RETIREMENT SAVINGS

CONFRONTING THE CHALLENGE OF LONGEVITY

PAMELA PERUN

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The Aspen Institute
Dupont Circle, NW
Washington, DC 20036-1133
Published in the United States of America
in 2010 by the Aspen Institute

10-019
ISBN: 0-89843-534-X

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The Aspen Institute Initiative on Financial Security gratefully acknowledges the support of The Atlantic Philanthropies, The Ford Foundation, Prudential Financial, The Prudential Foundation and The Rockefeller Foundation. The views, opinions, and analysis expressed in this publication are solely those of the Aspen Institute Initiative on Financial Security. We thank Raymond O'Mara III and Colby Farber for their efforts and helpful comments on this paper.

Introduction

In 2010, the Initiative on Financial Security at the Aspen Institute (Aspen IFS) is launching its Lifelong Financial Security project to provide the integrative thought leadership critical to framing a successful U.S. retirement policy on lifelong income. As the world of defined contribution retirement savings has grown, and with the potential vast expansion of private retirement savings through automatic IRAs, the majority of savers now nearing retirement and in the generations to come will have nest eggs, which they will have primary responsibility for managing during retirement. Annuities are traditional means for managing the risk of outliving savings in retirement. But annuities as an investment or distribution option are virtually absent from defined contribution plans. Outside of the plan universe, payout annuities have never been popular with mass market consumers and could be considered the cod liver oil of investment products — a product that may be good for you but hard to swallow and too often avoided.

Federal agencies have recently put into place a process to consider how participants in defined contribution plans and IRAs could be helped to manage their savings in retirement. In the initial phase of this effort, the agencies requested information on over 30 topic areas in tax and employee benefits law. They received nearly 800 comments in response from the general public, the financial services industry, academics and policy experts, among others. Speaking broadly, four main observations can be made about the comments. First, there is a great deal of apprehension and concern on the part of the general public about any new policy that could be perceived to diminish participant control and ownership of 401(k) and other personal savings. Second, there is a vast body of knowledge – from the academic literature and from industry practice and marketing research – about the ways and means to secure lifelong income and a wide variety of opinions on the best way forward. Third, there *is* new learning about how savers might think differently about lifelong income products. Fourth, there *is* a new generation of lifelong income products with annuity-like features that could better meet the needs and goals of savers to protect their income in retirement.

Aspen IFS believes that many savers will want and need to annuitize at least some of their retirement nest eggs. Federal policy should assist them to do so. The Aspen IFS approach to this project is guided by a focus on the needs of the "ordinary" saver – not the high-income/high account balance saver – and especially on low- and moderate-income savers with modest or medium-sized nest eggs. By engaging experts from a variety of disciplines and backgrounds in thoughtful discussions in two Executive Institutes, supported by targeted analysis and writing, the goal of the Lifelong Financial Security project is to provide federal policy makers with essential guidance and support to inform the policy making process going forward.

The initial work of the Lifelong Financial Security Project is to lay the groundwork for constructing a policy that will provide secure income for low- and moderate-income workers, provide employers with an appropriate role, and provide industry with options that meet market realities. Above all, such a policy must be fair, secure and suitable for the many millions of retirees who will be trying to stretch hard-earned nest eggs throughout retirement, both today and in the future.

U.S. retirement policy is at a crossroad. The defined contribution plan system is maturing but the way forward to greater financial income adequacy is unclear. Should work-based defined contribution plans remain focused on asset accumulation for retirement? Or should the system be reshaped instead into a savings system that also sustains financial security throughout retirement? What pitfalls must be avoided and what obstacles will need to be overcome in order to provide longevity insurance to savings? Who is this new system intended to serve and what are their needs and wants? Will it require a re-alignment of the roles of the employer and the financial services industry under ERISA? What can the industry teach us about product innovation and differentiation to help retirees avoid outliving their savings? Is existing regulation adequate for protecting participants from insurance company insolvency? Can the defined contribution plan system be made flexible enough to meet the challenges facing near-retirees today while recognizing that future generations will undoubtedly present and be presented with new challenges?

Policy makers increasingly recognize that the United States needs to begin a broad discussion about the future direction of the U.S. retirement system. This paper is not intended to point out alternative pathways or discuss their merits or otherwise pre-empt that discussion. It is intended instead to describe how U.S. retirement policy arrived at this crossroad and to highlight some of the tensions and past choices that have brought the system to this turning point. It focuses on three areas of inquiry regarding the challenge of longevity at this point in time: employer plans, people and industry products. Understanding the journey the defined contribution plan system has made to this point in time is the first step toward charting its direction for the future.

The Context

> *Longevity risk management was a family obligation in the old days; in the 20th century, as development, migration, and the scattering of families became more common, government and employers took over the role of providing longevity insurance. In the 21st century, demographic shift and government overspending has put all of these sources under stress … the future … [may] be an era of more general and formalized private longevity insurance provision through annuities.*[1]

Managing the last phase of life financially is now a global problem, as governments seek new ways to support the needs of aging societies. Although there is wide variation among countries, one mechanism to which many countries are turning in various degrees is increasing reliance on the private sector financial industry to provide the products and services that can sustain income throughout retirement.

The United States is now embarked on a search for solutions to the financial burdens imposed by an aging society. Just ten years into a new century, it has become all too apparent that that the 20th century American paradigm for retirement income is dysfunctional. The stress points are well-known.

- Social Security provides only a base level of income in retirement, and its future structure and financing is a current political issue.
- The Baby Boom generation (1946-1964) is reaching retirement age, and roughly 4 million of them will retire each year over the next twenty years.
- Birth rates have been declining over the long term, sharply reducing the ratio of workers to retirees.
- The idealized view of a long-married couple entering retirement with children grown-up and a mortgage paid off is increasingly unrealistic as adult life patterns become more diverse. Some near-retirees have young families, while others are supporting parents and children (and grandchildren) or both.
- The private pension system is not yet providing a substantial second tier of retirement income for many Americans and covers only about 50% of workers at any given time.
- Defined benefit pension plans are fading from the scene.
- Account balances in 401(k) plans and other private saving vehicles are modest for most Americans and have been adversely affected by the 2008-2010 Great Recession.

1 Olivia S. Mitchell and John Piggott, "Turning Wealth into Lifetime Income: The Challenge Ahead," PRC WP 2010-13, Pension Research Council, The Wharton School, University of Pennsylvania, September 2010. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1678081.

- The housing wealth of millions of Americans has been devastated by the Great Recession and, for many, can no longer be a planned source of income in retirement.

- Healthcare and long-term care costs threaten to absorb an increasing share of retirement income in the future.

Policy makers are well aware that an aging society poses profound financial challenges for the economic future of the United States. For example, the Employee Benefit Research Institute just recently projected that the total national aggregate deficit in U.S. retirement income adequacy is $4.6 trillion, which would almost double to $8.5 trillion without the current level of Social Security benefits.[2] The United States, unlike some other countries, is not turning first to its social insurance system, Social Security, for a solution to this challenge. A discussion of the future of Social Security is pending but more in the context of deficit reduction than retirement income adequacy.

