



1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

May 3, 2010

Submitted Electronically

Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

Internal Revenue Service, CC:PA:LPD:PR
Department of Treasury
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

Re: Request for Information on Lifetime Income Options

Ladies and Gentlemen:

The Investment Company Institute¹ is pleased to submit comments on the Department of Labor's and Department of Treasury's request for information regarding lifetime income. The Institute strongly supports efforts to meet the needs of American retirees to manage retirement savings, which will increasingly consist of assets in defined contribution plans.

Defined contribution plans such as 401(k) plans are proving to be highly effective in helping Americans save for retirement and are particularly well-suited for today's mobile workforce. Institute survey research shows that Americans in large majorities value the tax benefits and disciplined approach to saving that individual account plans provide and believe these plans will help them meet their retirement goals. Research by the Employee Benefit Research Institute and ICI, modeling a full career for a group of actual plan participants, finds that participants will replace a significant amount of their pre-retirement income with their plan balances and Social Security.

Because most Americans will have several jobs during a working career, when they retire they likely will have several potential sources of retirement income – including other defined contribution plans, IRAs, defined benefit plans, and other savings or assets, as well as Social Security. Participants have the task of determining how to manage those combined assets in retirement.

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.94 trillion and serve almost 90 million shareholders.

We applaud the Agencies for asking for information on the various options that American workers have to manage their retirement assets with a view to obtaining a stream of income over their retirement years. Our letter responds by topic to the questions posed in the RFI based on Institute and other research, and our analysis of the policy issues. In addressing the questions, we make the following key points:

- Participants have distribution choices and effective strategies to manage assets in retirement, including annuity and non-annuity approaches. Institute research shows that people act responsibly with their defined contribution plan balances at retirement.
- Because all strategies have tradeoffs, and participants have different circumstances and needs, decisions on managing assets in retirement must be made on an individual basis.
- It is critical to raise awareness of retirement income options and help plan sponsors and participants understand and evaluate their choices. Providing high quality information, education and advice should be a shared priority of government and the private sector.
- Low take-up rates for annuities among retirement plan participants who have distribution choices is not necessarily evidence of a market failure or bias caused by how the annuity decision is “framed.” Most retirees already hold most of their lifetime wealth in annuity-equivalent form.
- The government should not mandate or incentivize particular retirement income products. Rather, government policy should recognize that both annuity and non-annuity approaches to lifetime income are valid.

What Retirement Distribution Options Are Available and What Do People Choose?

Participants have choices at retirement. The most common forms of distribution available in defined contribution plans are lump sums, installment payments (whether pre-determined or ad-hoc), annuities, and systematic withdrawals based on a percentage of the account or other formula. In the PSCA’s annual survey of profit-sharing and 401(k) plans, 21 percent offered an annuity option at retirement, 52 percent offered installment payments, and nearly 100 percent offered a lump sum.² A

² See Profit Sharing/401k Council of America (PSCA), *52nd Annual Survey of Profit Sharing and 401(k) Plans (Reflecting 2008 Plan Experience)* (2009). The annuity offer rate does not vary systematically with plan size. Nearly 75 percent of plans surveyed allowed participants to retain their account balances in the plan. In addition, all plans, as required by law, permitted direct transfer to an IRA or other qualified retirement plan.

survey by Hewitt Associates puts the annuity offer rate at only 7 percent of plans, though they highlight the fact that another 2 percent expect to offer the option next year.³

Participants and IRA owners seeking to obtain a lifetime stream of income in retirement have a range of options. Multiple products and strategies are available to meet individuals' varying needs.

Installment payments and systematic withdrawal plans. Installment payments and systematic withdrawal plans (SWPs) from a plan account are methods to spread income from retirement savings over one's retirement. With installment payments, which are common in defined contribution plans today, a participant selects a period of years over which his or her account balance is to be distributed (typically 10 or 20 years). In a systematic withdrawal plan, a participant or IRA owner elects to receive a specified percentage or amount from the account on an established schedule. Financial planners recommend various ways to determine these payment streams. For example, some financial planners recommend individuals withdraw 3 percent to 4 percent of the initial account balance at age 65 and to increase that dollar amount by 3 percent for inflation in subsequent years.⁴ These recommendations, which derive from these financial planners' modeling and Monte Carlo simulations, typically are based on a time horizon of 30 years.⁵

Life expectancy withdrawals. Another approach designed to ensure the retiree will not exhaust his or her savings before death is to calculate withdrawals based on remaining life expectancy, similar to a required minimum distribution (RMD) calculation in an IRA or qualified plan. Under this method, the withdrawal amount is recalculated each year by dividing the account balance by the individual's remaining life expectancy. As the account balance decreases, so will the denominator (life expectancy) in this calculation, and the resulting payment will never be zero. This method has the advantage of automatically satisfying the required minimum distribution rules and, as discussed later, Institute research shows that, for those IRA owners who take a withdrawal, the most common method cited for calculating the withdrawal is to meet the required minimum distribution rules.

³ See Hewitt Associates, *Survey Findings: Trends and Experiences in 401(k) Plans* (2009).

⁴ See, e.g., Harris, "Market Cycles and Safe Withdrawal Rates," *Journal of Financial Planning* (Sept. 2009), at 44 (research into safe withdrawal rates have resulted in "findings that range from 3 to 8 percent, with the most prevalent finding being 4 percent to 5 percent"). If an individual retires significantly after age 65, he or she might use a higher percentage, such as 5 percent.

⁵ If retirees experience a bear market just after retirement (such as in 2008), experts recommend different ways to adjust the withdrawal strategy to sustain a high chance of not outliving one's assets. While the most effective tactic is to reduce withdrawal amounts, another option – less drastic to a retiree – is to forego pre-planned inflation adjustments for a number of years. See "Strategies for Coping After Retiring Into a Bear Market," *T. Rowe Price Report*, Issue No. 99 (Spring 2008), at 14.

Annuities. Insurance company annuities are another method of generating lifetime income from the participant's retirement accounts. The term annuity generally means any right to receive regular payments. In the insurance context, an annuity is a financial contract between an individual (the "annuitant") and an insurance company, in which the annuitant agrees to pay the insurance company a single premium or multiple premiums in return for income guaranteed for a specified time period, typically the remaining life of the annuitant. The purest form is a fixed immediate life annuity, in which the payment is either a fixed nominal amount or a fixed real amount that increases with inflation and the annuitant receives payments over his or her lifetime only. Several other features can be layered onto an annuity, such as guaranteed minimum withdrawal benefits, inflation protection, and death benefits.

Longevity insurance. Participants also can combine installments or SWPs with longevity insurance. Longevity insurance is a type of single premium deferred life annuity; that is, at a certain age (e.g., age 65) an investor would purchase a life annuity that does not begin to make payments until a later date (e.g., age 85). Because there is a significant chance that the annuitant will never receive a payment, longevity insurance is significantly less expensive per dollar of regular income than an immediate annuity. The remainder of the retiree's portfolio can remain invested in the market, but the longevity insurance provides a floor beneath which income of a long-lived retiree cannot fall regardless of the age to which the annuitant survives.

Managed payout and other new products. Today, new products and services are coming to market to speak to a wide range of retirement income needs. Some mutual fund companies offer funds designed to be investment vehicles and payment vehicles all in one. Commonly known as managed payout funds, these mutual funds are managed with sophisticated payout designs meant to provide a predictable monthly check. Some managed payout funds are designed to preserve principal throughout the life of the investment, and others are designed to distribute the entire account, including principal, over a set number of years. Some insurance companies are developing and offering products that combine mutual fund investments with annuities. For example, the investment option in the plan could consist of a mutual fund portfolio or target date fund alongside an annuity purchased over time with participant or employer contributions. Alternatively, instead of buying a single investment product, individuals can build portfolios – either on their own or with the help of an adviser – that combine both investments in mutual funds and fixed immediate life annuities. One way to do this is to target a certain percentage of the portfolio to be invested in immediate annuities and to buy annuities ratably over time to reach the desired portfolio allocation.

Delay Social Security benefits. Another strategy that may be advantageous for individuals who have assets in addition to Social Security is to live initially on the additional assets and delay taking

Social Security benefits. An individual can, in effect, purchase annuity income by delaying receipt of Social Security benefits. For example, every month that an individual delays receiving Social Security benefits after age 62 and before reaching age 70, his or her monthly benefit is increased by anywhere from half of 1 percent to three-quarters of 1 percent, or about 7 percent to 8 percent a year. One advantage of this strategy is that, because benefit adjustments are approximately actuarially fair, a dollar spent delaying Social Security receipt buys more annuity income than a dollar spent purchasing a private-sector annuity.

Annuity demand is low. Two recent studies show that the two most common distribution methods used by plan participants (each used by about one-third of older workers leaving their jobs) are rolling over their accumulated balances into an IRA or leaving the balances to continue accumulating earnings in the employer's plan.⁶ The fraction of participants who withdraw their funds without rolling them over is about 15 percent and the remaining 15 percent or so report some "other" distribution. These studies also estimate that the fraction of older workers leaving their jobs who convert their defined contribution balance to an annuity (either through an in-plan option or externally) is somewhere between 3 percent and 4 percent. Another study found that in defined contribution plans that offer in-plan annuities, the annuity option is chosen only around 6 percent of the time.⁷

⁶ See Johnson, Burman, and Kobes, "Annuitized Wealth at Older Ages: Evidence from the Health and Retirement Study," Urban Institute (2004), available at www.urban.org/UploadedPDF/411000_annuitized_wealth.pdf; and Hurd and Panis, "The Choice to Cash Out Pension Rights at Job Change or Retirement," *The Journal of Public Economics* (2006).

