Statement on Pension Risk Transfers
ERISA Advisory Council
August 18, 2015

Steve Vernon, FSA
President, *Rest-of-Life* Communications

1. It's my experience, that the vast majority of American workers do not have the skills and expertise to make fully informed decisions on how to generate lifetime retirement income from savings. I base this conclusion on:

    - My six years of interfacing with older workers at retirement planning workshops that I conduct.
    - Interacting with readers of my twice-weekly column on retirement planning at CBS MoneyWatch for the last 5-1/2 years.
    - Reading the extensive literature on the low level of financial literacy among American workers, which often measure financial literacy at a very basic level. The task of generating retirement income from savings is one of the most complex financial planning decisions workers will make in their lifetimes.
    - Reflecting on the fact that I've spent years of study and research as an actuary to understand the relevant issues.

2. A worker making retirement income decisions faces a number of significant risks:

    - Unanticipated investment losses. During the last 28 years, there have been four major stock market declines. Workers retiring today can expect to live 10 to 30 years or more, most likely with more than one stock market crash in their future.
    - Uncertainty about how long they'll live. There are good chances they could live much shorter or much longer than their life expectancy – you just can't predict how long you'll live (for a tutorial on life expectancies as they relate to retirement planning, see Appendix A, from one of my retirement planning workshops).
    - Possible losses due to fraud, poor advice, and/or high fees.
    - Cognitive decline in their later years.

3. A monthly income from a defined benefit (DB) plan protects against the above risks. If a worker accepts a lump sum payment from their DB plan, they forgo this protection. Evaluating these risks and the potential advantages of DB plans is very difficult for many workers, as noted in item 1 above.

4. It is with mixed feelings that I offer comments on pension risk transfer disclosure. Some workers will take the time to read and understand these

disclosures, and make informed decisions that best suit their needs and circumstances. It is for these workers that it's a worthwhile effort to prepare these disclosures that summarize the advantages and disadvantages of lump sum pension payments. However, I'm afraid that the majority of workers receiving such statements will not fully understand these disclosures, or will rely on the advice of friends or family who are not qualified to provide such advice, or will rely on advisors who are not trained in the complexities of retirement income planning or are conflicted by their manner of compensation. It's my view that a plan sponsor subverts the advantages of DB plans by offering a lump sum payment to plan participants.

5. That being said, here are comments on the draft of the lump sum notice:

   - It's very complete, makes most of the appropriate points, and is written as simple language as possible. I only have a few comments.
   - *Item A-1) Will my lump sum provide lifetime retirement income?*
     - I'd be more explicit about the advantages of the monthly income for the surviving spouse of a married couple. If you're married and die first, your surviving spouse will also face the risk that he or she runs out of money before they die.
   - *Item A-2) How hard is it to invest the lump sum to provide equivalent income?*
     - You could mention that many financial advisors will recommend a version of the four percent rule, where you invest your savings and make systematic withdrawals from savings. The amount of annual withdrawal is a percentage that is applied to savings. Whether the appropriate percentage is four percent or another percentage is a topic of great debate among retirement planners and analysts, but it serves as a starting point for comparison purposes. If the worker applies four percent to the amount of the proposed lump sum payment, how does that compare to the monthly income provided by the plan?
     - I'd add a statement that nobody knows how long they'll live, and that they could easily live to their life expectancy or longer. The uncertainty about how long you'll live is a significant retirement planning challenge (as shown in Appendix A), and the monthly income from a pension plan addresses that challenge.
     - I'd be stronger on the caution about conflicts with financial advisors. If they are paid by a percent of assets under management, as is very common, they have a financial incentive to recommend that the worker elects the lump sum and invests it with them.
     - I'd add a statement that a surviving spouse faces all of the challenges itemized in this section, if the worker elects a lump sum payment.
   - *Item B-4) Is my pension insured and what level of benefits is protected?* You could state the current level of monthly benefits guaranteed by the PBGC for a worker retiring at age 65, just to give them an idea of the amount of the

guarantee. I fear that many workers will not bother to go to the PBGC website.

- *Chart comparing differences between lifetime payments and a lump sum.*
    - I'd treat separately the effect on a spouse vs. children.
    - First footnote marked by *. I'd reverse the order as follows: "Payments from your pension plan are backed by your employer and the Pension Benefit Guaranty Corporation (the latter subject to certain limits)."
    - Second footnote marked by #. The words "worth less" are ambiguous.
    - I'd rephrase as follows: "The amount of monthly income purchased by an annuity will be less than the amount of monthly income from the Plan."

6. Here are comments on the draft pension risk transfer notice.

- I'd check the statement that each state provides a guarantee of at least $100,000. That may not be accurate. Some insurance guaranty associations may guarantee only a percentage of the annuity, not 100%,
- I have no other comments on this draft.

Thank you for allowing me to testify on this important topic.

Best regards,

Steven G. Vernon
FSA