Policy makers have instead turned to efforts to strengthen the private savings system found in employment-based plans by focusing on the build-up years before retirement and enhancing the ability of Americans to accumulate financial assets during their working years. With the goal of increasing saving for retirement, recent changes in tax and pension law have promoted "auto-enrollment" and "auto-escalation" contribution policies in 401(k) and similar plans to increase the number of workers saving in plans and the amount they save. "Default" investment options in plans promise to help relieve workers of some of the burdens of making investment decisions for their savings and could substantially increase the return to saving, resulting in larger nest eggs at retirement. Recent data indicate that these automatic techniques are putting more workers, and especially workers under 30, on a better savings trajectory.[3]

Recent Obama Administration proposals have also focused on workers who have no savings plan at work.[4] If legislation to enable "Automatic IRAs" is enacted, over 40 million more workers will be automatically enrolled to save in an IRA unless they opt out.[5] These workers would join the roughly 60 million Americans who now have access to a 401(k) savings plan at work.[6] An enhanced and expanded "Saver's Credit," which rewards saving by low-income workers would help build the nest eggs of workers who need help the most. In 2007, some 69 million tax filers had incomes low enough to qualify for the current credit but some 45 million could not claim it because they had no income tax liability.[7] The most recent proposal removes the income tax requirement by making the credit refundable, reaches Americans with a broader range of incomes and provides an

2 Testimony of Jack VanDerhei before the Senate Committee on Health, Education, Labor and Pensions hearing on "The Wobbly Stool: Retirement (In) Security in America," October 7, 2010. Available at: http://www.ebri.org/pdf/publications/testimony/T-166.pdf.

3 Margaret Collins, "Auto-Enrollment Benefits Younger Savers, Financial Engines Says," Bloomberg Business Week, October 8, 2010. Available at: http://www.business-week.com/news/2010-10-04/auto-enrollment-benefits-young-savers-financial-engines-says.html.

4 Senator Bingaman introduced the "Automatic IRA Act of 2010" (S. 3760) in the Senate on August 5, 2010. Representative Neal introduced the "Automatic IRA Act of 2010" (H.R. 6099) in the House of Representatives on August 10, 2010. The text of the bills is available at: www.thomas.gov/cgi-bin/thomas.

5 *See* http://bingaman.senate.gov/news/20100806-03.cfm.

6 The estimates of current participation in the 401(k) plan system reflect Department of Labor statistics in 2006 and are available at: http://www.dol.gov/ebsa/pdf/1975-2006historicaltables.pdf.

7 *See* the letter dated February 24, 2010 from the Retirement Security Project to Vice President Joe Biden available at: http://www.whitehouse.gov/sites/default/files/microsites/100226-retirement-security.pdf.

individual tax credit of $250 for saving $500.[8] Over the long run, these tax and benefit policy initiatives should increase the number of Americans, and especially low- and moderate-income Americans, who arrive at retirement with larger nest eggs. Even with this renewed focus on financial asset accumulation, achieving retirement income adequacy may remain a moving target because of one often overlooked but absolutely critical trend – increasing longevity. Among the most significant social changes that the U.S. experienced in the 20th century was a major increase in the human lifespan. The Society of Actuaries reports that, with respect to the secular trend for life expectancy as measured at birth,

> as recently as 1900, US life expectancy at birth was about 45 years for males and just below 50 for females; by 2000, it had increased to almost 75 for males and 80 for females. A wide disparity of opinion exists as to how rapidly human longevity can continue to increase. Those focusing on past trends suggest that while improvements will continue through the first several decades of the 21st century, they will be more modest, perhaps below a year each decade for males and even less for females. Other experts believe that at least an additional year of life expectancy might be gained in each decade. Still other observers, noting recent breakthroughs in life-extending medical technology, predict significantly greater increases in longevity, and foresee increasing populations of seniors living well into their nineties and beyond.[9]

It's not just life expectancy at birth that is increasing. Life expectancy in the retirement years has also exhibited substantial increases in the last 100 years. In 1900, life expectancy for men at age 65 was 11.4 years and for women was 12.2 years. In 1997, parallel figures were 15.9 years and 19.2 years, respectively.[10] The Society of Actuaries also reports that currently

> at age 65, average life expectancy is 17 years for American men and 20 years for women. Half of those reaching 65 will survive longer. Thirty percent of all women and almost 20% of men age 65 can expect to reach 90.[11]

Confronting the longevity challenge to retirement savings is largely unexplored territory in the United States. For seventy-five years, Social Security has been seen as the major solution because it provides a nearly universal, inflation-adjusted, basic level of lifelong income in retirement. The private pension system of workplace-based plans has been the second line of defense against outliving savings. For decades, defined benefit pension plans have been traditionally viewed as the source of additional income that lasts throughout retirement. But their numbers are dwindling as is the number of workers covered by them. In the future, most retirees will face the challenge of managing the spend-down phase of saving over an uncertain time frame rather than receiving a guaranteed income stream for life. And because the U.S. private saving system has been focused almost exclusively on asset accumulation for the past several decades, it is a task that most savers are unprepared to handle.

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8 *See* "General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals," Department of the Treasury, Febrary 2010: 19. Available at: http://www.treas.gov/offices/tax-policy/library/greenbk10.pdf.

9 Society of Actuaries, "Key Findings and Issues: Longevity: The Underlying Driver of Retirement Risk," 2005 Risks and Process of Retirement Survey Report, July 2006: 2. Available at: http://www.soa.org/files/pdf/Longevity%20Short%20Report.pdf.

10 *See* http://www.efmoody.com/estate/lifeexpectancy.html.

11 Society of Actuaries, "Key Findings and Issues: Understanding and Managing the Risks of Retirement," 2007 Risks and Processes of Retirement Survey Report, May 2008: 3. Available at: http://www.soa.org/files/pdf/research-key-findings.pdf.

Longevity Protection and the Private Pension System

It is well recognized that the major responsibility for building and managing financial assets for retirement has been shifted to savers, as the private pension system seems to have definitively morphed into a defined contribution plan model.[12] In 2004, for example, only about 3 in 10 of Americans over age 75 had an IRA or 401(k)-like account in comparison to over 40% of those between age 65 and 74, over 60% of those between age 55 and 64 and about 60% of those between age 45 and 54.[13] It is likely that savers in younger generations will accumulate assets for retirement almost exclusively in these accounts, particularly if the Obama Administration's proposals to increase plan availability, saving rates and account balances are as successful as projected. But savers have been left on their own in terms of confronting the spend-down challenge. According to one survey estimate, only about 7% of employers with a 401(k) plan offered an annuity option in 2008.[14] Statistics reported by other industry sources also indicate that a very small fraction of 401(k) plans offer participants the option to choose an annuity.[15] What accounts for this? Why has the private saving system so ignored preparing savers to manage their resources in the last stage of life?

