

Lifetime Income as a Qualified Default Investment Alternative (QDIA)
-- Focus on Decumulation and Rollovers

American Academy of Actuaries
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("ERISA Advisory Council")
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Thank you for the opportunity to participate in today's hearing. Finding ways to address inadequate conversion of defined contribution plan accumulations into lifetime income is important to creating better retirement income security for retirees.

The American Academy of Actuaries (Academy) is a 19,000-member professional association whose mission is to serve the American public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Lifetime income risk has been a focal issue of the Academy for many years. Our Lifetime Income Risk Joint Task Force includes both pension and life insurance actuaries in order to identify issues and solutions to lifetime income risk as it relates to retirees, plan sponsors, and financial advisers. The results of our work in this area can be found on the Academy's website at the [Lifetime Income Initiative tab](#).

The presentations thus far at the ERISA Advisory Council's hearings have covered a full spectrum of income generation possibilities, with a heavy emphasis on actions during the accumulation period. Even with proactive efforts in the design of Qualified Default Investment Alternatives (or QDIAs) during the period of pre-retirement accumulation, many retirees will be faced with the challenge of making their savings, including lump sums at termination of employment, last throughout retirement. For that reason, my comments are focused on actions that can be taken to address the conversions of savings into lifetime income.

I will address three topics today:

- Actions that could better facilitate the provision of income options, both annuity and withdrawal, upon an individual's ceasing active participation in a qualified defined contribution plan. These have been described in the American Academy of Actuaries' [position statement](#) released in October 2017.
- Actions that could increase the utilization of Qualifying Longevity Annuity Contracts (QLACs) to address retiree longevity risk.
- Open Retiree Defined Contribution Multiple Employer Plans (Open Retiree MEPs), which could facilitate decumulation for plan participants.

Position Statement on Income Options in Defined Contribution Plans

The Academy's position statement states: "The American Academy of Actuaries supports policy and educational initiatives that increase the availability of retirement income options within employer-sponsored defined contribution (DC) plans. Such options, based upon actuarial principles such as longevity pooling and other risk mitigation strategies, can help retirees manage their financial security over their remaining lifetime."

Implementation of these approaches require several critical components:

- Education throughout the participant's working career. Periodic education could include ways to address the longevity risk in retirement, and the income value of current and projected DC plan accumulations. The latter might be provided on an annual basis. Additional education on the same topics would ideally be provided at the point of cessation of employment.
- Income options that meet retiree needs. These include both annuities and structured withdrawal approaches. Annuities, both single premium immediate annuities and deferred income annuities (including deeply deferred income annuities such as QLACs within qualified plans), can provide a guarantee of lifetime income protection. The annuities could be provided either as a purchase within the plan or from a platform after an account balance has been rolled over into an individual retirement arrangement (IRA). It is advisable for structured withdrawal programs also to be supported by recognition of participants' preferences.
- New legislation, expanded guidance. Legislative and regulatory actions can further support and protect employers in selecting providers, designing solutions, educating employees, and offering income strategies to minimize their fiduciary concerns. Although the Department of Labor (DOL) currently offers safe harbor guidance for including annuities within DC plans, there is a concern that the guidance could still expose plan sponsors to some fiduciary risk. There are currently no DOL safe harbors governing structured withdrawal programs. Clear safe harbors could encourage more employers to include income options within DC plans.

In addition to facilitating the purchase of a lifetime income option or establishing a structured withdrawal program, employer-sponsored qualified DC plan options provide additional benefits to the retiree:

- Pricing efficiency. Employers that maintain DC plans have access to institutionally priced financial products and services. The lower costs provide greater net benefits.
- Ease of transaction. A retirement income option can be elected without the need to perform an IRA rollover or by seeking out potential providers.

- Provider and product due diligence. Plan fiduciaries are capable of providing thorough due diligence beyond that which an individual is capable of performing. This scrutiny can help minimize poor choices in provider selection, product selection, and strategy implementation.
- Guidance on retirement income planning and longevity risk management options. While some employees may have external financial advisers to help them through the decision process, many individuals do not have this support nor the financial literacy to analyze the choices on their own. Employer- or plan-provided educational materials and tools could efficiently fill this gap.

Perspectives on QLACs

The Internal Revenue Service (IRS) introduced QLACs in 2012 as an approach to managing longevity risk at a low cost while also providing an offset of the cost through a reduction of assets subject to Required Minimum Distribution (RMD) rules. Despite the lifetime income management advantages of QLACs, they have gained little traction in the marketplace. Steps can be taken to improve awareness of the availability of QLACs and to remove some of the hurdles to the purchase of them.