⁷ See Hewitt Associates, *Survey Findings: Trends and Experiences in 401(k) Plans 2003, 2005* (2005). Given that the overall use of annuities by older workers leaving their jobs is 3 percent to 4 percent, and at most 20 percent of plans offer annuities, this estimate of the take-up rate when a plan offers an annuity could be at the lower bounds of the overall population take-up rate, possibly due to the survey's sample. The Institute's own research based on a sample of retired workers suggests take-up rates among retirees from 401(k) plans who recall having an annuity option is just over 20 percent. See Sabelhaus, Bogdan, and Holden, *Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring Between 2002 and 2007*, Investment Company Institute Research Series (Fall 2008); available at www.ici.org/pdf/rpt_08_dcdd.pdf. The inclusion criteria for ICI's study were: (1) be the primary or co-decisionmaker for saving and investment decisions; (2) have retired from his or her lifetime occupation in 2002 or later; (3) have personally contributed to a defined contribution plan or some other individual account plan at the organization from which he or she retired; and (4) determined how his or her account balance was invested before retiring. One indication of how this sample differed from the general population is that the fraction who recalled having an annuity option (or said the annuity was their only option) was 44 percent, while (as noted above) the estimates for 401(k) plans generally are on the order of 20 percent or less.

The highest estimates of annuity take-up in defined contribution plans are found in plans run by TIAA-CREF, where just under half of retirees took the annuity option in 2001. See Ameriks, "How Do Retirees Go from Stock to Flow?" in Mitchell and Utkus, *Pension Design and Structure: New Lessons from Behavioral Finance* (2004), pp. 237-58. This may suggest differential demand for annuities across the retiree population. Because the population served by TIAA-CREF (employees in higher education) has generally higher incomes and typically lacks defined benefit pensions, their higher propensity to annuitize is consistent with their greater need to supplement Social Security to achieve some target

The low level of annuity demand seen within defined contribution plans is consistent with the current take-up of annuities in defined benefit plans. In defined benefit plans, annuities are required and serve as default options in that spousal consent is required to opt out of the annuity. For example, one study showed that overall, only 11.5 percent of participants leaving defined benefit plans that provided a choice of distribution option chose the annuity option, including 34.8 percent of separating defined benefit plan participants over 60 years of age.⁸ Additional evidence that defined benefit plan participants desire alternative (non-annuity) payouts comes from considering the evolution of plan designs over time. Just over a decade ago, 76 percent of private sector defined benefit plans of medium and large businesses offered annuities as the only distribution choice.⁹ By 2005, more than half of private-sector defined benefit plans offered a full or partial lump-sum distribution option.¹⁰

Evidence from outside of employer-sponsored plans also suggests that, when provided the option, investors rarely purchase immediate life annuities. Although all non-qualified deferred annuities include the option to annuitize, few investors take advantage of the option. For example, less than 5 percent of deferred variable annuities are converted to an immediate annuity.¹¹

What Factors Determine Whether Participants Select Annuities or Other Options?

Choosing retirement income products or solutions involves tradeoffs. The various distribution forms described above – from fixed immediate life annuities to systematic withdrawals

annuitization of lifetime wealth. It is also worth noting that in TIAA-CREF the annuity was the only option until 1989. After lump-sum and other distribution options were added, the take-up rate for annuities began falling steadily from 100 percent in 1988 to 45.1 percent by 2001 (the last year for which the TIAA-CREF data are available). If the decline in annuitization continued after 2001, the take up of annuities within TIAA-CREF may be coming into line with estimates from other sources.

⁸ See “Choose Employees Choose Lump Sums!” *Watson Wyatt Insider* (April 1998), available at www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=7249. Other estimates from defined benefit plans are within this range of annuity demand. See “Immediate Income Annuities and Defined Contribution Plans,” *Vanguard Center for Retirement Research*, Volume 32 (May 2008), available at <https://institutional.vanguard.com/iam/pdf/CRRADC.pdf>. The Vanguard study also notes that the annuitization rate from the federal employees’ Thrift Savings Plan is only 1 percent, but that group also has a substantial defined benefit plan.

⁹ See U.S. Department of Labor, *Employee Benefits in Medium and Large Private Establishments, 1997* (1999), p. 107, available at www.bls.gov/ncs/ebs/sp/ebbl0017.pdf.

¹⁰ See U.S. Department of Labor, *National Compensation Survey: Employee Benefits in Private Industry in the United States, 2005* (2007), p. 66, available at www.bls.gov/ncs/ebs/sp/ebbl0022.pdf.

¹¹ See Margaret E. Haering, “A Bad Marriage? Variable Annuities and 401(k) Plans,” *Workforce Management* (May 2006), available at www.workforce.com/section/02/feature/24/37/11/index.html.

from plan accounts, and everything in-between – have advantages and disadvantages. Annuities allow individuals to receive a regular stream of income without worrying about market volatility and outliving one’s assets.¹² On the other hand, buying an annuity usually means not having access to savings in case of emergency and the ability to leave unused assets to heirs.¹³ There are annuities available with features designed to mitigate these problems, such as annuities that provide lump-sum cash-out options, promise minimum distribution benefits, or provide death benefits to survivors. Adding these features to an annuity reduces the monthly payment amount that continues regardless of how long the annuitant lives. With systematic payout arrangements, the participant typically has a higher rate of return, remains in control of the assets, can access money in an emergency, and can pass on any remaining assets to heirs. Systematic payment options do not, however, come with a “guarantee” – the contractual promise to continue regular payments over the holder’s lifetime. The money in the participant’s account remains invested and subject to market risk, and there is no guarantee that the return on the account will allow the anticipated payments to continue as planned.

Whether an annuity or other lifetime income option is appropriate is a highly individualized question. While there are certain risks that apply universally – longevity, declining markets, and inflation – there are many other factors that vary from individual to individual. Participants must take account of their personal circumstances, including other assets or income, health status and life expectancy, the need to have cash available for emergencies, goals in retirement and interest in leaving assets to heirs. Participants may have personal preferences relating to the cost and complexity of financial products or a desire to keep control of their money. All of these relevant considerations could lead individuals to different conclusions as to their most appropriate retirement income arrangement.

The current low rate of annuitization among plan participants and IRA owners does not indicate a market failure or societal problem. The extent to which a retiree may want to annuitize his or her wealth will depend on the factors described above. There are several practical reasons for not electing to annuitize a defined contribution plan account balance.

First, as explained in more detail later, an individual may already be highly annuitized through Social Security and defined benefit pension income.¹⁴ It is important to recognize that many

¹²The guaranteed income of an annuity depends on the insurance company’s ability to pay. This guarantee typically is backed up by a state guaranty association, subject to any maximum benefit limits the state sets that may operate to limit the amount of the insurer’s obligation on any annuity contract that the guarantee fund provides. *See* www.nolhga.com/policyholderinfo/main.cfm/location/questions.

¹³If the annuity does not include an increase for inflation, annuitants face the risk that their relative annual income will fall due to inflation.

¹⁴Although coverage of private-sector workers in defined benefit plans has declined, there still are many Americans who will retire with a defined benefit pension, especially if they spent all or part of their career in the public sector.

individuals will get the bulk of their retirement income in the form of an inflation-indexed immediate life annuity; that is, in the form of Social Security benefits. For example, looking at individuals age 65 and older in 2006 who reported they did not work, 51 percent of all income received by the group came from Social Security benefits, with 14 percent coming from private-sector pensions (both defined contribution and defined benefit) and 12 percent coming from government pensions.¹⁵ Ranked by income, *the bottom half of individuals in this group get 85 percent of their income from Social Security benefits.*¹⁶

Second, retirees may place a high value on being able to address a health shock or other unexpected life event in retirement. For example, retirees may face situations (or perceive they may face situations) where they will need funds to pay for an expensive medical procedure, maintain their residence, or enable them to continue to live independently. As described below, Institute research shows that these are exactly the types of expenses listed by IRA holders in explaining how they manage their IRA balances.

There are other factors that also could make someone reluctant to annuitize, such as the problem of adverse selection. Adverse selection can occur when those with a shorter than average expected lifespan select out of the insurance pool, thus making the insurance more expensive for the remaining individuals, and less of a “good deal.”¹⁷ Another possible reason is counterparty risk, or the

¹⁵ Statistics reported are ICI tabulations of Bureau of Labor Statistics, Current Population Survey (CPS) data. See Submission from Paul Schott Stevens, President and CEO, Investment Company Institute, to Honorable George Miller, Chairman, Committee on Education and Labor, U.S. House of Representatives (March 10, 2009), for the record in connection with Education and Labor Committee Hearing on February 24, 2009.

¹⁶ The importance of Social Security has not changed much over time, as the story was much the same three decades ago (based on ICI tabulations of CPS data). Whatever changes may be made to Social Security in the future, we assume it will continue to provide significant income to lower-wage workers in retirement.

¹⁷ An “actuarially fair” investment is one that is expected, in present value, to provide a dollar of benefit for a dollar invested. For the average individual, a dollar invested in a fixed immediate life annuity is expected to pay out less than a dollar of benefits over the individual’s lifetime. There are two reasons for this. First, as with all financial products, there are sales and administrative expenses that must be covered, and these are typically paid out of the proceeds used to purchase the annuity or by reducing the rate of return of the investment. These charges can vary depending on how the annuity is sold (for example, a group annuity versus an individual annuity) and on the efficiency of the administrative services.