A look back into legal history is revealing. About thirty-five years ago, the private pension system encountered a problem – in defined benefit pension plans, not in defined contribution plans - and the fix has led to the current state of affairs. The problem to be fixed was not vesting or funding or non-discrimination rules or fiduciary liability – the usual hot spots in pension law. No one made a conscious decision to favor the build-up of financial assets and ignore the spend-down phase. The problem was about spousal rights. And it was really about spousal rights in work-based plans whose purpose was to pay income in retirement.[16] Under tax law regulations, these plans are defined benefit pension plans and money purchase pension plans which are defined to be "pension" or "retirement" plans.[17]

12 This paper assumes that the basic structure of the 401(k) plan system today will remain largely intact even as it evolves in the future. There are, however, a number of policy proposals to reshape this structure substantially by giving a larger role to government and by reducing the role that the financial services industry now plays in 401(k) plans. The Retirement USA proposal (http://www.retirement-usa.org/who-we-are), for example, envisions a new system requiring contributions by workers and employers and administered by a government agency or non-profit organization. The Society of Actuaries' Retirement 20/20 Project has been exploring models for a new tier of retirement savings on top of Social Security. Many of these models share similar principles of standardizing and centralizing the 401(k) plan system (award winning papers are available at: http://retirement2020.soa.org/new-designs.aspx). Finally, in her book, *When I'm 64, The Plot against Pensions and the Plan to Save them,* Professor Teresa Ghilarducci proposes a new plan system housed in the federal government that would require mandatory contributions from workers and employers and provide a government guarantee of a 3% return to savings after inflation.

13 John A. Ameriks, Willian J. Burns, Charles J. Klose, Frank W. Nessel and Stephen P. Utkus, "Immediate Income Annuities and Defined Contribution Plans," Volume 32, Vanguard Center for Retirement Research, May 2008: 1. Available at: https://institutional.vanguard.com/iam/pdf/CRRADC.pdf.

14 *See* Hewitt Associates, "Research Highlights: Trends and Experiences in 401(k) Plans (2009)". Available at: http://www.hewittassociates.com/_MetaBasicCMAssetCache_/Assets/Articles/2009/Hewitt_Research Trends_in_401k_Highlights.pdf.

15 For example, Vanguard reports that, among the plans for which it does record-keeping, less than 5% offered an annuity payout option. See Gary Mottola and Stephen Utkus, "The Retirement Income Landscape," Volume 34, Vanguard Center for Retirement Research, December 2008: 10. Available at: https://institutional.vanguard.com/iam/pdf/CRRRIL.pdf. In its recent survey of 149 companies with more than 1,000 employees across a broad range of industry sectors, Watson Wyatt Worldwide reports that 22% of surveyed companies offered lifetime annuity options in their DC plans. See Watson Wyatt Worldwide, "Managing Defined Contribution Plans in the Current Environment," 2009: 6. Available at: http://www.towerswatson.com/assets/pdf/650/Managing%20Defined%20Contribution%20Plans%20in%20the%20Current%20Environment.pdf. Transamerica, in its 11th Annual Transamerica Retirement Survey, estimated 26% of employers offered annuities as distribution options in 401(k) or other self-funded plans. See Transamerica Center for Retirement Studies, "11th Annual Retirement Survey (2009-2010)": 78. Available at: http://www.transamericacenter.org/resources/tc_center_research.html.

16 Under Treasury Regulation section 1.401-1 a "pension" plan (defined benefit pension plan and money purchase pension plan) is a plan "to provide for the livelihood of the employers...after...retirement...through the payment of benefits" while a " profit-sharing plan" is a plan that enables employees... to participate in the profits of the employers' trade or business..."

17 A money purchase plan is a defined contribution plan that is analogous to a defined benefit pension plan because, historically, its purpose was to accumulate assets for the purchase of an annuity. These plans have largely disappeared since their tax advantages over 401(k) plans were removed in the early 2000s.

The problem largely concerned defined benefit pension plans. When ERISA was passed in 1974, these plans were required to provide life annuities to participants. But ERISA did nothing to prevent married plan participants from opting for a single-life annuity that would provide greater current income than one with survivor benefits. Many married participants made this choice. As a result, spouses of deceased participants were often horrified to learn that they had NO right to any future income from pensions earned during the marriage. Many of those spouses were left nearly destitute with Social Security as their remaining financial support. The Retirement Equity Act of 1984 fixed this problem by requiring married participants in defined benefit pension plans to receive an annuity that protected a spouse's right to some survivor income unless the spouse opted out in writing witnessed by a notary public.[18] This change in law secured the rights of spouses to a portion of the retirement income provided by pension plans, unless the spouse chose otherwise.

How to handle the issue of spousal rights in profit-sharing plans, now commonly known as 401(k) plans, was complicated. These plans are defined to be savings, not retirement, plans and may allow participants to withdraw funds before retirement. For many employers, obtaining spousal consent to every distribution is viewed as burdensome and risky. Employers can be sued and forced to pay a second benefit if a spouse later claims that the notice of spousal rights was inadequate or that consent was improperly obtained. So how should the rights of spouses be protected in these plans? Not, Congress decided, by requiring 401(k) plans to follow the new rules for pension plans but by making the spouse the automatic beneficiary for whatever remained in the account on the death of the participant.[19] Spousal consent would be required only if the plan offered an annuity and a participant chose that form of payment.[20] Employers who sponsored 401(k) plans could therefore immunize themselves against spousal consent rights in their plans by avoiding annuities.

So a compromise political decision over spousal rights made many years ago has complicated the legal landscape for products with longevity insurance features in savings plans. At that time, savings plans played a secondary role in the private pension system. Policy makers could not have predicted how 401(k) plans would grow in the following twenty-five years. They could not have foreseen that between 1984 and 2006 the number of 401(k) plans would expand from 17,000 to 466,000 plans, increase coverage from 7 million to 58 million participants, and represent financial assets that grew from $91 million to almost $3 trillion.[21] Even if they are technically not "retirement" or "pension" plans, 401(k) plans (along with their analog plans for the public and non-profit sectors, 403(b) and 457(b) plans) are the primary means by which most people accumulate income for retirement today.

Employers, of course, have always been free to offer annuity options in their 401(k) plans and many did. But in the 1990s, three events combined to marginalize annuities in 401(k) plans even further. The first was a broad secular trend increasing the prevalence of mutual fund investments, rather than insurance options, in the menu of 401(k) plans. The Investment Company

18 This rule also applies to money purchase pension plans which are a type of defined contribution plan also treated under the law as a retirement plan. A detailed history of spousal rights in work-based plans can be found in Camilla E. Watson, "Broken Promises Revisited: The Window of Vulnerability for Surviving Spouses under ERISA," 76 Iowa L. Rev. 434 (1990-1991). Available at: http://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1323&context=fac_artchop.

19 Internal Revenue Section 401(a)(11)(B)(iii).

20 The Internal Revenue Service has recently issued PLR 200951039 which provides guidance on the definition of an annuity in defined contribution plans and when an annuity election occurs for the purposes of spousal consent requirements. *See* http://www.businessofbenefits.com/2010/01/articles/401k-annuitization-1/irs-plr-helps-pave-the-way-for-dc-annuities/ for an explanation of the significance of this guidance.

