen IFS calls the "people" problem, that is, on the behavioral challenges of turning people into savers and savers into investors. There is a large element of truth in that belief. We have learned the hard way not to place too much investment risk and responsibility on the shoulders of savers and not to burden them with complex choices. Aspen IFS believes, however, that equally important is what it calls the "product" problem, that is, the prevalence of opaque investment options with high fees and expenses. The magnitude of the product problem is well-illustrated by the current controversy over the use of poorly-understood target-date funds as a default 401(k) investment. The world of annuity design and marketing is vast and complex, and its products, like any other investment product, can be subject to high fees and expenses.

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Before we "nudge" or perhaps even mandate millions of Americans into annuity policies that will bind them for decades, we have an obligation to carefully consider the needs and abilities of diverse groups of savers as well as critical annuity product design and regulatory issues. This is particularly important now that the Obama Administration seeks to expand pension coverage significantly beyond the roughly 70 million active savers now in employer-based defined contribution plans. The Automatic IRA proposal, if passed, would *more than double* the size of our private retirement saving system by adding some 78 million new savers, many of them low- and moderate-income workers. Millions of them, and millions more savers in 401(k) plans, will be content to remain in default products blessed by statute or regulation. We owe these savers a rigorous debate over the core elements of appropriate annuity or similar investment products before they become a routine feature of investment menus.

This is particularly true because even preliminary questions surrounding annuitization as a policy are complex and there are no clear answers. Which savers should annuitize? How much of their savings should be annuitized? Aspen IFS believes that a sizeable portion of those who do not annuitize at least some of their retirement nest egg could benefit from doing so. The academic literature, however, provides no easy-to-apply rules for potential annuity purchasers. It does suggest that decisions about annuitization are highly personal and require careful analysis of family circumstances and other financial assets, over and above retirement plan account balances. When should savers annuitize, i.e., over their work lives, at retirement, or perhaps only for extreme old age? Again, this is a subject of considerable debate among academics and financial professionals. What annuity products – new or old – best serve low and moderate-income savers? What role should an employer play, if any? Is the current state-based regulatory scheme for annuity products suitable for a diverse, highly mobile workforce? Many state guarantee funds limit their liability to only $100,000 in present value, and protection can vary depending on state of residence. Moreover, while annuities play an important role in reducing longevity risk, they do not guard against other significant risks to retirement income. For example, few annuities are available today that protect retirement income against inflation. In addition, annuities remain subject to default risk, the risk that promised payments will not be made if an annuity provider becomes insolvent.

Aspen IFS believes that, before we add another layer of complicated laws and employer responsibilities to qualified plans and impose arduous new requirements on IRAs, we should first explore already successful public annuitization policies. For that, we have only to turn to the experience of Social Security. Social Security already provides a popular, almost universal annuity that protects against default, inflation and longevity risks. Aspen IFS believes that the success of the Social Security annuity should be leveraged as the first stage of a new national policy on lifelong income. Partnering Social Security with private annuities could significantly enhance the prevalence of annuitization because it would provide purchasers with the familiarity, convenience, and trust enjoyed by the Social Security program. This approach also adds the benefit of comparability because monthly Social Security benefits are the yardstick by which those who are about to retire or who have just retired measure their real retirement income.

In its report, *Savings for Life*, Aspen IFS proposed utilizing the resources and good will associated with Social Security to market and distribute "Security Plus Annuities" through a public/private partnership. A Security Plus Annuity is an immediate, inflation-adjusted, life annuity that would enable retirees to buy an additional amount of Social Security-like income for life. New retirees could buy a Security Plus Annuity only during a critical period – the first 12 months of receiving Social Security retirement benefits. This is a highly-relevant time for retirees to compare the value of their Social Security benefits against their real income needs and other assets. By limiting the purchase period, retirees would be nudged into making an annuity purchase decision promptly.

A Security Plus Annuity would primarily be a "starter" annuity, available in up to $100,000 in purchase amount and suitable for savers who would like to annuitize at least a portion of a small nest egg. Retirees who wish to buy larger annuities or additional annuities later in life would be encouraged to obtain them from the private sector. Monthly annuity payments would be added to and delivered through monthly Social Security checks. Security Plus Annuities would be reasonably priced on a group basis and underwritten by private insurance companies selected by the federal government through a competitive bidding process. In the Security Plus Annuities program, the federal government would act primarily as an intermediary providing record-keeping, marking, distribution, and other administrative services while the private sector would play its customary role as an underwriter of group annuities. More information about Security Plus Annuities can be obtained at http://www.aspeninstitute.org/policy-work/financial-security.

In conclusion, Aspen IFS believes that many savers will want and need to annuitize at least some of their retirement nest eggs. Federal policy should assist them to do so. The first step in developing such a policy need not and should not result in the layering of more complex laws onto qualified plans and complicating the structure of IRAs. Rather, the first step should be to examine what we can learn about the design of an annuity policy from what is already popular. In addition, any federal policy must be mindful that increasing annuitization involves more than an effort to fix the "people" problem. It must also involve a serious focus on the "product" problem so that all savers but especially low- and moderate-income savers have access to a suitable and secure lifetime income option.

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