However, the primary reason that annuities are not actuarially fair for the average individual is because of asymmetric information and adverse selection: Typically individuals have a better estimate than an insurance company as to how long they will live. If an insurance company offered an annuity that was actuarially fair for the average individual (that is, paid out a dollar in expected benefits for a dollar invested), those who had private information indicating that they would live longer than average would choose to annuitize and those who had private information indicating that they would live shorter than average would choose not to annuitize. As a result, any insurance company that offered an annuity that was actuarially fair for the average individual would lose money. To stay in business, the insurance company needs to increase the price of (reduce the payments from) the annuity. The end result is that annuities are priced so that they are not actuarially fair for the average individual, and only a portion of individuals, who in aggregate expect to live longer than average, will annuitize

risk that the insurance company will default on its obligation.¹⁸ Individuals may be uncomfortable with turning over all or a significant portion of their assets to a single company that could cease to exist several years in the future or fail to provide the level and quality of service they seek.

Some have advanced behavioral hypotheses for lack of annuity demand, including the principles of “regret aversion” and “framing.” Regret aversion refers to the notion that an individual will overweight a possible outcome that he would particularly dislike, such as discovering a terminal illness soon after purchasing a life annuity. Framing involves the argument that the way the annuity transaction is presented to the individual will impact the decision to buy or not buy the annuity.¹⁹ For example, if the annuity is presented as a transaction in which the purchaser loses money if he does not live beyond a certain age, it will be viewed less favorably than if presented as obtaining a predictable spending stream that will never run out. Underlying calls to “reframe” the annuity contract, or use other behavioral strategies, to influence more Americans to choose annuity income is the presumption that for large numbers of Americans not electing an annuity is an irrational choice. We strongly believe, for the reasons we explain, this assumption is false.

their wealth. (Leaving aside sales and administrative expenses, annuities are presumably actuarially fair for the average annuitant; the average annuitant lives longer than the average individual.) The typical estimate is that the average individual can expect a nominal annuity to pay out 80 cents to 85 cents for each dollar invested. *See, e.g.,* Mitchell, Poterba, Warshawsky, and Brown, “New Evidence on the Money’s Worth of Individual Annuities,” *American Economic Review*, vol. 89, no. 5 (1999), pp. 1299-1318.

Even when annuities are offered as a distribution option from a defined contribution plan, as long as participants can choose not to elect the annuity (as most do), the problem of adverse selection continues to exist. In other words, the Agencies could not solve the pricing effect of adverse selection by mandating that all plans offer an annuity as an investment option.

¹⁸ The Department of Labor recognizes the importance of considering the ability of an insurance company to meet its obligations. *See, e.g.,* 29 C.F.R. § 2550.404a-4(b)(4) (safe harbor for selection of annuity providers satisfied if, among other things, fiduciary “[a]ppropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract”).

¹⁹ The principle of “framing” suggests that the way in which the tradeoff is presented to potential annuitants matters a great deal in how they perceive the contract. If the description of the contract focuses on the annuity as one of two possible investment decisions, they might tend to downplay the possible gains (income for life) relative to the possible losses (their investment vanishes if they die soon after purchasing the annuity). However, if the contract is “framed” as a choice between two consumption decisions—where the lump sum is characterized as an uncertain spending stream that might be exhausted before the person dies—their view of the annuity might change. *See* Brown, Kling, Mullainathan, and Wrobel, “Why Don’t People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle,” *American Economic Review*, vol. 98, no. 2 (2009): pp. 304-09. In assessing the validity of any study on the effects of framing, it is important to consider the exact wording of the questions posed and whether information pertinent to the decision was left out. Asking survey participants to compare two possibilities with limited details may lead to a shift in responses, but does not necessarily mean that the survey participant would make the same choice in the real world.

Most retirees already hold most of their lifetime wealth in annuity-equivalent form. Social Security, defined benefit plans, and owner-occupied housing represent significant annuitized wealth for most retired Americans.

Social Security. For most Americans, their claim to Social Security benefits represents the largest component of their overall wealth. Social Security not only provides regular income for the life of the recipient, it also adjusts the payments for inflation. In addition, Social Security benefits are progressive, so they replace a higher percentage of pre-retirement earnings for workers with lower lifetime earnings than they replace for higher earners. A recent Congressional Budget Office (CBO) report estimates that scheduled Social Security benefits will replace about 43 percent of average earnings for the median worker born between 1950 and 1959.²⁰ The median replacement rate for the 20 percent of workers with the lowest earnings in this group is projected to be 70 percent.

Defined benefit plans. A second source of annuitized income is defined benefit pension plans. Although fewer private-sector companies offer defined benefit plans today, many retired private-sector employees and many approaching retirement still have claims to annuity payments from defined benefit pension plans. In addition, government employees typically have defined benefit pensions and, to date, there is no indication that defined benefit coverage has fallen among this group. Perhaps not surprisingly for a benefit designed to supplement Social Security, pension coverage is more common among workers with higher earnings.

Owner-occupied housing. Another type of wealth that can be considered “annuitized” is owner-occupied housing. If a household did not own its home, it would be required to pay rent to live in the home. The primary benefit of owner-occupied housing is that it provides imputed rental income in excess of expenses, which reduces the need for a regular stream of income from other sources. For many households, the home is the most valuable asset. According to tabulations of the Federal Reserve Board’s 2007 *Survey of Consumer Finances*, of households with a household head age 65 to 74, 85 percent own their home; and about half of these homeowners, or 42 percent overall, own a home unencumbered by mortgage debt.

A recent study looked at the components of wealth in 2006 for households with at least one member born between 1948 and 1953 (between 53 and 58 years of age in 2006).²¹ To calculate Social

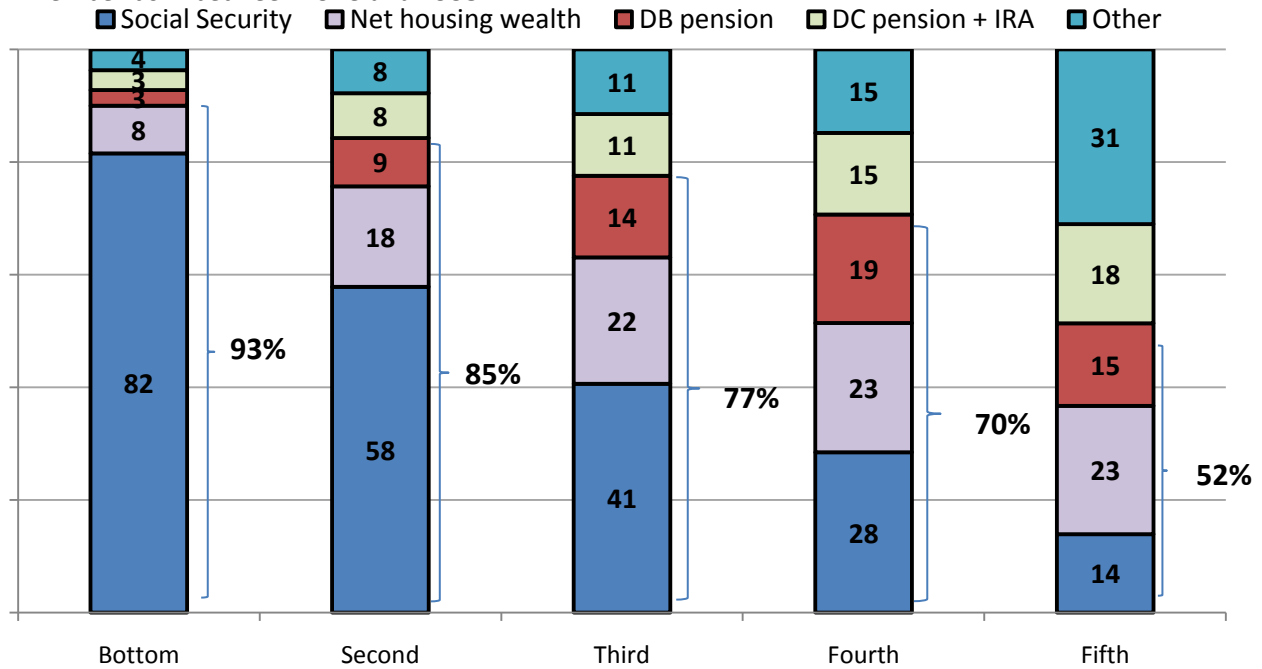
²⁰ See CBO’s *Long-Term Projections for Social Security: 2009 Update* (August 2009), Table 4, available at www.cbo.gov/ftpdocs/104xx/doc10457/08-07-SocialSecurity_Update.pdf.

²¹ Gustman, Steinmeier, and Tabatabai, “What the Stock Market Decline Means for the Financial Security and Retirement Choices of the Near-Retirement Population,” Michigan Retirement Research Center Working Paper WP2009-206 (Oct. 2009).

Security wealth, the authors used detailed data of each individual’s earnings history to project future benefits and then calculated a present value for that stream of income. For most households, the bulk of wealth was already in annuitized form – that is, either Social Security wealth, net housing wealth, or accrued defined benefit pension benefits. For the bottom 20 percent of the wealth distribution, annuitized assets accounted for 93 percent of wealth. Even for households in the second highest wealth quintile, annuitized assets accounted for 70 percent of wealth. The top 20 percent of the wealth distribution had a comparably low proportion of wealth annuitized, with 52 percent. These statistics suggest that it is higher-income households that are most likely to desire supplemental annuity income, not lower-income households.