21 *See* Footnote 6 above.

Institute reports that in 1990 mutual funds accounted for only $35 billion or 9% of the assets held in 401(k) plans. By 2009, the market share of the mutual fund industry had increased to over $1.5 trillion or about 55% of all defined contribution plan assets.[22] This meant that, as 401(k) plans increasingly turned investment control and choice over to participants in the 1990s, lifelong income products became increasingly scarce.

The second event was legal in nature. In the early 1990s, ERISA was amended to impose additional fiduciary liability on employers related to annuities. This change also came about in response to a problem in defined benefit pension plans. When a number of large insurance companies failed, regulators learned that some plan sponsors had selected very low-bid offers to pay the benefits owed to participants in terminated plans in order to increase the amount of excess funds to be returned to the plan sponsor. It seemed that existing law left pensioners without a remedy for their employer's failure to put the interests of plan participants first when transferring pension obligations to an insurance company. So, in the Pension Annuitants Protection Act of 1993, Congress gave workers who received payout annuities from their plans more recourse against plan sponsors. The new legislation not only gave participants the right to sue plan fiduciaries who failed to put participant interests first, but it also expanded the time when law suits could be filed and gave participants the ability to obtain money damages, including the purchase of back-up annuities.[23]

The difficulty caused by this legislation is that regulators imposed very strict standards for the process that employers should follow when selecting annuity providers if they wished to avoid fiduciary liability. Employers responded, often on the advice of their attorneys, by shunning annuity options in their plans.[24] Since the Pension Protection Act of 2006, these standards have been eased somewhat for defined contribution plans but they are still quite demanding.[25] For example, employers must perform a detailed credit analysis of annuity providers or hire an independent expert to perform one when choosing an annuity provider. One of the more problematic requirements to employers is that they must "[*a]ppropriately conclude … that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract.'*[26] Many savings plan sponsors have concluded that avoiding the fiduciary liability attached to annuities makes sense. They lack confidence in their ability to evaluate the future performance of insurance companies and do not want to become the potential guarantors of private annuity providers. They feel that offering annuities inside their plans is just not worth the risk when participants always have the option of buying an annuity on their own after receiving a lump sum distribution.

The third change gave employers in 401(k) plans who did offer annuities the ability to eliminate them. For years, employers who did offer annuities had little flexibility. The general rule is that once a plan includes certain types of features or options they become "protected benefits" for participants, at least with respect to amounts already invested those options.[27] This means that plan sponsors cannot remove these options from their plans except on a going-forward basis. So, for example, if

22 ICI Research Fundamentals, "The Economics of Providing 401(k) Plans," Vol. 19, No. 5: Figure 1. Available at http://ici.org/pdf/fm-v19n5.pdf.

23 Pamela J. Perun, "Putting Annuities Back into Savings Plans," Chapter 8 in Teresa Ghilarducci and Christian Weller, Eds., *Employee Pensions: Policies, Problems and Possibilities*, ILR Press, 2007.

24 *Ibid.*

25 These regulations can be found at 29 CFR 2550.404a-4.

26 29 CFR 2550.404a-4(b)(4).

27 The relevant rules are under IRC Section 411(d)(6) and its regulations.

a plan sponsor's plan offered annuities as a distribution option in 1993 the plan had to continue to offer that same option in 2003. This rule was not necessarily an issue for stable plans and stable companies. But it caused many complications when, as a result of a company acquisition or merger, plans from previously separate companies had to be merged into one. The new employer and the survivor plan were often faced with the difficulty of maintaining multiple annuity forms of benefits for a small number of participants from plans that no longer existed. After years of discussions, however, employers received some relief in 2005 when regulations were changed to allow them to eliminate annuity contracts from their plans, so long as participants are able to receive an equivalent lump sum distribution of their account balances when they leave the plan.[28]

So, circa 2010, the result of these developments is that the 401(k) universe of plans is virtually annuity-free. The law imposes very strict standards when annuities are available in a plan but also gives employers an easy out. Employers don't have to offer them and most don't. Employers who do offer them can generally remove them from their plans. Employers who do offer them must undertake rigorous analysis before adding an annuity provider to a plan or face additional fiduciary liability if the provider later becomes insolvent. The legal standards for the type of analysis required, however, are uncertain and, in some cases, impracticable.

Longevity Protection and People

In order for a national policy on lifelong income to succeed, it has to be one that individual savers endorse, support and are willing to use. Long-standing trends in annuity utilization suggest that designing an appealing policy will not be easy. Outside the employer plan system, few people opt to convert their savings into the traditional form of annuity – an immediate, fixed income annuity in which a purchaser transfers a lump sum of savings to an insurance company and receives a guaranteed stream of income that begins immediately and usually continues for life in return. Industry statistics report that annual sales of this type of annuity nearly quadrupled between 1996 and 2008 but only from $2.8 billion to $8 billion.[29]

To the extent that people buy annuities, the preferred form is the variable deferred annuity.[30] In a variable deferred annuity, a purchaser invests a sum of money, either all at once or over time, in various investment portfolios offered by an insurance company. This is a popular insurance product because, among other reasons, there is no tax on investment gains until funds are withdrawn. These policies do give owners the option to annuitize the value of their portfolios. But owners also typically have the right to withdraw their funds in whole or in part, and most do. Few owners convert their holdings into payout annuities.[31] Sales of these annuities grew from $74 billion in 1996 to $155.5 billion in 2008.[32]

28 Treasury Regulation section 1.411(d)-4, Q&A-2. *See* http://www.irs.gov/irb/2005-10_IRB/ar08.html.

29 Anthony Webb, "The United States Longevity Insurance Market," Pension Research Council Working Paper 2010-17, The Wharton School, University of Pennsylvania, September 2010. Available at: http://www.pensionresearchcouncil.org/publications/document.php?file=889.

30 For more information about the market for variable annuities, *see* Jeffrey R. Brown and James M. Poterba, "Household Demand for Variable Annuities," Working Paper 2004-08, Boston College Center for Retirement Research, 2004. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=546245.

31 Kenneth S. Apfel, Michael J. Graetz, Catherine Hill, Joni Lavery and Virginia P. Reno, *Uncharted Waters: Paying Benefits from Individual Accounts in Federal Retirement Policy,* Study Panel Final Report, National Academy of Social Insurance, Washington, DC, 2005. Available at: http://www.nasi.org/sites/default/files/research/Uncharted_Waters_Report.pdf.

32 *See* Footnote 29.

