



April 28, 2010

To: Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor, Room N-5655
200 Constitution Avenue, N.W.
Washington D.C. 20210, USA

ATTENTION: Lifetime Income RFI - RIN: 1210-AB33

We the undersigned are all researchers in the fields of finance, actuarial science, insurance and mathematics and have individually and collectively published over a dozen peer-reviewed research studies on the topic of annuities as it related to “lifetime income.” We would therefore like to take this opportunity to respond to the Request for Information RIN 1210-AB33, *Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans* issued on February 2, 2010.

Given the extensive nature of the RFI and the rather narrow area of our expertise we have decided to respond to only a subset of the questions. This document provides our responses to the questions for which we feel best able to comment. We have also provided references to our relevant research at the end of our submission.

[1.] From the standpoint of plan participants, what are the advantages and disadvantages for participants of receiving some or all of their benefits in the form of lifetime payments?

The fundamental benefit of receiving lifetime income is that *longevity risk is pooled across participants* – and thus income for surviving participants is subsidized by assets from participants who die, giving rise to what actuaries call “mortality credits”.

This basic benefit increases as longevity risk increases. That is, for a given population, the greater the uncertainty with respect to longevity – i.e., the greater the difference in time between the earliest and latest expected death dates – the greater is the benefit from pooling longevity risk.

The sharing or pooling of longevity risk is fundamentally the **only** reason that lifetime income has any economic value or financial benefit to the retiree. Accordingly, in our view it is extremely important to emphasize and make clear that (theoretically) if all members of a retirement group lived for the same or very similar amounts of time – or conversely if everyone demanded guaranteed payments for 30 or 40 years regardless of survivorship status -- there would be little if any benefit to lifetime income (i.e., annuitization). We believe that the concept of *lifetime income* is inseparable from *pooling of longevity risk*.

Of course the flip-side or downside of longevity risk pooling is the need to make this pool irreversible to avoid moral hazard (i.e., to ensure people who are on the verge of death do not remove themselves from the pool).

There are additional benefits to lifetime income which are not directly related to longevity risk. True lifetime income provides a guaranteed long-term yield, longer than any investment will give. Mortality

credits, as mentioned above, ensure that the yield from lifetime income exceeds the yield from comparable investments. Additionally, lifetime income typically is received automatically by the recipient, which allows participants to put this part of their finances “on autopilot.” Finally, depending on how the income is structured, the cash flow pattern can be adjusted to accommodate any desired income profile, including cost of living adjustments and inflation protection.

The disadvantages of lifetime income options include the lack of flexibility (lifetime income typically cannot be “cashed out” by the participant but instead involves total or near-total loss of liquidity) and the lack of inflation protection (although inflation-indexed and cost-of-living-indexed options are available, they are relatively rare and expensive).

[2.] ...Are there steps that the Agencies could or should take to overcome at least some of the concerns that keep plan participants from requesting or electing lifetime income?

It should be noted that the lack of flexibility and inflation protection inherent in most lifetime income plans (and as mentioned above) are legitimate reasons for people to opt against lifetime income options and instead attempting to self-annuitize.

However, people may opt against annuitization for other, not-so-legitimate reasons. We suspect that the main reason people do not annuitize, or opt against lifetime income, is that they lack understanding of annuities. People may feel they can get higher yields elsewhere, not taking into account the guaranteed and long-term nature of the annuity yield. Some – even many – potential annuitants may feel that with annuities their money is being “stolen” from them when they die.

Accordingly, we feel that the most important steps the Agencies could take include doing a better job of explaining the *value of lifetime income* and the *risks of self-annuitization*. Perhaps the best place to start is by ensuring the concept of longevity risk is better understood by the retiring public.

In addition, perhaps, instead of “annuitization,” a move could be made to adopt the term “pensionization” – so that the odious A-word is avoided.

Another step the agency could take to encourage lifetime income would be to make it easier for plan sponsors to offer pure longevity insurance in the form of deferred annuities that are accumulated slowly over time, and provide a lifetime income benefit starting at some advanced age (say 85) assuming the individual retiree is still alive. Thus, for example, a plan participant would be encouraged to allocate 0.05\$ of every dollar they contribute (save, invest) into a longevity pool/fund that would entitle them to a lifetime benefit of \$1 starting at age 85. Obviously the pricing itself would depend on market conditions and economic other factors, but the main idea is that for a very small amount of money – paid over a long period of time with no survivor benefits – the retiree would be protected against longevity risk. This, of course, is the spirit of a Defined Benefit (DB) pension.