Most Retirees Already Hold Most Lifetime Wealth in Annuity-Equivalent Form

Percentage of wealth by wealth quintile in 2006 for households with at least one member born between 1948 and 1953

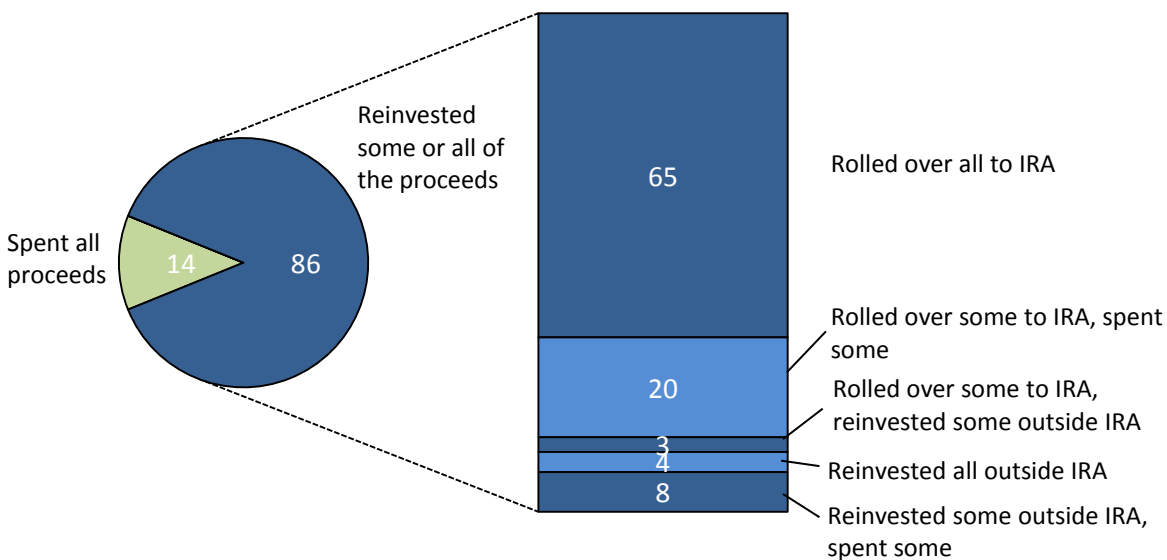


Note: Households with top and bottom 1 percent of total wealth excluded. Components may not add to 100 percent because of rounding. Source: Gustman, Steinmeier, and Tabatabai, "What the Stock Market Decline Means for the Financial Security and Retirement Choices of the Near-Retirement Population," Michigan Retirement Research Center Working Paper WP2009-206, October 2009.

Institute research shows that, by and large, people act responsibly with their defined contribution plan account balances at retirement. Few retirees cash out their balances; most select reinvesting a lump-sum distribution, installment payments, annuities, or leaving the balance in their employer’s plan.

Participants' use of plan assets upon retirement. In late 2007, ICI surveyed recent retirees who had actively participated in defined contribution plans (including 401(k), 403(b), and governmental defined contribution plans) about how they used plan proceeds at retirement.²² Respondents reported a wide variety of options, but the dominant outcomes were distribution through a reinvested lump-sum, installment payments, annuities, or leaving the balance in the employer's plan. Of those that chose a lump-sum distribution, only 14 percent spent all the proceeds of the distribution. Notably, for those that spent all the proceeds, the median value of the lump-sum distribution was only \$25,000. The remaining participants rolled over some or all of the balance to an IRA or otherwise reinvested the assets. The fact that higher balances tend to be rolled over means that "leakage" from the defined contribution system is low; the Institute's study found that 7 percent of the value of lump-sum distributions were cashed out (and possibly spent), and that represented only 3 percent of all total accumulated defined contribution account balances (because lump sums represented about half of the total).

Bulk of Lump-Sum Distributions at Retirement are Rolled Over
Percentage of respondents



Note: Individuals retired from a defined contribution plan between 2002 and 2007. Data as of fall 2007.
 Source: ICI Defined Contribution Plan Distribution Decisions Survey, 2007

²² For the complete report, see Sabelhaus, Bogdan, and Holden, *Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring Between 2002 and 2007*, Investment Company Institute Research Series (Fall 2008); available at www.ici.org/pdf/rpt_08_dcdd.pdf.

In making their distribution decision, retirees with a choice of options often consulted multiple sources of information. Forty-two percent indicated they sought advice from a professional financial adviser that they found on their own. Three in 10 indicated they attended a seminar or workshop offered by their employer; 29 percent reviewed printed materials provided by their employer; and 13 percent used a professional financial adviser provided by their employer. Fifteen percent sought advice from a publication and 10 percent considered information provided in mutual fund company materials.

Use of IRA assets by IRA owners. A large portion of the assets distributed from employer plans are rolled over into IRAs. In a separate survey of IRA owners, ICI found that households that own IRAs tend to be responsible stewards of their IRA assets.²³ In May 2009, ICI surveyed households that owned IRAs and asked a series of questions about withdrawals. Overall, few households withdraw money from their IRAs in any given year, and most withdrawals are retirement related. Of households with traditional IRAs in 2009, 19 percent reported taking a withdrawal in tax year 2008. Withdrawals were typically modest: the median withdrawal is \$6,000 and 32 percent of withdrawals totaled less than \$2,500. The median ratio of withdrawals to account balance was 8 percent. The most common method for calculating a withdrawal, cited by 64 percent of households that took withdrawals, was to meet minimum distribution requirements under the Internal Revenue Code.

Among the traditional IRA-owning households that took withdrawals where either the head or spouse was retired, the most commonly cited use of the funds (44 percent of respondents who took withdrawals) was to pay for living expenses. That suggests the minimum distribution guidelines are a benchmark that retirees use to determine how much they should spend out of their IRAs, which is a conservative approach because the minimum distribution rules are based on life expectancy. Other reasons for taking withdrawals cited by respondents included spending it on a healthcare expenses (19 percent), using it for an emergency (14 percent), and using it for home purchase, repair, or remodeling (15 percent). These motives for making IRA withdrawals underscore the fact that retirees have differing needs and desire the flexibility to manage their own funds should unexpected life events occur.

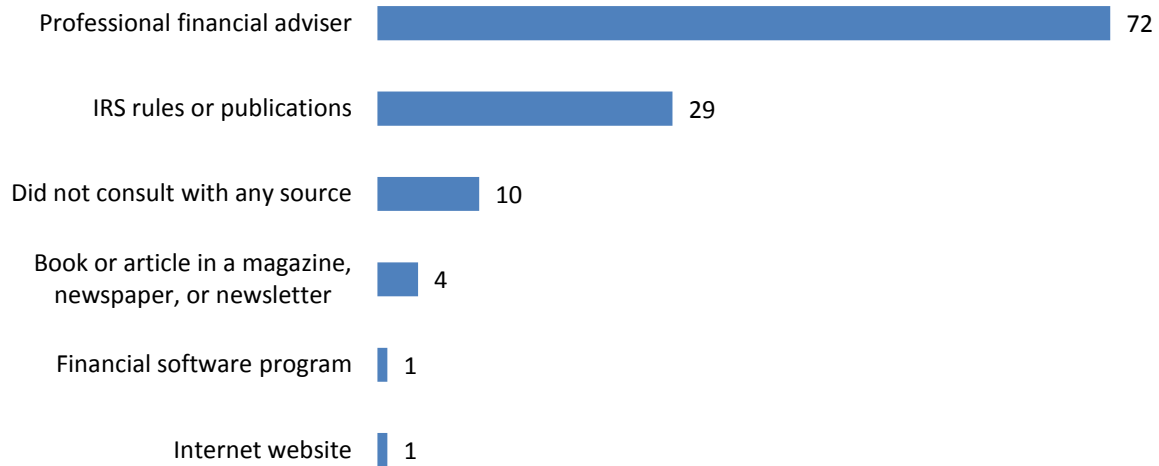
IRA-owning households that took withdrawals in tax year 2008 usually consulted outside sources to determine the amount of the withdrawal. Among households owning traditional IRAs in 2009 that took a withdrawal in tax year 2008, 72 percent consulted a professional financial adviser to determine the amount to withdraw. The second most-cited source of information for the distribution

²³ See Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2009," *ICI Fundamentals*, vol. 19, no. 1 (Jan. 2010), available at www.ici.org/pdf/fm-v19n1.pdf. See also Holden and Schrass, "Appendix: Additional Data on IRA Ownership in 2009," *ICI Fundamentals*, vol. 19, no. 1A (Jan. 2010), available at www.ici.org/pdf/fm-v19n1_appendix.pdf.

decision was IRS rules or publications, consulted by 29 percent of traditional IRA-owning households with withdrawals.