Within the private pension system, fewer and fewer plan participants are embracing annuities as their preferred form of retirement income, even in plans where annuities are required to be the default form of benefit. For decades, most defined benefit pension plans paid benefits only in the form of a life annuity. In the early 2000s, however, many defined benefit pension plans began to add lump sum distributions as an alternative. Statistics from the 2003 National Compensation Survey indicate that only about 25% of participants had the option of a lump sum distribution but by 2003 it was available to close to 50% of participants.[33] The 2005 National Compensation Survey found that 53% of participants in defined benefit pension plans had access to a lump sum distribution, and 43% of participants had the option of taking their entire benefit in a lump sum.[34] Precise statistics on the take-up of lump sum options are not available. One major industry player estimates that about 50% of participants in defined benefit pension plans who can take a lump sum distribution do so.[35] According to statistics from the Profit Sharing/401(k) Council of America, in the 50% of defined benefit pension plans that offer a lump sum distribution, 90% of participants will choose that option.[36]

A recent in-depth study of two defined benefit pension plans in two Fortune 500 companies illustrates the attraction that lump sum options hold for participants in traditional defined benefit pension plans. The researchers analyzed distribution choices in a traditional defined benefit pension plan and a cash balance plan, which is a defined benefit pension plan but is designed to operate like a defined contribution plan. They found that take-up of lump sums was actually higher in the traditional plan than in the cash balance plan. About 27% of participants in the traditional defined benefit pension plan chose lump sums but, surprisingly, only 17% of those in the cash balance plan where lump sum options have always been an available and popular feature did so. Even so, the researchers still found that

> [l]ess than one-quarter of married participants in our study chose an annuity, even though it is the federally mandated default option for married couples. Married participants worked actively to overcome the default annuity option by submitting a written, notarized waiver … The desire among married participants in their 50s and 60s to "deannuitize" a DB plan distribution appears to be quite strong, and stands in sharp contrast to the inertia typically displayed by defined contribution participants in the accumulation phase.[37]

The researchers also found that older participants (age 70+) were more likely to annuitize than younger ones while high-net-worth and male participants were more likely to choose a lump sum.[38]

Similar results are evident in 403(b) plans. These plans are defined contribution plans, similar to 401(k) plans in that they often accept participant contributions that are available to a special subset of employers such as non-profit entities and public

33 *See* http://www.investorguide.com/igu-article-733-pensions-pension-income-planning-lump-sum-or-monthly-fixed-pension.html.

34 National Compensation Survey: Employee Benefits in Private Industry in the United States (2005), U.S. Department of Labor, May 2007: Table 51. Available at: http://www.bls.gov/ncs/ebs/sp/ebbl0022.pdf.

35 John A. Ameriks, William J. Burns, Charles J. Klose, Frank W. Nessel, and Stephen P. Utkus, "Immediate Income Annuities and Defined Contribution Plans," Volume 32, Vanguard Center for Retirement Research, May 2008.

36 Testimony of David L. Wray, before the Departments of Labor and Treasury Joint Hearing on Lifetime Income Products, September 14, 2010. Available at: http://www.dol.gov/ebsa/pdf/PSCA091510.pdf.

37 Gary R. Mottola and Stephen P. Utkus, "Lump Sum or Annuity? An Analysis of Choice in DB Pension Payouts," Volume 30, Vanguard Center for Retirement Research, November 2007: 1. Available at: https://institutional.vanguard.com/iam/pdf/CRRLSA.pdf.

38 *Ibid.*

schools. For decades, the leading provider of these plans, TIAA-CREF, offered only life annuities but in 1989 began to make non-annuity forms of payment available to participants. By 1997, the number of participants choosing a life annuity had fallen by 30% from the 1988 level.[39] By 2001, only about 45% of participants chose a life annuity.[40] The TIAA-CREF data indicate that giving more choice to participants elicits new behavioral patterns that seem to work to the disadvantage of annuities.

> As non-annuity distribution options became available to retirees, more of them elected not to use a life-contingent annuity as a form of payout, at least at or near the time of retirement. More retiring individuals are electing to allow assets in their employer-sponsored retirement plans to continue to accumulate without taking distributions; use 'temporary' or 'transitional' mechanisms for distribution of assets that do not involve life contingencies; and receive only the minimum amount of distributions needed to avoid federal tax penalties.[41]

Given these dismal statistics, many employers might be justified in concluding that adding lifetime income options to their plans is not worth the bother. If participants don't want annuities, why assume the additional risks and plan complications? There are some indications, however, that saver sentiment about annuities is becoming more positive, impelled in part by the sharp decline in account balances experienced by 401(k) savers in the Great Recession. Industry statistics indicate a sharp increase in purchases of immediate and deferred fixed annuities in 2008 and 2009.[42] It's not yet clear if this trend will continue if the stock market continues to recover but a recent major survey found that plan participants "*are more cautious, and have an increasing appetite for investment options that offer more safety than the potential of high returns, at least for now*."[43] The study also reports that employers may now be significantly underestimating their employees' interest in having annuity options in their plans.[44]

In recent years, moreover, there has been a substantial advancement in understanding what economists call "the annuity puzzle." Why is it that the basic annuity – a fixed, immediate annuity that guarantees income for life – is so unpopular? It is well-recognized that an annuity is not for everyone, and a decision not to purchase one could have any number of reasonable explanations. Some have sufficient income from Social Security or a substantial pension from a defined benefit pension plan to provide the amount of guaranteed income they believe necessary. Others prefer to maintain investment control over their assets or plan to transfer a substantial portion of their assets to their heirs or a charity upon death. Many are concerned about the future solvency of an annuity provider or believe the annuity is unfairly priced. Still others don't believe an annuity is a good value for them, given what they believe to be their potential life expectancy.[45]

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39 John Ameriks, "The Retirement Patterns and Annuitization Decisions of a Cohort of TIAA-CREF Participants," TIAA-CREF Research Dialogues, Issue No. 60, August 1999. Available at: http://www.tiaa-crefinstitute.org/pdf/research/research_dialogue/60.pdf.

40 John Ameriks, "Recent Trends in the Selection of Retirement Income Streams Among TIAA-CREF Participants," TIAA-CREF Research Dialogues, Issue No. 74, December 2003. Available at: http://www.tiaa-crefinstitute.org/pdf/research/research_dialogue/74.pdf.

41 John Ameriks, "How do Retirees Go From Stock to Flow?," Working Paper 2003-18, The Pension Research Council, The Wharton School, The University of Pennsylvania, 2003. Available at: http://www.pensionresearchcouncil.org/publications/document.php?file=118.

42 Alan LaWine, "Investors Take a Shine to Fixed and Immediate Annuities," Registeredrep.com, May 19, 2009. Available at: http://registeredrep.com/newsletters/insuranceletter/investors_stash_cash_fixed_deferred_immediately_annuities_0519/.

43 MetLife, "8th Annual Study of Employee Benefit Trends: Findings from the National Survey of Employers and Employees," 2010: 11. Available at: http://www.metlife.com/business/insights-and-tools/industry-knowledge/employee-benefits-trends-study/index.html?WT.mc_id=vu1351#highlights.

44 *Idem*. P. 52.

45 For a review of the literature, *see* Jeffrey R. Brown, "Rational and Behavioral Perspectives on the Role of Annuities in Retirement Planning," NBER Working Paper 13537, 2002. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=546245.