QLACs have several advantages:

- QLACs could help manage a retiree's risk for investments and longevity. The guaranteed income reduces investment risk, while the lifetime income eliminates the longevity risk.
- Because they reduce income risk in later years, individuals can invest other assets more aggressively to fund income before the QLAC income begins.
- QLACS can be purchased at a lower premium paid than for an immediate lifetime income annuity for the same income amount. Premium savings can be used to fund retirement income in the years prior to the commencement of QLAC income payments.
- They can be priced to each purchaser's circumstances. The cost is dependent upon age at purchase, age at benefit commencement, death benefit feature, inflation feature, and market conditions at time of purchase.
- QLACs can provide significant value for individuals with sufficient assets to support lifetime income under average circumstances, but they could be at great financial risk if they lived a very long life.

QLACs have not gained popularity for various reasons:

- Rules and regulations—IRS regulations impose limits on amounts and features in qualified DC plans (e.g., unisex basis, \$130,000 current limit to premiums, 25 percent limit on account balance in each DC plan, no variable or equity indexed basis allowed).
- Insurance companies report low demand, hence they engage in minimal marketing and consumer education.
- Advisers are generally circumspect about the use of annuities.
- For individuals, downsides to QLACs have reportedly included loss of premium upon early death (unless return of premium version, with higher cost, is chosen), perceived

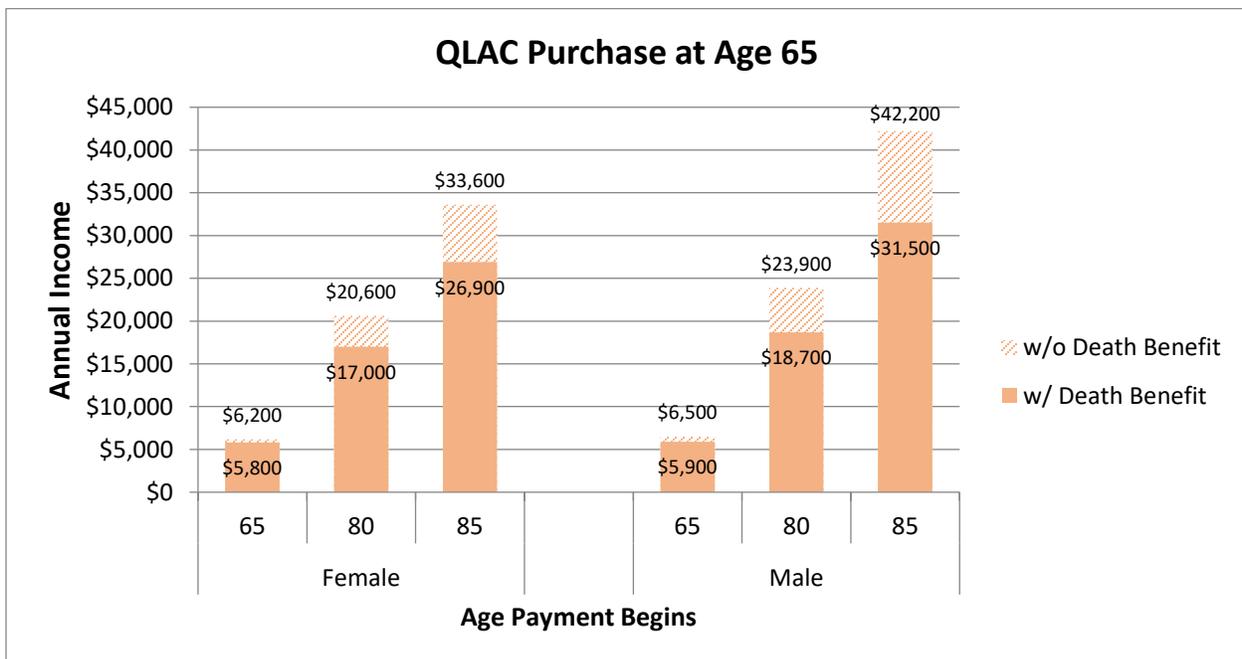
costs, perceived conservative investing, liquidity, concern about the strength of the insurer long-term guarantee, and loss of investment control.

- Plan sponsors face administrative complexities, low demand, portability, fiduciary risks.

Steps can be taken to improve the utilization of QLACs:

- Through regulations or legislation, allow variable/index-based returns; eliminate unisex pricing; allow aggregation among DC plans for 25 percent rule.
- Modify annuity selection safe harbors in order to remove fiduciary concerns.
- Consumer education, starting with efforts by the DOL.