The Majority of Households Consult with a Professional Financial Adviser to Determine the Amount of Traditional IRA Withdrawals

Percentage of traditional IRA-owning households that made withdrawals in tax year 2008



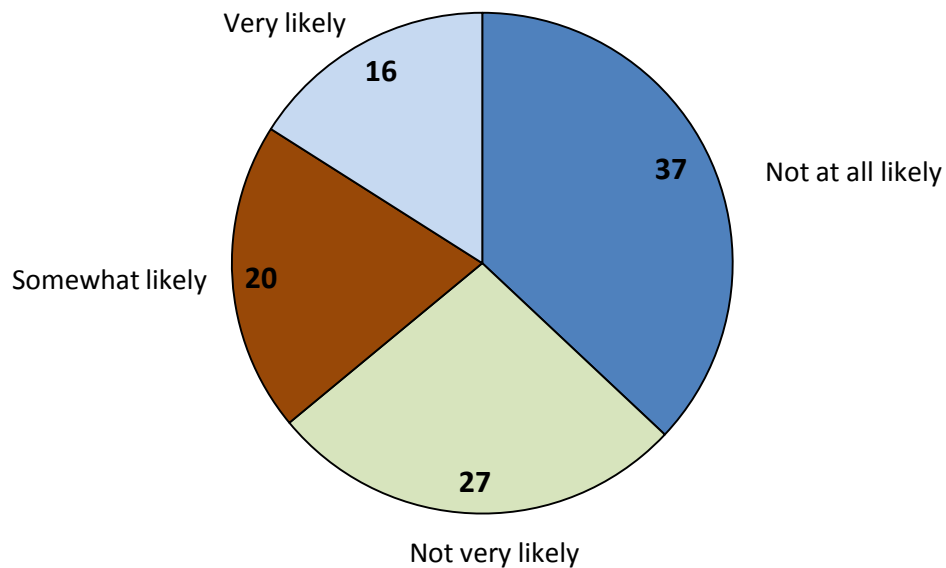
Note: Multiple responses are included.

Source: Investment Company Institute IRA Owners Survey, 2009

Because current withdrawal activity may not be a good indicator of future withdrawal activity, ICI also asked about future plans. Among traditional IRA-owning households in 2009 that did not take a withdrawal in tax year 2008, 64 percent said that they were unlikely to take a withdrawal before age 70½. The most commonly cited planned future use of IRA withdrawals was to pay for living expenses, although 67 percent of traditional IRA-owning households without withdrawals indicated a future use of the monies could be to cover an emergency. The expectations revealed by future retirees are consistent with the actual use of withdrawals among current retirees, and once again highlight the competing risks and priorities that retirees face when deciding how to manage their wealth.

Likelihood of Withdrawing from Traditional IRA Before Age 70 ½

Percentage of traditional IRA-owning households that did not take a withdrawal in tax year 2008



Source: Investment Company Institute IRA Owners Survey

In sum, Institute research provides evidence that retirees are not quick to spend their retirement savings. Instead, research illustrates rational decision-making by defined contribution plan participants at retirement. Retirees often consulted multiple sources of information in making their distribution decision. Only a very small portion of defined contribution plan retirees took a lump sum at retirement and spent the entire distribution. Those that did so tended to have small balances that could not be annuitized or gradually withdrawn over retirement on a reasonable basis. IRA owners tend to leave assets in the IRA for as long as legally possible, as part of an overall strategy for managing assets in retirement. In formulating this strategy, it is common for IRA owners to consult a professional financial adviser. The behavior of IRA owners suggests that 401(k) plan participants would make use of greater access to education and advice as they retire.

Should Some Form of Lifetime Income Distribution Option be Required for Defined Contribution Plans?

The government should not mandate or incentivize particular retirement income products. First, because of the wide variation in individual circumstances, it would be a mistake for the government to institute mandates or artificial incentives (such as a tax benefit for annuity income) in

favor of one particular retirement income product. In a government mandate for an annuity, it would be impossible to formulate a legitimate general rule as to how much of the account should be annuitized and what features should be part of the annuity. The general rule would not be suitable for all, or even most, individuals.

Second, our research shows that Americans are overwhelmingly against being required to annuitize some portion of their 401(k) plan accounts. At the end of 2009, ICI surveyed American households about their thoughts on retirement accounts and retirement plan reforms suggested in policy circles.²⁴ Seven in 10 U.S. households indicated they opposed the government requiring retirees to trade a portion of their retirement plan accounts for a fair contract that promises to pay income for life, whether from the government or an insurance company. Opposition to such a proposal was more than 80 percent among older, higher-income groups, for whom annuitization is a more salient issue. Survey responses also indicate that households value the discipline and investment opportunity that 401(k) plans represent. Households' views on policy changes revealed a preference to preserve retirement account features and flexibility. Ninety-six percent of all U.S. households indicated they did not want the government to take away retirees' ability to make decisions about retirement assets and income.

Third, creating incentives or mandates for annuities necessarily would involve the government in extensive line-drawing as to what products qualify for the incentive or mandate. When policymakers discuss annuitizing income, they typically have in mind a fixed immediate life annuity, in which the payment is either a fixed nominal amount or a fixed real amount that increases with inflation and the annuitant receives payments over his or her lifetime only. Annuities of this form are pure insurance because individuals insure against the risk of outliving assets by pooling their assets. But annuities take many different forms. Some products labeled as an "annuity" are not what policymakers mean when they use the term annuity. For example, some are designed to accumulate assets rather than provide regular income. Although these products typically have a provision that allows investors to convert the account balance to an immediate annuity at some point in the future, that option is rarely exercised. Others have features, such as guaranteed payments and death benefits, that reduce the amount of pure insurance offered by the annuity. Any government policy to incentivize or mandate particular lifetime

²⁴ Questions were asked in a series of national telephone surveys that GfK Custom Research North America fielded every other weekend from November 20, 2009, through December 20, 2009, covering a total sample of 3,000 U.S. households. Survey results are described in Holden, Sabelhaus, and Reid, *Enduring Confidence in the 401(k) System: Investor Attitudes and Actions*, available at www.ici.org/pdf/ppr_10_ret_saving.pdf.

income options would be flawed unless it looked beyond the form of the product and extensively analyzed its economics and how it typically is used.²⁵

Finally, and most important, there is no “one size fits all” solution for obtaining lifetime income in retirement. The annuity and non-annuity options available to Americans involve tradeoffs and government policy cannot and should not posit that one approach is preferable for all or even a majority of Americans. Rather, government policy should recognize that both annuity and non-annuity strategies are valid.

The government should not seek to influence behavior by automating retiree choices.

Some proposals aimed at increasing annuitization, such as making an annuity the automatic default distribution option, seek to use inertia to result in allegedly more rational choices. The trend of automation works well in the accumulation phase of employer-sponsored retirement savings but we do not believe automation is appropriate in the distribution phase. Today’s automated plan features are simple, easy to understand and easy to apply to a whole participant population. The goal of automatic enrollment in 401(k) plans is to kick-start the retirement savings process. If one can afford to save for retirement, it is generally a good idea to participate in one’s plan and to increase the level of contribution over time. The basic principles of investing (i.e., diversification) can generally apply to most retirement savers. Most importantly, for a participant who does not feel that the automatic choices (whether the default contribution rate or the default investment) are right for him or her, undoing the automatic election is easy and does not involve significant cost.

In the distribution phase, the needs of individuals can vary widely based on such factors as health status, family situation, goals for retirement, and other sources of income that the individual has, such as Social Security and defined benefit pension income. Automation of the retirement income decision is less advantageous. The choice of a spend-down product or approach is an individual decision. For these reasons, a plan sponsor that determines to designate a default distribution option may want to select one that participants can undo easily and without great expense. The decision to use automatic accumulation features such as automatic enrollment and escalation in plans rests with plan sponsors. Likewise, the decision on what distribution option will be the default also should rest with plan sponsors.

²⁵ In the past, bills have been introduced in Congress that would provide tax incentives for annuities even if the payments vary with market returns or they contain features not designed to provide lifetime income streams. *See, e.g.*, “Retirement Security for Life Act of 2009,” S. 1297, 111th Congress (2009).

What Influences Plan Sponsor Decisions to Include Annuities in Plans?

While factors like regulatory complexity and fiduciary compliance costs play a role, plan sponsors decide to offer annuities largely based on participant demand, or lack thereof. For a plan sponsor, the prospect of selecting and monitoring an annuity provider involves fiduciary considerations and may not be worth the time and expense given the low number of participants who may be interested in buying an in-plan annuity. Another consideration for the plan sponsor is the ability to change providers when the selected provider or product is no longer deemed appropriate under the plan's ongoing fiduciary process – switching to a new provider for an in-plan annuity may not be easy due to surrender charges and other contract obligations. Understanding annuity products also can be daunting to some plan sponsors.

While cost, potential liability, and complexity together may deter a plan sponsor from offering annuity options, we believe that lack of participant demand is one of the key reasons why annuities are not common in defined contribution plans. If participant demand were greater, more plan sponsors likely would offer annuities, notwithstanding the fiduciary and administrative burdens involved. In the end, a sponsor may want to assist employees with securing retirement income, but may feel that other methods better serve the needs of a participant population that is not disposed towards annuities – such as installment payments and systematic withdrawal plans and offering education and advice to participants about retirement income strategies and options.

Mandating that annuities be offered in plans would impose new fiduciary obligations that could discourage plan sponsorship or increase the costs of sponsoring plans unnecessarily, given the low interest level of participants in annuities. Mandating that an annuity option be the default distribution option choice in a plan also would create new administrative hurdles for sponsors and for participants, who will likely end up selecting the same form of distribution that they otherwise would have selected absent the default regime. Increasing administrative burdens for employers will do nothing to encourage plan sponsorship. Employers that are interested in making lifetime income options, including annuities, available to their participants can do so without mandates.

What Are the Advantages of Offering Annuities In-plan vs. Out-of-plan?