Increasingly, however, economists are becoming convinced that a major contributor to the low take-up rate for traditional annuities is the way in which they have been marketed to people. Experimental research indicates that the way in which the marketing message is "framed" or presented to potential purchasers can have a significant impact on the decision to purchase a life annuity. One major variable appears to be the effect of "negative" framing. In one study, participants were shown three slides: one favoring annuities by highlighting the potential negative effects of investing in equities and bonds; one favoring investments by highlighting the negative effects of annuities; and one neutral slide. The negative framing in the presentation was an emphasis on either the risks of loss through investing in the stock market or the risk of dying early when purchasing an annuity. Researchers found

> that negative framing can be very effective in influencing financial decisions, in particular the decision to purchase an annuity. For males and females, one or both of the biases had significant and sizeable effects on the choice to purchase an annuity. The influence of the biases is even more striking because the biased presentations lasted only 5 minutes, were factual, and were not exaggerated.[46]

A second study tested a different but related aspect of framing the annuity purchase decision. In this case, the research examined the effect of whether the annuity purchase decision was presented in an "investment" frame (emphasizing the return on an account and the use of such words as "invest" and "earnings") or a "consumption" frame (emphasizing how much the product would allow purchasers to consume and the use of such words as "spend" and "payment"). The results showed a powerful effect for framing. When presented in a consumption frame, 72% of survey respondents preferred a life annuity to a savings account but when the same products were discussed using an investment frame only 21% chose the annuity. The researchers interpreted these results to suggest that

> when consumers think in terms of consumption, they perceive the annuity as offering valuable insurance that protects a level of consumption against the risk of outliving one's resources. Alternatively, when they think in terms of investment, annuities appear to increase risk without increasing return, because of the possibility that the total value of the stream of payments will be less than the initial investment.[47]

The results of studies in this vein of research suggest that adding annuity options to plans is not inevitably a waste of time. Participant rejection of annuities in work-based plans could be overcome and higher take-up rates could be attained by providing more education to workers about the merits of longevity protection for retirement consumption and marketing materials that better overcome psychological biases. Policy makers have already begun to consider how to introduce framing techniques into participant disclosure materials. The "Lifetime Income Disclosure Act" recently proposed by Senator Bingaman and co-sponsored by Senators Kohl and Isaakson would require participant benefit statements about account accumulations to include an illustration of how current accumulations might translate into income at retirement.[48]

46 Julie R. Agnew, Lisa R. Anderson, Jeffrey R. Gerlach, and Lisa R. Syzkman, "The Annuity Puzzle and Negative Framing," Issue in Brief No. 8-10, Boston College Center for Retirement Research, July 2008: 4. Available at: http://www.investmentnews.com/assets/docs/CI51831731.PDF.

47 Jeffrey R. Brown, Jeffrey R. Kling, Sendhil Mullainathan and Marian V. Wrobel, "Framing and Annuities," Trends and Issues, TIAA-CREF Institute, January 2009: 5. Available at: http://www.tiaa-crefinstitute.org/pdf/research/trends_issues/ti_framingannuities_0109.pdf.

48 The full text of the Lifetime Income Disclosure Act, S.2832, is available at: http://www.thomas.gov/cgi-bin/query/z?c111:S.2832.

A second line of offense to improve annuity acceptance rates by savers has been suggested by the success of "default" techniques in improving savings rates. Techniques such as automatic enrollment and default investment options are intended to mitigate the "inertia" effects that cause people to postpone action when confronted with difficult and complex choices. One recent proposal would encourage employers to make annuity options a default distribution option in 401(k) plans.[49] Under this plan, these annuities would become entitled to treatment under the fiduciary liability rules of ERISA as "default" options. Provided that participants received advance notice and the opportunity to opt out, employers would be relieved of much of the fiduciary liability currently associated with annuities when participants are defaulted into annuities. The trigger point for default annuitization would be the first time participants make a non-hardship request for a distribution, at which time half of their account balances would be automatically annuitized unless they opted out.

A second proposal would provide that participants who were over a certain age threshold, who had account balances over an amount designated by the plan sponsor, and who had made account withdrawals exceeding a set amount would be defaulted into a "trial annuity" unless they opted out.[50] The trial annuity period would last for twenty-four months at which point participants could choose another form of payment. Those who did not would continue to receive their annuity payments. The theory here is that, rather than having to make an abstract choice between a lump sum or an annuity, participants would have the opportunity to experience receiving monthly checks in retirement and many will decide or let inertia decide to continue the annuity.

A third proposal endorses the use of default annuitization strategies but suggests more must be done to give annuities enhanced acceptance by 401(k) plan savers.[51] The authors propose that lifetime income products should be embedded in the asset accumulation phase of retirement saving rather than assigning them solely to the distribution phase. They suggest that a program of phased or incremental acquisition of deferred annuities beginning perhaps at mid-career or earlier, with participant opt out available, would fundamentally re-frame how participants perceive annuities. The program could be structured in one or both of the following ways: first, by dedicating the employer match to the purchase of annuity-income units; and second, by incorporating the purchase of annuity-income units over time into a "QDIA" or "qualified default investment alternative" sanctioned by the Department of Labor.[52]

The techniques of these proposals may differ but at their core are the lessons recently learned about how savers might think (and act) differently about lifetime income products. Succinctly put, those lessons are

- Avoid all or nothing decisions … [don't require] retirees to use all, or none, of their savings to buy lifetime income instruments

49 Jeffrey R. Brown, "Automatic Lifetime Income as a Path to Retirement Income Security," New York University School of Law, Colloquium on Tax Policy and Public Finance, Spring 2010. Available at: https://law.nyu.edu/ecm_dlv4/groups/public/@nyu_law_website__academics__colloquia__tax_policy/documents/documents/ecm_pro_064385.pdf.

50 William G. Gale, J. Mark Iwry, David C. John and Lina Walker. "Increasing Annuitization in 401(k) Plans with Automatic Trial Income," No. 2008-02, The Retirement Security Project, 2008. Available at: http://www.brookings.edu/~/media/Files/rc/papers/2008/06_annuities_gale/06_annuities_gale.pdf.

51 J. Mark Iwry and John A. Turner, "Automatic Annuitization: New Behavioral Strategies for Expanding Lifetime Income in 401(k)s," No. 2009-02, The Retirement Security Project, 2009. Available at: http://www.brookings.edu/~/media/Files/rc/papers/2009/07_annuitization_iwry/07_annuitization_iwry.pdf.

52 A "QDIA" is a type of investment option that satisfies Department of Labor definitions and can be used by employers to serve as investment options for employees who fail to choose one. An employer who uses a QDIA in this manner is relieved of much of his or her fiduciary liability under ERISA.

- Avoid now or never decisions … [don't confront plan participants] with a single moment of truth when the decision of whether or not to take an annuity is thrust upon them

- Avoid never-or-forever decisions … [don't forbid retirees from reversing] any or all of an annuity purchase, at least for a while.[53]

Longevity Protection and Insurance Products

Just as there are new approaches to helping savers think differently about lifetime income products, there are also new (and old) industry products and arrangements available to plan sponsors. Table One illustrates the varieties of lifelong income products currently available in the marketplace. Table One describes their structure, the amount and type of income they guarantee and how their fees are reflected on a product-by-product basis. Table One also describes which insurance companies, by themselves or in combination with other financial services companies or distribution arrangements, specialize in each type of product.