[7.] What product features have a significant impact on the cost of providing lifetime income or other arrangements designed to provide a stream of income after retirement, such as features that provide participants with the...option of accelerating distributions if needed?

Any options which provide other than straight lifetime income “water down” the mortality credits and thus the overall strength and rationale for lifetime income options.

The ability to reverse, refund, cash-out and receive payments even after death negatively impacts the cost of lifetime income options by driving prices higher and monthly payout amounts lower.

[12.] How should participants determine what portion (if any) of their account balance to annuitize? Should the portion be based on basic or necessary expenses in retirement?

The optimal or “right” portion of a retirement account balance to annuitize will depend on the participant’s bequest motive versus his or her desired for guaranteed lifetime income. At a basic level, however, we believe that the absolutely required expenses in retirement should annuitized.

The decision to annuitize any amounts above this basic bottom line depends on whether the participant wants to maximize *legacy* or *sustainability*. Indeed, just like there is no universal risk/return point of the efficient frontier that is optimal for everyone, the same applied to the tradeoff between bequest and sustainability.

For every retiree, higher lifetime income comes at the cost of a lower expected bequest amount. This tradeoff should be explained carefully, just like the tradeoff between risk and return in the accumulation phase. Models that illustrate this specific tradeoff would be useful.

[13.] Should some form of lifetime income distribution option be required for defined contribution plans...? If so, should that option be the default distribution option, and should it apply to the entire balance?

As touched on above, it is difficult to justify full annuitization of a retirement account balance, especially given the existence of pre-existing annuities in the form of Social Security. We are not in favor of mandatory full annuitization, but rather believe that every plan should be required to offer options (possibly with a “safe harbor” provision) so that retirees have the ability to acquire lifetime income products with group pricing, favorable rates and with the understanding that employers will explain the mechanics to employees. We also believe that requiring full (or even 50%) annuitization would be negatively viewed by many, if not most, plan participants, even if this was only a default option.

No matter what range of options is offered, we believe it would be worthwhile to require plans to educate participants about their choices in a way that is similar to the education 401(k) investors are provided about their investment options.

[17.] What information (e.g. fees, risks, etc.) do plan participants need to make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement?

Plan participants need two basic sets of information in order to make informed decisions:

First, they should be able to compare the income from a pure life-only annuity to the income from whatever other option(s) are available. Plan participants should be provided with expected payouts from all available options. To this end some sort of “lifetime income index” would help participants and plan sponsor gauge the relative value from various options.

Secondly, they need to be able to consider how long they are likely to live, and to do that, they should have some idea of the state of their health. Models or tools which allow for discussion and appreciation of longevity risk should be made available to plan participants.

[20.] To what extent should plans be encouraged to provide or promote education about the advantages and disadvantages of lifetime annuities...?

We believe that educating prospective annuitants about the advantages and disadvantages of lifetime annuities is very important and should be promoted and emphasized in all future discussions of this issue.

We further suggest that employers and plan promoters should be encouraged (“nudged”) to educate prospective plan participants by the development of guidelines on how to fulfill this without incurring any legal risk on the part of employers and plan sponsors.

[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. Participants should be able to VALUE their holdings across two dimensions: expected monthly lifetime income and current account balance. As interest rates change and mortality tables are revised the lifetime income stream would change to reflect this, even if the account balance has remained relatively constant.

[22] If the answer to question 21 is yes, how should a lifetime stream of income payments be expressed on the benefit statement?

The most useful information would be monthly payments projected at a future retirement age. The plan probably would need to employ an impartial (third party) service to ensure the numbers were fair and appropriate (perhaps based on PBGC interest rates.)

Monthly payments should be shown from as a single life annuity, a joint and last survivor annuity, and possibly also with a guaranteed period (say 10 years). In fact, providing estimates for the last two options is likely more important than providing single life annuity estimates, as most people do not choose the straight life annuity.

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In conclusion, we appreciate the opportunity to respond to this RFI. Please feel free to contact us (collectively or individually) at The IFID Centre, 222 College Street, Toronto, Ontario, M5T 3J1.

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