Whether obtaining an annuity in a plan or outside a plan is preferable depends on several factors. There are some advantages to participants as a group if an employer decides to make annuities available inside of a plan. Plan participants could benefit from group purchasing power, as group

annuities tend to be priced more favorably than individual annuity contracts.²⁶ The downside, however, is that the group annuity may not be as portable when individuals change jobs. The importance of this factor should not be discounted, as median job tenure in the United States is 4.1 years (7.2 years for government jobs and 3.6 years in the private sector).²⁷ This means that an individual could very likely work for seven different employers in a 30 year career.

Whether an in-plan or out-of-plan annuity is preferable also depends on individual participant circumstances. For example, gender may play a role in whether an in-plan annuity option would be beneficial. Compared to an out-of-plan annuity, an in-plan annuity may be more advantageous to women than for men. Annuities purchased outside a plan are priced separately for men and women, while annuities offered under employer-sponsored retirement plans must be provided on a gender-neutral basis. All else being equal, a unisex annuity will be more expensive (i.e., provide lower regular payments) to men because they are placed in an insurance pool with women, who have higher life expectancies. Conversely, all else being equal, a unisex annuity will be less expensive (i.e., provide higher regular payments) to women. Thus, in-plan annuities, both because they are unisex and because they are group, are typically less expensive for women than out-of-plan annuities. In contrast, in-plan annuities, because they are unisex and despite being group, may be more expensive for men than out-of-plan annuities.

Whether and to what extent a participant has other assets outside an individual's last 401(k) plan also can affect whether electing an in-plan annuity would be advantageous compared to a retail annuity. Sometimes it will make sense for an individual to roll over a plan account from a previous job into the 401(k) plan at a new job, but other times, the individual may prefer to stay in the prior employer's plan or may not be permitted to roll over the entire balance from a prior employer's plan. In addition to having multiple plan accounts, some individuals also will have other assets intended for retirement not sitting in employer plans. Therefore, it makes little sense to place emphasis exclusively on the distribution forms available within a plan, particularly the plan at the worker's final job. For many people who seek annuity income, the best course of action may be to take some portion of their combined assets and look for an annuity or other product outside of the plan.

²⁶ As discussed in note 17, sales and administrative expenses and adverse selection both affect annuity pricing. Group annuities may have lower sales and administrative expenses than an individual annuity, but will still be subject to adverse selection.

²⁷ Data on job tenure in the United States is collected every two years by the Bureau of Labor Statistics; the most recent values are for January 2008, published online September 26, 2008. The *Employee Tenure Summary* report is available at www.bls.gov/news.release/tenure.nr0.htm.

What Role Do IRAs Holding Rollovers Play in Decisions About Retirement Income and What Options Are Available to IRA Investors?

IRA investors have access to the same distribution options and strategies as plan participants—sometimes more. IRAs play a crucial role in helping Americans accumulate retirement savings and in managing those savings over a lifetime and hold a significant portion of the retirement savings of American workers. They were created in 1974 under ERISA for the purpose of allowing workers without access to workplace retirement plans to save for retirement and as a vehicle for holding retirement assets after leaving employment. ICI data shows that IRA assets were \$4.2 trillion at the end of 2009, accounting for about 25 percent of all retirement wealth and about 8 percent of all household financial assets.²⁸ Most of the money flowing into IRAs consists of rollovers of lump-sum distributions from employer-sponsored retirement plans.²⁹

IRAs are used both to accumulate retirement savings and to manage assets in retirement. An IRA investor generally has access to the same strategies for obtaining lifetime income as a 401(k) plan participant—sometimes more. An IRA holder generally can purchase an annuity, arrange for systematic withdrawals, or purchase any other product or service designed to enable retirees to generate regular income streams from their retirement accounts.

The RFI asks specifically about annuities within IRAs. At the end of 2009, IRA assets held at life insurance companies were \$303 billion, and another \$85 billion of IRA assets were held in variable annuities invested in mutual funds. Together, these annuity investments accounted for over 9 percent of IRA holdings.³⁰

What Information Do Participants Need to Make Informed Decisions About Lifetime Income?

Government and industry have a shared responsibility to raise awareness of retirement income options and help plan sponsors and participants understand and evaluate their choices. Because there is no one-size-fits-all solution in the distribution phase, information, education and advice are of paramount importance. An individual must consider his or her own needs in retirement

²⁸ See Investment Company Institute, *2010 Investment Company Fact Book*, available at www.ici.org/pdf/2010_factbook.pdf.

²⁹ See Sabelhaus and Schrass, “The Evolving Role of IRAs in U.S. Retirement Planning” *ICI Perspective*, vol. 15, no. 3 (Nov. 2009), available at www.ici.org/pdf/per15-03.pdf.

³⁰ These data do not necessarily provide an accurate measure of annuity demand by retirees with IRA accounts, because, as explained above, only about 5 percent of deferred annuity contracts are ever converted to immediate annuities.

and understand what tools can help meet those needs. It is important to understand the objectives of the various distribution options available (both in and outside the plan) and how those options address an individual's needs, appreciate the limitations of each option, and understand product fees and expenses. As explained above, all of the options involve tradeoffs. The Agencies should update their regulatory guidance to deal with spend-down decisions and should play leadership roles in new initiatives to equip participants to make informed decisions about lifetime income.

Guidance relating to education and advice. The Agencies should tailor their policies to encourage education and advice programs in the distribution phase. The Department of Labor should extend Interpretive Bulletin 96-1 or provide other guidance that makes clear that sponsors and service providers may convey the general advantages and disadvantages of various distribution forms without triggering fiduciary liability. The Department also should complete its project to implement the PPA's investment advice exemption, which is designed to expand opportunities to provide advice within 401(k) plans and IRAs.

The Department also could provide guidance on the appropriate use of plan assets to pay for educational efforts to help participants make informed decisions about lifetime income and other distribution options, including options available outside of the plan. In PSCA's most recent survey, only roughly 35 percent of plans provided some sort of education to participants taking a retirement distribution.³¹ This number could increase with clearer guidance and encouragement from the Agencies.

Leadership in equipping participants to make informed decisions. Most importantly, the Agencies should serve as catalysts for public- and private-sector initiatives to develop educational materials to help participants with distribution decisions at retirement. The private sector, non-profits, and the government should partner to develop curriculum and publicize an educational campaign. This type of public/private partnerships might be modeled after the "Educate to Innovate" campaign, announced by the Obama Administration in late 2009 in which the government will partner with industry to promote advancement of American students in the science, math, engineering and technology fields.³² This initiative involves (1) public-private sector partnerships to harness the power of the media and develop innovative approaches to spark the interest of students to pursue careers in science, technology,

³¹ See Profit Sharing/401k Council of America (PSCA), *52nd Annual Survey of Profit Sharing and 401(k) Plans (Reflecting 2008 Plan Experience)* (2009).

³² See www.whitehouse.gov/the-press-office/president-obama-launches-educate-innovate-campaign-excellence-science-technology-en.

engineering and mathematics and (2) private-sector financial commitments to support state of the art educational programs in these fields.

For example, public- and private-sector stakeholders could work together to develop educational tools that meet the needs of those entering retirement and that deliver information in an effective manner. These materials will be most useful if they are made prominent and easily accessible through use of technology and new media, including YouTube videos, computer courses that employers could offer, or social networking sites. Materials should be developed with research in mind that shows that people like clear and concise information presented in graphic form and, for computer-based information, want to be able to click through easily to additional relevant information.³³ The Agencies and other interested public- and private-sector parties also may want to build a financial education curriculum based on these same principles. Policymakers may want to consider offering individuals and employers incentives to participate in or offer the financial education curriculum. They may also want to consider efforts to make Americans aware of the potential advantages – in terms of monthly income – of delaying the date at which they begin taking Social Security.

The Agencies also should work with other regulatory agencies with an interest in assisting and protecting retirement savers. In an effort to improve services to older investors, the Securities and Exchange Commission, the North American Securities Administrators Association, and the Financial Industry Regulatory Authority announced in 2008 that they will seek to identify effective practices used by financial services firms in dealing with senior investors.³⁴ Each of these regulators has developed extensive websites devoted to addressing the problem of senior fraud.³⁵ It would be a natural progression for the Agencies, as retirement plan regulators, to join forces to expand these tools to protect retirement investors. The Agencies should not only facilitate education but should maintain robust enforcement of investor protection rules in connection with senior fraud.

³³ For survey results summarizing mutual fund–owning households’ views on information presentation, *see, e.g.*, Sabelhaus, *Investor Views on the U.S. Securities and Exchange Commission’s Proposed Summary Prospectus*, Investment Company Institute (March 14, 2008), available at www.ici.org/pdf/ppr_08_summary_prospectus.pdf; and West and Leonard-Chambers, *Understanding Investor Preferences for Mutual Fund Information*, Investment Company Institute (2006), available at www.ici.org/pdf/rpt_06_inv_prefs_full.pdf.

³⁴ *See SEC, NASAA and FINRA Announce New Steps to Help Protect Senior Investors* (press release issued Feb. 8, 2008), available on the SEC’s website at www.sec.gov/news/press/2008/2008-16.htm. The initiative was to seek input in the following areas: marketing and advertising to seniors; account opening; product and account review; ongoing review of the relationship and appropriateness of products; discerning and meeting the changing needs of customers as they age; surveillance and compliance reviews; and training for firm employees.

³⁵ *See* www.sec.gov/investor/seniors.shtml; www.saveandinvest.org/55Plus/index.htm; www.nasaa.org/investor_education/Senior_Investor_Resource_Center/.