As Table One illustrates, the traditional immediate life annuity as well as the traditional deferred life annuity continue to be available as both an in-plan and out-of-plan option. In addition, there are now several annuity "supermarkets" offered by private sector companies that make a variety of annuity options available for participants to purchase with their rollovers from a plan. Employers who wish to alert their participants about the benefits of lifetime income products without assuming the potential liability of offering them in their plans can direct them to one of these platforms. This simplifies annuity shopping for participants and gives them the benefit of choosing among pre-vetted options.

Table One also lists the insurance companies who have developed or are marketing a new suite of products typically described as "guaranteed living benefit" products. Guaranteed living benefit products provide partial protection from outliving assets in retirement. They are designed to appeal to savers' often expressed desire to retain control over a substantial portion of their assets. They insure only a portion of the account value. The income guarantee offered in these products typically comes in two varieties: 1) a guaranteed minimum income benefit (GMIB); and 2) a guaranteed minimum withdrawal benefit (GMWB). These options are built upon a variable annuity base so that individual account values fluctuate according to the market performance of the underlying variable annuity investment options. For an additional fee or a fee built directly into the product, purchasers receive the insurance company's promise to pay a guaranteed benefit for life or for a number of years, depending on the product, that provides a floor of income for their accounts.

In the GMIB, participants receive a minimum guaranteed income stream, even if their account value falls to zero. The insurance contract typically requires the purchaser to own the contract for several years before the benefit can be activated. It also requires the account to be annuitized. In the GMWB, participants are entitled to take fixed annual withdrawals equal to a

53 *See* Footnote 44, page 6.

Table 1. Current Lifetime Income Products*

Number	Product Category	High Level Description	Nature of Income Guaranteed	Fee Structure	Product Insurer	Product Insurer
1	In-Plan Deferred Fixed Annuity	• Each contribution purchases guaranteed future income • Contributions are typically invested into insurance company general account • Purest 'DB in DC'	• Maximizes initial income at time of investment (no upside potential) • Participant must annuitize account to receive income benefit	• Fees are embedded in the purchase rates and impact of future income amount • Incorporates investment management, longevity, administration, and risk charges	Hartford (Lifetime Income) → Met Life (Personal Pension Builder) → Barclays Global Investor (SponsorMatch) → Mutual of Omaha (Lifetime Guaranteed Income Account) →	Hartford Insurance MetLife MetLife (Future multiple insurers) United of Omaha Life Insurance Company
2	In-Plan Guaranteed Minimum Income Benefit (GMIB)	• Each contribution purchases a minimum level of future income • Contributions are typically invested into insurance company separate account	• Favorable performance of underlying investment portfolio will increase future income • Participant must annuitize account to receive income benefit • Payment is typically paid out over a lifetime or a lifetime with a period certain	• During accumulation phase, explicit investment and insurance fees • During the income phase, all fees are typically built into the annuity guarantee	Genworth (Clear Course Income Benefit) →	Genworth Insurance
3	In-Plan Guaranteed Minimum Withdrawal Benefit (GMWB)	• Each contribution establishes participant's benefit base upon which future withdrawals are calculated • Future income stream is expressed as a percentage withdrawal factor applied to benefit base • Participant retains control of account balance • Contributions are typically invested into insurance company separate account	• Favorable performance of underlying investment portfolio will increase the participant's benefit base • Income generated is initiated based on the benefit base • Participant does not annuitize account at retirement and has access to their account value during income phase • No guarantee of principal; guarantee of income	• Explicit investment and insurance fees throughout accumulation and income phases • Fee is expressed as percentage of account value or benefit base	Alliance Bernstein (TBD) → Genworth (Clear Course Withdrawal Benefit) → John Hancock (Guaranteed Income for Life) → Prudential (IncomeFlex) → Milliman (RGN) → Great-West (SecureFoundation) →	Multiple Insurers Genworth Insurance Hancock Insurance Prudential Insurance Multiple Insurers Great-West Life & Annuity Insurance

Table 1. (Continued) Current Lifetime Income Products*

Number	Product Category	High Level Description	Nature of Income Guaranteed	Fee Structure	Product Distributor		Product Insurer
4	Out-of-plan Rollover Guaranteed Minimum Withdrawal Benefits (GMWB) Institutional Offering	• Rollover contribution establishes participant's benefit base upon which future withdrawals are calculated • Future income stream is expressed as a percentage withdrawal factor applied to benefit base • Participant retains control of account balance • Contributions are typically invested into insurance company separate account	• Favorable performance of underlying investment portfolio will increase the participant's benefit base • Income generated is initiated based on the benefit base • Participant does not annuitize account at retirement and has access to their account value during income phase • No guarantee of principal; guarantee of income	• Explicit investment and insurance fees throughout income phase • Fee is expressed as percentage of account value or benefit base	Lincoln (i4Life) Fidelity (MetLife Growth and Guaranteed Income	→ →	Lincoln Financial MetLife
5	Out-of-plan Rollover Annuity Platform "Supermarket Approach"	• Maximize income at point of distribution • Choice of insurers for fixed annuities	• Maximizes initial income at time of investment (no upside potential) • Participant must annuitize account to receive income benefit	• Fees are embedded in the purchase rates and impact future income amount • Incorporates investment management, longevity, administration, and risk charges	Hueler Platform Fidelity Platform	→ →	Multiple Insurers Multiple Insurers
6	In-plan Immediate Annuities	• Purchase at retirement • Maximize income at point of distribution • Plan Sponsor selects the insurer	• Maximize initial income at time of investment (no upside potential) • Account value is liquidated at time of purchase • Participant must annuitize account to receive income benefit • Payments are made in a specified amount over a lifetime, a selected period, or a lifetime with a period certain	• Fees are embedded in the purchase rates and impact future income amount • Incorporates investment management, longevity, administration, and risk charges	Multiple Insurers	→	Multiple Insurers

pre-determined percentage of their contributions for a guaranteed number of years. Annuitization is not required. Industry statistics indicate these products have proven to be extremely popular, becoming important drivers of variable annuity sales in the out-of-plan market.[54]

The industry has developed more flexible products and creative investment structures that may well fit the needs and goals and provide important longevity protection to today's 401(k) plan savers. Beyond their control, however, are two issues related to insurance products that may continue to dampen their appeal within 401(k) plans. The first issue is gender pricing of annuities. In the out-of-plan market, insurance companies generally use separate male and female actuarial tables to price annuities. Because women on average live longer than men, this results in women receiving smaller annuity payments than men for the equivalent premium. The Supreme Court in *Norris v. Arizona*, however, has held that it is illegal to use sex-linked actuarial tables in employee benefit plans under the Title VII of the Civil Rights Act of 1964 which prohibits sex discrimination in employment.[55] The effect of the *Norris* decision is to make in-plan annuity purchases advantageous to women and out-of-plan purchases advantageous to men. This means that male savers in 401(k) plans may decline to purchase one of these products through their plans because the same product may be more attractively priced outside the plan.