Education emphasizing the high annual income amounts achieved could also help in the uptake in QLACs. Whereas single premium immediate annuities might provide an annual income of 4 to 7 percent of the premium, a QLAC can provide many multiples of that, as shown in the example in the chart below. As shown in the illustration, at the extreme, a male aged 65 who purchases a QLAC that provides an income beginning at age 85 can receive an annual income in excess of 40 percent of the premium for the rest of his life.



Source: American Academy of Actuaries, annuity rates represent illustrative rates available from publicly available information.

Open Defined Contribution Retiree MEP

An Open Retiree MEP is a fairly new concept that deserves consideration. An Open MEP, as included in recent proposed legislation (the Retirement Enhancement and Savings Act (RESA)), consists of a group of unrelated employers that participate in the same qualified defined contribution plan. An Open *Retiree* MEP also consists of a group of unrelated employers in the same DC plan, but only for inactive employees of the participating employers. This design would

offer retirees the opportunity to roll assets over to a plan specializing in retiree solutions rather than leave defined contribution plan assets in their employer's plan or roll assets into an IRA with all of the necessary, open-ended decision-making required. Many plan sponsors do not encourage retirees to remain in the plan. The Open Retiree MEP would not be allowed to provide its own financial products and services, but instead serve as a conduit to the financial marketplace.

Most of the current Open MEP public policy discussion has focused on the wealth accumulation component of retirement readiness as a means of expanding coverage to smaller employers. The Open Retiree MEP idea has received less attention and could be attractive to plan sponsors of all sizes.

Retirees in the drawdown phase of retirement obviously have different financial needs than employees accumulating savings. Because Open Retiree MEP plans would focus *exclusively* on retirees generally a population older than that of a traditional defined contribution plan and one with different interests—the plan features and services could be tailored to this population.

Advantages for Retirees

The Open Retiree MEP could:

- Offer a range of investment choices comparable to those provided by the largest defined contribution plans today, and if they can attain an economy of scale, could do so at very attractive fees.
- Serve as a plan that is an unbiased, singularly focused provider of retirement services.
- Facilitate and spur the development of customized retiree drawdown strategies and post-retirement risk-pooling techniques to help retirees deal with unexpected shocks during retirement (e.g., voluntary participation in pools to address poor investment returns, inflation, or retiree health issues).
- Encourage plans to develop additional retiree-focused assistance that goes beyond income payment administration, investments, and annuities (e.g., assisting with decisions around commencement of Social Security, understanding Medicare options, or even assisting with the implications of part-time employment).

Overall, the Open Retiree MEP could benefit retirees by creating a competitive marketplace that offers a choice from among fully vetted investment services and annuities. The Open Retiree MEP could be responsible for assuring the choices are appropriate, competitive, and easy to understand, thus simplifying the decision-making process.

Advantages to Plan Sponsors

Many employers sponsor qualified DC plans to help employees save for retirement. However, once these individuals retire or move to another employer, the employer may not be in the best position to act (or appoint others to act) as a fiduciary of these retirement savings. It could be beneficial to allow other willing service providers to fill a fiduciary role and focus on post-retirement pay-out options and participant education. The Open Retiree MEP can provide

excellent support to retirees without financial or fiduciary burdens to the employer. The employer would continue to sponsor a qualified DC plan for its active employees.

If Open MEPs become available, Congress might consider granting the IRS and DOL flexibility to set rules that can adapt to these new Open Retiree MEP design concepts without requiring further legislation.

Additional Academy Resources

The American Academy of Actuaries has dedicated significant effort to raise awareness of lifetime income issues. Resources include:

- Papers on various aspects of lifetime income risk and ways to address it. These are posted under our *Lifetime Income Initiative* on the Academy's website. <http://www.actuary.org/content/lifetime-income-initiative>
- The *Actuaries Longevity Illustrator* is an internet tool that helps individuals understand the need to consider an appropriate horizon for retirement planning. <http://www.longevityillustrator.org/>
- The Academy's web-based *Lifetime Income Quiz* helps increase awareness of lifetime income risks. <http://www.actuary.org/lifetime-income-quiz>

Summary

We commend the attention that the ERISA Advisory Council is dedicating to the provision of lifetime income from DC plans. While QDIAs on accumulations during active plan participation are important, it is equally important to address the challenges of converting lump sums into lifetime income.

Applying defaults to the decumulation phase of retirement could have the potential to help many retirees faced with the difficult decisions related to making retirement savings last a lifetime. We've also highlighted the benefits of providing lifetime income alternatives within the qualified defined contribution. Decumulation QDIAs that are flexible enough to include QLACs can also be of value to some retirees. Finally, we've described the Open Retiree MEP concept that could facilitate better retirement security.