Should Participants Receive Information About the Income Stream Their Account Might Generate?

Disclosure that translates an account balance into a projected monthly income is useful and many plans have begun to provide this information. It would be premature, however, to codify a single approach to providing the information. It generally is important for participants to think about their account balances in terms of the income they reasonably could generate in retirement. Many plans and plan providers have begun to provide this information to help participants understand whether their retirement saving is on track. For example, some providers offer participants online calculators, which calculate a participant's projected income stream in retirement based on various assumptions and allow the participant to see how the projected income stream would change if, for example, the participant reduced or increased contributions to the plan. In addition to offering these interactive tools on plan websites, some providers include information on account statements projecting the monthly income a participant might receive at age 65. These calculations assume the participant continues to participate at the same rate and typically assume historical rates of inflation and account performance in projecting an account balance at age 65.

We believe it would be premature to codify a single approach or methodology for this disclosure. We recommend, however, that the Agencies encourage plans to provide this information and develop and publish guidelines for its use. For example, plans and providers should make clear that the information is an estimate and should disclose the key assumptions underlying the calculations. Because the market for retirement plan services is highly competitive and providers compete based on the quality of the information and services they provide to plans and participants, we are confident that we shortly will see the disclosure of this information throughout the plan market and that more and more effective ways of presenting the information will develop. Letting this competitive market evolve will better serve the interests of plan participants – the users of this information – than trying to codify a single approach at this time.

If, despite our recommendation, the Agencies are determined to mandate a methodology for lifetime income disclosure on benefit statements, we strongly oppose using as the basis for disclosure what *today's account value* would buy in terms of lifetime income in the future when the participant reaches age 65, as some have proposed.³⁶ This disclosure would provide meaningful information only to those close to retirement whose accounts are near the end of the accumulation stage. The information would be meaningless or confusing to younger participants because their account balances likely will be

³⁶ See "Lifetime Income Disclosure Act" S. 2832, 111th Congress (2009).

small and generate very small annuity equivalents. This, in turn, could cause an employee to cash out the retirement account when he or she changes jobs rather than rolling it over to a new employer's plan.

The principal goal of lifetime income stream disclosure should be to allow participants to see if their retirement saving is on track. To provide meaningful information to all participants, lifetime income disclosure should take into account and project future contributions. This is the approach Social Security uses in the benefit statement notices it provides to American workers and the Agencies should encourage its use in retirement plan benefit statement disclosure as well.

The RFI asks whether lifetime income payments should be expressed in the form of annuity payments and, if so, what actuarial or other assumptions would be needed. If the Agencies determine to mandate a methodology for disclosure (a course we do not recommend), they should not require disclosure expressed as annuity payments because of the complex judgments the Agencies would be required to make and the complex assumptions they would be required to prescribe for the disclosure. If the Agencies determine they must provide a methodology for translating a projected final account balance into an income stream, one simple approach would be to divide the projected account balance by the life expectancy stated on IRS tables at a certain age, such as age 65.³⁷ Another approach would be to use 3 percent or 4 percent of the projected final account balance at age 65, the approach some financial planners use.

Do Plan Qualification Rules Affect Plan Sponsor or Participant Interest in Lifetime Income?

Other than the administrative requirements associated with the qualified joint and survivor rules, we are not aware of any plan qualification rules that impede plan sponsors from offering lifetime income arrangements.³⁸

Qualified joint and survivor rules. When a defined contribution plan offers annuities as a distribution option, it does face one administrative burden under the qualification rules. Under Code section 401(a)(11), a defined contribution plan may not allow a married participant to elect a single life annuity unless the participant's spouse consents in writing. This consent must be witnessed by a plan representative or notary. No consent is required if the participant elects a lump-sum distribution or elects the qualified joint and survivor annuity.

³⁷ See IRS Publication 590, Appendix (Jan. 7, 2010). The single life expectancy (Table I) at age 65 is 21 years.

³⁸ That 21 percent of plans offered an annuity option at retirement as a distribution option as of 2008 suggests that plan sponsors that wish to offer annuity options are able to do so.

The reason this protection applies only when the participant elects a single life annuity is that when the participant elects a lump-sum distribution, the assets continue to be available to the participant's spouse after death in accordance with estate law. But the election of a single life annuity prevents the spouse from receiving any benefit if the participant predeceases the spouse. Accordingly, current law requires that a spouse be informed of and consent to a single life annuity before the participant elects it.

While the Institute has not taken a position on whether Congress should consider relaxing the spousal consent rule, we would support efforts to streamline the administrative process associated with spousal consent. We question, however, whether relaxing the spousal consent rules would significantly increase the number of defined contribution plans that offer annuities as a distribution option. Plan sponsors decide to offer annuities largely based on participant demand, or lack thereof, and we see no reason the low demand for annuities is due primarily to the spousal consent rules. Plan sponsors who believe participants will use and value annuities as a distribution option will offer them regardless of the specific regulatory boxes they must check, except at the margins. Further, since participants in defined benefit plans that offer lump-sum distributions commonly select the lump-sum option, we know that the requirement to obtain spousal consent is not a significant impediment to participants who wish to select a lump-sum option.

Required minimum distributions. The Agencies' focus on lifetime income provides a good opportunity to examine whether the required minimum distribution rules should be changed to reflect longer life expectancy. One option is to increase the age at which distributions must begin from age 70½ to, for example, age 75.³⁹ According to the Social Security Administration, the average life expectancy at age 65 is about four years longer for men, and three years longer for women, today than it was in 1962, when the 70½ rule was first added to the retirement plan rules as part of the creation of Keogh plans. Meanwhile, the Social Security normal retirement age has increased, from 65 to 67. Given that Institute research shows that IRA owners tend to preserve their IRA balances until the government forces a distribution at age 70½, as part of an overall strategy for managing assets in retirement, there is strong evidence that many workers delay tapping their IRA account balances until later in retirement.

³⁹ See Testimony of Paul Schott Stevens, President and CEO, Investment Company Institute before the Education and Labor Committee, U.S. House of Representatives, Hearing on "Strengthening Worker Retirement Security" (February 24, 2009), available at www.ici.org/policy/ici_testimony/09_house_401k_tmny.

Should the Department of Labor Make Changes to its Safe Harbor for the Selection of Annuity Providers?

In the PPA, Congress instructed the Department to modify its rules to provide that the selection of an annuity contract as an optional form of distribution from an individual account plan is not subject to the safest available annuity standard under Interpretive Bulletin 95-1 and is subject to all otherwise applicable fiduciary standards. In implementing this direction, the Department adopted a safe harbor for the selection of annuity providers for distributions from defined contribution plans. The modified rules for defined contribution plans reflect that inherent in annuities is a tradeoff between the safety of the annuity and the cost of the annuity and therefore the income generated from the account balance used to purchase the annuity.

The Institute supports removing regulatory obstacles that inhibit employers from making available distribution options that make sense and are valued by plan participants. On the other hand, like the selection of an investment option, the selection of an annuity provider is a fiduciary act and plan fiduciaries should be expected to act in accordance with ERISA fiduciary rules. Evaluating an annuity can be complex. We believe that a safe harbor approach, which provides certainty to plan fiduciaries that they prudently evaluated annuity providers, but which is not the exclusive means to select and monitor annuity providers, is a reasonable solution. We do not believe that further relaxing the safe harbor would significantly increase the number of defined contribution plans that offer annuities as a distribution option. Plan sponsors decide to offer annuities largely based on participant demand, or lack thereof.

The Department asks whether the safe harbor in 29 C.F.R. § 2550.404a-4 should be extended to cover “other lifetime annuities or similar lifetime income products.” We are unsure what other products are being contemplated, but if the Department is considering applying them to installments or other systematic withdrawal arrangements, we believe these rules would be inapposite. The safe harbor rules address the need to evaluate the annuity provider that is being given all or part of the participant’s account balance. An installment or systematic withdrawal plan, in contrast, keeps undistributed amounts invested in the plan’s investment options. (The selection and monitoring of these investments is of course subject to the fiduciary standards of ERISA.)

Are Fixed Deferred Lifetime Annuities Used as Investment Options in 404(c) Plans?

The Agencies ask about the relationship between the ERISA section 404(c) rules and fixed deferred lifetime annuities used as investment options. Since most participant-directed defined

contribution plans are designed to comply with ERISA section 404(c), presumably those plans that offer fixed deferred lifetime annuities as an investment option are 404(c) plans. We would be surprised, however, if the annuities are offered as one of the three core investment options described in 29 C.F.R. 2550.404c-1(b)(3). Generally these core investment options are required to allow participants to give investment instructions no less frequently than once within any three-month period.

Incremental or accumulating annuities as plan options are new products and we believe as they develop and mature they could serve as a complement to investment options typically offered in plans. We are not aware of any significant impediment in the regulations under section 404(c) to using incremental or accumulating annuity arrangements as one of a plan's investment options. Those regulations support many investment arrangements.

We have long-supported updating the disclosure rules in the 404(c) regulation to ensure that participants have key information on all investment options. There are a number of disclosures in the current 404(c) regulation that would apply particularly to fixed deferred lifetime annuities that should be retained in any revision of the 404(c) regulation, particularly the requirement to describe any restrictions on the transfer to or from the investment option and a description of any fees and expenses which affect the participant's account balance in connection with purchase or sale of the investment.

To What Extent Do QDIAs Include Lifetime Income Features?