A second issue concerns the quality of the protection available to purchasers through existing regulation of the insurance industry and its products. The regulation of insurance companies has largely been left to the states since passage of the McCarren-Ferguson Act of 1945. When an insurance company become insolvent, state regulators step in to manage its affairs. State guarantee funds become available to protect policy holders from default. The private pension system had its first major brush with state guarantee systems in the early 1990s when a number of large insurance companies failed.[56] As a result of that experience, the benefits community has expressed concern about the inter-play of state-regulated insurance products and a federally-regulated employee plan system. The primary concerns are that 1) state guarantee associations do not currently provide an adequate level of guarantees (generally ranging from $100,000 to $300,000 in the present value of annuity benefits), 2) the eligibility for and extent of state guarantees vary from state to state, and 3) even when guarantees are adequate, there can be a lengthy process and delay before the state fund begins payment.[57]

Integrating lifetime income products into 401(k) plans successfully will require confidence on the part of policy makers, employers and savers alike that these products have adequate regulatory support. Some experts believe that the state regulation of insurance companies is strong, and guarantee funds are adequate to protect savers. Others suggest that additional protection can be achieved if plans offer a diverse set of products and providers that will minimize the risk of insurance company default. But many others are calling for uniform reforms at the state level such as standardizing and strengthening state guarantee funds or setting minimum federal standards. Still others feel that a strong federal role will be required and propose a variety of alternatives. They range from providing protection through the federal Pension Benefit Guarantee Corporation, creating

54 Susan Sell, "Guaranteed Living Benefits Experience Study," Issue 64, Product Development News, Society of Actuaries, March 2006. Available at: http://www.soa.org/library/newsletters/product-development-news/2006/march/pdn-2006-iss64-sell.pdf. *See also* Susan Sell, "The GLWB Feature is Seeing Sales Success," National Underwriter, January 6, 2008. Available at: http://www.lifeandhealthinsurancenews.com/Issues/2008/1/Pages/The-GLWB-Feature-Is-Seeing-Sales-Success.aspx.

55 *Norris v. Arizona Governing Committee*, 103 S. Ct. 3942 (1983).

56 *See* Footnote 23.

57 A description of insurance coverage provided by the various states can be found at: http://www.immediateannuities.com/guaranty_liability/guaranty.htm.

an optional federal charter for insurance companies and a new federal regulatory body to oversee the insurance industry, or establishing a federally-backed and uniform guarantee for lifetime income products based on the private sector reinsurance market with an underlying federal guarantee and an FDIC-like insurance system funded by premiums.[58]

This issue may, in fact, become a significant stumbling block on the road to greater inclusion of lifetime income products in 401(k) plans. It is key to resolving the issue of fiduciary liability that employers will require before including these products in their plan. It is also key to convincing savers that it is safe to transfer a portion of their accounts to an insurance company in exchange for a future promise to pay. The issue raises other broad issues of federalism and financial services industry regulation that are outside the jurisdiction of the private pension system. The federal government has been given a greater footprint in regulation of the insurance industry through the creation of the Federal Insurance Office in the Treasury Department as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[59] But the footprint is very small, and the Federal Insurance Office is without authority to preempt state measures governing rates, premiums, underwriting or sales practices, coverage requirements, applications of antitrust laws, or capital or solvency measures.[60] Consensus on the best way forward on this issue, and successful strategies for implementing it through regulation or legislation may be elusive for a long time to come.

Future Directions

One of the assumptions of the Lifelong Financial Security Project is that increased longevity should cause a re-examination of the role that lifetime income products might play in savings plans. Not everyone agrees. Jane Austen, for one, suggests that causation could well be in the opposite direction. In *Sense and Sensibility*, for example, Fanny Dashwood argues "an annuity is a very serious business" because "if you observe, people always live forever when there is an annuity to be paid them."

Fanny Dashwood aside, there *is* both a new urgency and a new opportunity to confront the longevity challenge to retirement savings in the United States. Outside the workplace plan market, there is rapid product innovation occurring in the financial services industry to meet the needs of an aging society. Savers are also expressing more interest in lifetime income products. The time seems ripe for new policy initiatives to begin to assist savers in workplace plans in managing their nest eggs in retirement.

This paper has demonstrated that there is a whole constellation of policy and legal issues to be resolved before lifelong income products can overcome the current inhospitable legal environment in 401(k) plans. Legally speaking, this is largely

58 In comments to the federal agencies in May, 2010, a number of organizations such the American Council of Life Insurers, the Committee of Annuity Insurers, the American Benefits Council, and the Financial Roundtable called for streamlining the process that employers should follow when selecting an annuity provider to avoid fiduciary liability. Some, including the American Academy of Actuaries and Charles Schwab & Co., suggested diversifying providers, albeit at increased costs, as a means for minimizing risks for purchasers. Still others such as the Institutional Retirement Income Council, ING, and the Pension Rights Center suggested providing a federal backstop for lifelong income products similar to those now available through the FDIC and the PBGC. *See* http://www.dol.gov/ebsa/regs/cmt-1210-AB33-2.html for all comments to the agencies.

59 Title V of this Act creates the Federal Insurance Office which will act as the monitor of systemic risk within the insurance industry and will provide for reforms to certain state practices concerning insurance and reinsurance.

60 *See* Duane Morris, "U.S. Financial Reform: Creation of the Federal Insurance Office and the Financial Stability Oversight Council," August 24, 2010. Available at: http://www.duanemorris.co.uk/alerts/financial_reform_federal_insurance_office_FIO_3763.html.

the unintended consequence of a decision made decades ago that profit sharing/401(k) plans should not be characterized as "retirement" or "pension" plans. As a result, they lack required retirement plan features, such as annuities and other longevity-protection products.

Practically speaking, however, they are now the prime drivers of the financial assets that savers will need to sustain them in increasingly lengthy retirements. The policy discussion about providing lifetime income products in these plans today will certainly be different than it was twenty-five years ago. Driven then by the goal of protecting spouses from destitution in old age, the existing legal paradigm, designed primarily for defined benefit pension plans, was reinforced and strengthened.

The existing legal paradigm for 401(k) plans no longer seems adequate, however, when viewed through a new lens of providing lifelong financial security. Lifelong income products present many challenges to the current legal structure of 401(k) plans, among them, how to design and pay for participant education, how to enable the portability of products as employees change jobs, how employers should choose and monitor products and providers, how to minimize product fees, expenses and costs, how to incorporate products into plans, either as distribution options or investments, how to regulate product guarantees, and how to clarify the fiduciary obligations of employers. The current structure will also be challenged to respond to continued innovation in products by industry and to incorporate new learning about savers and their financial behavior. This suggests that the old balance of rights and responsibilities in 401(k) plans between savers and employers and between employers and the financial services industry and its regulators probably will not hold. And it probably should not hold.

Framing a successful policy of lifelong financial security will require a more flexible and dynamic legal paradigm for 401(k) plans. It will also require a special emphasis on the needs of the many millions of retirees who will be trying to stretch hard-earned nest eggs throughout retirement, both today and in the future. The goal of the Lifelong Financial Security Project is to begin shaping the contours of that future policy.

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