

Comment to: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

U.S. Department of Labor, Employee Benefits Security Administration,
RIN 1210-AB33

U.S. Department of the Treasury, Internal Revenue Service,
REG-148681-09

February 9, 2010

As a young American just beginning to enter the workforce, I am deeply concerned about the state of retirement plans, particularly the demise of defined benefit plans and the loss of security that comes from having lifelong annuity payments. Even for the well-educated and financially savvy, the time wasted in coordination and planning and the burden of the risk that one will outlive retirement savings are enormous costs placed on all Americans, pre- and post-retirement. I therefore strongly support retirement rules that require annuity-based payments as the default on all retirement plans, regardless of type. In support of the agencies' Request for Information, I outline some relevant analogies and research in response to Question 2.

2. Currently the vast majority of individuals who have the option of receiving a lump sum distribution or ad hoc periodic payments from their retirement plan or IRA choose to do so and do not select a lifetime income option. What explains the low usage rate of lifetime income arrangements? Is it the result of a market failure or other factors (e.g., cost, complexity of products, adverse selection, poor decision-making by consumers, desire for flexibility to respond to unexpected financial needs, counterparty risk of seller insolvency, etc.)? Are there steps that the Agencies could or should take to overcome at least some of the concerns that keep plan participants from requesting or electing lifetime income?

While all of the listed concerns likely contribute to the choice of lump sum distributions, modern research on decision-making emphasizes the systematic cognitive biases that lead to such choices. As a student of law and behavioral decision-making, in response to this Request for Information, I outline below two areas of research that I urge the agencies to examine while crafting default rules to promote lifetime income options in retirement plans. Specifically, there are strong analogies to be found in research regarding:

- (1) the deleterious effects of lump-sum settlements versus structured annuity-like settlements in tort law; and,
- (2) the choice of lump-sum lottery payments in lieu of annuities.

The Problem of Lump-Sum Settlements/Judgments in Tort Law

Tort law settlement structures present similar problems to the lump-sum versus annuity distribution choice for retirement income. Especially when tort settlements or damages awards are made to compensate a victim for ongoing medical expenses or lifetime lost earnings, the typical lump-sum damages award can be problematic for the same reasons that lump-sum retirement payments are troubling: the recipient bears the burden and risk to invest, manage, and

slowly draw down the award to ensure sufficient annual income to meet the ongoing medical or living expenses that the award was designed to fund.

Because of these difficulties, structured settlements in the form of annuities have gained widespread support, including through default rules in many state statutes. *See* Ellen S. Pryor, *After the Judgment*, 88 VA. L. REV. 1757, 1759 (2002) (noting the enormous change in settlements away from lump-sum payments). Leaving aside potential tax advantages and possible preferences of defendants, the annuity form of settlement ensures that the tort victim will receive needed income to meet ongoing medical expenses or to replace annual lost earnings, as appropriate. Indeed, the importance of such mechanisms is reflected in the specific amendment of the Internal Revenue Code to reflect these options. *See* 26 U.S.C. § 5891. Studies have shown that lump-sum payments are often rapidly dissipated. *See* Pryor, *supra*, at 1779 n.67; Marcus L. Plant, *Periodic Payment of Damages for Personal Injury*, 44 LA. L. REV. 1327, 1332 (1984) (discussing relevant studies). And so analogy to lump-sum settlements and award judgments in tort law would help with understanding the similar problem in the retirement context.

The Choice of Lump-Sum Lottery Payments

Most lotteries offer winners two payment options: a lump-sum payment or a fixed annuity paid out over a specified number of years. Lottery winners who choose lump-sum payments are in some ways analogous to those who choose lump-sum payments upon retirement: they face the same challenges of investment, planning, and income-smoothing. Yet studies have shown the same problems as in the case of lump-sum tort settlements. For example, a recent study shows that lump-sum lottery winnings have little effect on bankruptcy filings because of the squandered wealth. Scott Hankins et al., *The Ticket to Easy Street? The Financial Consequences of Winning the Lottery* 2-3 (Vanderbilt U. Law Sch., Law & Econ., Working Paper No. 09-01, 2009), available at <http://ssrn.com/abstract=1324845>.

By looking to analogous situations, the agencies can build on existing research to support the implementation of strong default rules that encourage lifetime income options rather than lump-sum payments upon retirement.

Respectfully submitted,

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