The RFI asks to what extent plans are using default investments that include guarantees or other similar lifetime income features ancillary to the investment fund, product or model portfolio, what are the most common features currently in use, and what actions the Agencies could or should take to encourage the use of lifetime income features in connection with QDIAs. The QDIA regulation does not prevent the incorporation of income features into an investment that otherwise meets the criteria for a QDIA. In fact, the final regulation and preamble specifically state that the availability of certain features such as annuity purchase rights or investment guarantees will not alone affect the default investment's status as a QDIA. We caution, however, against attempting to hardwire distribution choices into a QDIA, since many workers who are automatically enrolled into a plan and invested in a default investment will be young and far from retirement. Pushing these workers into a distribution choice so early in their careers could have negative ramifications later. Therefore, we do not believe there is need for additional guidance relating to QDIAs and the distribution phase.

Economic Impact and Cost/Benefit Analysis

We have two concerns with the economic analysis underpinning the RFI that the Agencies should address in performing their regulatory impact analysis. One involves the distinction between adequacy and lifetime income decisions. The other involves the macro costs and risks of various options.

Distinction between adequacy and lifetime income decisions. The preamble to the RFI suggests that the Agencies are conflating the concept of retirement adequacy with the concept of managing retirement savings. For example, the Agencies assert that in a defined contribution plan, as opposed to a defined benefit plan, “there is no promise as to the adequacy of the account balance.” Defined benefit plans make no promise as to the “adequacy” of the benefit, which depends on the vesting status, the benefit accruals, and final compensation of the participant. In addition, when participants in these plans are offered and elect a lump-sum distribution at retirement, they must manage those assets just like a distribution from a defined contribution plan.

To a large extent the increased public policy interest in annuitization has been motivated by the shift of private-sector employers toward defined contribution plans and away from traditional defined benefit pensions. Concerns by some that lack of availability and take up of annuities in defined contribution plans will put American retirement security at risk – a concern reflected in the RFI – appears to come from the belief that, in the past, private-sector defined benefit plans generated a substantial amount of retirement income for a large segment of the population. Defined benefit plans have many positive features but the reality is that they never provided significant benefits to a large proportion of the American workforce because of the vesting and accrual rules. The end result is that few workers received regular income from private-sector defined benefit pension plans in retirement.

For example, in 1981, the year that 401(k) plans were introduced, fewer than 20 percent of individuals age 65 and older who did not work reported regular income from a private-sector pension plan (including both defined benefit and defined contribution plans), and the median benefit was less than \$6,000 a year in constant 2007 dollars.⁴⁰ Since 1981, the percentage of individuals age 65 and older who did not work who reported regular pension income has increased, so that by 2007

⁴⁰ ICI tabulations from the March *Current Population Survey*. For a more detailed discussion of this issue and the statistics discussed here, see Submission from Paul Schott Stevens, President and CEO, Investment Company Institute, to Honorable George Miller, Chairman, Committee on Education and Labor, U.S. House of Representatives (March 10, 2009), for the record in connection with Education and Labor Committee Hearing on February 24, 2009.

approximately 25 percent individuals age 65 and older who did not work received regular income from a private-sector pension plan and the median amount was just over \$7,000.⁴¹

The Agencies also cite to a November 2007 GAO report on the adequacy of savings workers have accumulated, and assert, surprisingly, that this GAO report is relevant to the RFI because “the need for lifetime income may be most acute among workers who have small but significant retirement savings balances.” Workers with small but significant retirement savings balances are likely to be low-wage workers or late career workers with relatively short tenure at that last employer. We fail to understand why the Agencies believe that a low-wage worker who will receive most of his or her retirement income from Social Security should be encouraged or required to annuitize the “small but significant” account balance.

The Agencies, citing the GAO report, state that the median defined contribution plan account balance is \$60,600 for workers age 60 to 64. The median account balance is not a meaningful number for assessing whether 401(k) savers will be prepared for retirement, even for those employees who are nearing retirement age. The median account balance includes those whose 401(k) accounts supplement a defined benefit plan, those who have 401(k) balances with both current and previous employers, those who have assets rolled over into an IRA, and those who have not been in the 401(k) system as the primary retirement vehicle for a full career.⁴²

A recent Congressional Research Service report found that in 2007 the median value of all retirement accounts owned by households headed by persons between the ages of 55 and 64 was \$100,000.⁴³ The report calculates that this would produce annual annuity income of approximately \$8,400 for a man and \$7,800 for a woman.⁴⁴ The report suggests that this amount of income is inadequate. Even though many workers have not had a defined contribution plan their entire career, this amount of annuity income is on par with the median amount of benefits generated by pension

⁴¹ Another 11 percent of individuals age 65 and older who did not work received regular payments from a government pension.

⁴² Research by the Employee Benefit Research Institute and ICI, modeling a full career for a group of actual plan participants, finds that participants will replace a significant amount of their pre-retirement income with their plan balances and Social Security. See Holden and VanDerhei, “Can 401(k) Accumulations Generate Significant Income for Future Retirees?” and “The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement,” *ICI Perspective* and *EBRI Issue Brief*, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at www.ici.org/pdf/per08-03.pdf and www.ici.org/pdf/per11-02.pdf, respectively.

⁴³ See Purcell and Topoleski, “Retirement Savings and Household Wealth in 2007,” *Congressional Research Service Report* RL30922, April 2009.

⁴⁴ Women receive less in annuity payments because women live longer than men, on average.

plans historically. In short, we do not agree that the shift from defined benefit to defined contribution plans has left Americans less prepared for retirement.

Macro costs and risks of mandating or incentivizing annuities. One risk that retirees face in using annuities is the risk that their insurance company will be unable to pay the promised benefit. This risk is born only by those individuals with annuities at a particular insurance company, and typically is ameliorated by state insurance guarantee pools. In assessing the economic impact of any policy proposal to encourage or mandate annuitization, we believe the Agencies also need to consider risks to the government and risks to sub-groups of Americans.

If the government enacts policies designed to shift significant retirement savings into annuities, the U.S. government may be compelled to step in to guarantee the annuities purchased if something that affects all insurance companies were to occur, such as a big jump in life expectancy or another financial crisis that imperils financial services firms.⁴⁵

Another factor the Agencies also should consider is how costs would be borne by those groups of workers that are incentivized, defaulted, or mandated to accept an annuity. The basic financial result of an annuity is to transfer assets from individuals who live shorter than average to those who live longer than average. Although each individual is different, certain groups tend to live longer than others, and the longer-lived group will tend to benefit from annuity payouts bolstered by those who did not live long enough to need the annuity insurance. If governmental mandates or incentives are applied to defined contribution plans or IRAs, then one effect could be a transfer of wealth, on average, from one group of Americans to another—such as from those who are poorer to those who are richer.⁴⁶

⁴⁵ The typical hedge for the risk of increasing life expectancy for an insurance company that writes annuities is for the insurer also to write life insurance policies, because payouts from life insurance policies should decline as payouts from annuities increase. There may be limits, however, to the extent that insurance companies can hedge these risks, and some have suggested that the government should step in and create a hedge for aggregate mortality risks. See Brown and Orzag, “The Political Economy of Government-Issued Longevity Bonds,” *Journal of Risk and Insurance*, vol. 73, no. 4 (2006); Friedberg and Webb, “Life Is Cheap: Using Mortality Bonds to Hedge Mortality Risk,” *B.E. Journal of Economic Analysis and Policy: Topics in Economic Analysis and Policy*, vol. 7, no. 1 (2007). The Agencies would need to consider the risks of this approach to the taxpayers, who not only have no natural hedge against the risks, but already face substantial risks from increased life expectancy through Social Security and Medicare.

⁴⁶ For evidence of differences in life expectancy by income – what demographers refer to as “differential mortality” – see Attanasio and Hoynes, “Differential Mortality and Wealth Accumulation,” *Journal of Human Resources*, vol. 35, no. 1 (2000). See also Gong and Webb, “Mortality Heterogeneity and the Distributional Consequences of Mandatory Annuitization,” *Journal of Risk and Insurance*, vol. 75, no. 4 (2008) (discussing the redistributive effect of mortality differentials under mandated annuities).

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Helping Americans take informed and sensible steps to translate their defined contribution account balances into income streams in retirement is important. Plan participants and IRA holders today have choices and effective strategies to do so, including annuity and non-annuity approaches. Research shows retirees are careful stewards of their retirement assets and that they seek input from various sources in making distribution decisions. Raising awareness of retirement income options and helping plan sponsors, employees and retirees understand and evaluate their choices should be the first priority. Meeting participants' needs for quality information that is delivered effectively should be a shared responsibility of government and the private sector.

The various products and services that are designed to provide lifetime income involve tradeoffs and participants themselves have different needs and circumstances. In addition, most retirees already hold most of their lifetime wealth in annuity-equivalent form. No single retirement income solution is suitable for all or even most Americans who are deciding how to take distributions from their defined contribution plan accounts or IRAs. For this reason, government policy should recognize that both annuity and non-annuity approaches are valid and should not seek to mandate or incentivize one approach over the other. Research shows that Americans are overwhelmingly against being required to annuitize some portion of their retirement plan accounts. The focus of government policy should be on helping Americans make decisions – decisions we believe they clearly want to make on their own – about how to manage their assets in retirement.

The Institute is committed to efforts to meet the needs of Americans for a secure retirement and looks forward to working with the Agencies on these important issues.

Sincerely,



Mary Podesta
Senior Counsel – Pension Regulation