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March 4, 2010

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room -5655  
U.S. Department of Labor  
200 Constitution Avenue, NW.  
Washington, DC 20210

Attention: Lifetime Income RFI.

RE: RIN 1210-AB33  
29 CFR Parts 2509, 2520 and 2550

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

Ladies and Gentlemen:

Qualified Annuity Services, Inc. (“QAS”) is a leading provider of immediate annuity solutions. We have served the insurance agent, broker, financial advisor, retail and institutional stock brokerage community for nearly 30 years. We have been a leading marketing organization that supported more than 50,000 retail stock brokers for immediate annuity plans for a major provider. We have individually negotiated thousands of immediate annuity plans for hundreds of millions in premium deposits.

QAS has served the institutional pension annuity marketplace since 1978. We are a leading provider of terminal funding annuity programs for terminating Defined Benefit (“DB”) plans. We provide an ERISA fiduciary compliant service to make the selection of an annuity provider for terminating DB plans. QAS’ selection process for adherence to the “procedural prudence” standards of ERISA per *Bussian* has been vetted by two independent favorable opinions of counsel.

QAS has developed proprietary systems and tools to manage the intricacies of the immediate annuity proposition, including multi vendor quotation systems. We have designed, developed and commercialized software tools to assist the market in assessing the economic value of immediate annuities, including development of a proprietary calculation engine known as The Bellersen Curve ®. We have designed developed and commercialized software systems and tools for managing the product positioning opportunities for immediate annuities. We have

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designed, developed and introduced various systems for assessing the optimum time to purchase an immediate annuity.

We are fully aware of the complexities in understanding and communicating the overall immediate annuity proposition in a product driven market. We have supported hundreds of financial services firms and tens of thousands of their producers in developing awareness as to the benefits of annuitization for both qualified and non qualified retirement plans.

We have witnessed the demise and near collapse of DB plans in America. It is time that the immediate annuity proposition, whether for an individual, couple, qualified plan, pensioner, or rollover account holder is better understood by both the public and the professional community that serve the interests of current and soon to be retirees.

Therefore, we are pleased to have the opportunity to share our thoughts with you in regard to your Request for Information dated February 2, 2010.

## **SUMMARY**

### **The Law of Mortality vs. the “Law” of Future Returns**

The commercial application of human life concepts is known as actuarial life science. The concepts are founded in statistical accuracy. The study of longevities is defined as the actuarial science of mortality. Few could refute that longevity has increased in this county. This Law of Mortality, or longevity risk, applies to the population in general and to each potential retiree in particular. With science in hand, actuaries can predict when given segments of a population, such as cohorts or groups by year of birth, will expire. We all will pass through that time. Actuaries cannot say who exactly among us may go first or last. ***Enter the science of probability.***

The “Law” of Future Returns states: “You *always* do better in the market.” We ask this question: Who *always* does better in the market? We also ask: How often is *always*? Some will likely question this “Law” of Future Returns. Indeed, we are reminded that “past performance is no guarantee of future results.” Timing, as they say, is everything. Who would say “No” to a second chance to exit the equity markets as of late 2007? ***Enter the unpredictable reality.***

The Law of Mortality knows that “all” will not survive. It can determine that “Some” will survive longer or shorter. The “Law” of Future Returns can likely claim that “Some” will receive a return. It cannot say “Who,” “When,” or “How much”, only “Some.” This is based upon following disciplined steps. Even then, a “Black Swan” may hover indefinitely overhead to create a very cloudy day.

Therefore, we question whether the “Law” of Future Returns is rationale, particularly as an ever

increasing population of retirees enters retirement armed with the probability of “Back to the Future.” We question the probability that past returns will reemerge again to retake their place from the “new normal.” For many, the time to retire is now, not in the future.

### **Timing is Everything**

The recession has caused millions to lose jobs. However, the most devastating blow is likely to those who had planned to retire over the past two years. Many such plans have likely been disrupted. This was similar during the 2000 recession and following 9/11 geopolitical events. We do not believe every potential retiree will somehow return to their former financial status.

We do not question whether long term returns will reach recent historical results. It is possible, but many say not probably. We do question timing. We question whether those returns will be sufficient to repair the damage for those who are to retire. For these individuals, the time is now. We also know that some individuals will live longer than others. We believe that mortality and longevity can be predicted with much more precision and for longer periods than investment returns. However, we cannot determine precisely who within a cohort will survive or expire at a certain time. Having said this, we are also fully cognizant that longevities may change dramatically in the future due to advances in health, nutrition, and medical science. We also know that a mortality “Black Swan” can appear, such as a devastating H1N1 virus in a much more virulent form. Armed with this, we also know, through the Law of Mortality, that the price paid for \$1 of annuity income will go up, not down, in the future, interest speculation aside.

### **What to Do**

There is a critical need to understand the importance for promoting systemic risk sharing methodologies to assure retirement security. There are systemic means to do this:

- 1) Social Security and public defined benefit pension
- 2) private sector defined benefit pensions
- 3) commercial lifetime immediate annuities
- 4) defined contribution account balances that are converted to immediate annuities

Treasury, DOL, EBSA and Congress should make changes to promote more use of risk sharing programs within these existing private sector systems and should act to do so quickly.

## **GENERAL**

### **1. From the standpoint of plan participants, what are the advantages and disadvantages for participants of receiving some or all of their benefits in the form of lifetime payments?**

#### **Advantages**

The historical approach to retirement involved three elements to retirement income security: 1) Social Security; 2) Defined Benefit (“DB”) pension, and 3) personal savings. The theory held

was that private pension together with Social Security could allow many retirees to anticipate a secure income at retirement. That retirement income was to be a replacement of the working income. This plan would allow a worker to transition from a working income lifestyle to retirement without having to make significant sacrifices or changes. The third leg of personal savings is generally regarded as needed for emergencies, inflation, and contingencies.

Social Security provides a baseline income for the general population. Private DB pensions are intended to replace a good portion of earned income. In this regard, Social Security and DB pensions may provide as much as 60-70% or more of earned income at retirement. Private DB plans cover more than 20 million workers, as noted in the RFI. However, many DB plans have been frozen to new participants and a number of plan sponsors are discussing further plan freezes. Much has been written regarding the solvency of private pensions. The reality is that the Pension Benefit Guaranty Corporation (“PBGC”) insurance system, while currently underfunded by \$35.5 billion as reported on May 20, 2009, provides a backstop.

### **People Are Living Longer**

The good news about advances in science and medicine is that people today are expected to live longer than in the past. From 1900 population life expectancies for males increased from 46 years to 75 years and from 48 to 80 for women. Between 1950 and 2006-life expectancy from age 65 increased from 13 years to 17 years for men and from 15 to 20 years for women.<sup>1</sup>

When longevity risk is coupled with recessionary and business risks, layoffs and cutbacks occur. Workforce reductions impact the future individual retirement security if only because people are encouraged to retire early while now living a comparatively longer part of their lives in retirement and past age 65. Having a secure and guaranteed retirement income for life is crucial for the health of the economy and for society in general.

### **Annuity Prices Are Rising**

It should be no surprise that if people are living longer, this would impact the pricing of life insurance policies. This has happened. It should come as no surprise that lifetime annuities are getting more expensive (disregarding interest) every day. As life expectancy increases, DB plans (and life insurers in this business) will be required to make payments for over a longer time frame. This is elementary to understanding the issue.

The most advantageous feature to Social Security and DB pensions is that these retirement income plans are payable for life. Lifetime income security means never being without income during retirement. Lifetime incomes cease upon death of the participant or participant and spouse. As medical advances are made and longevity increases, more individuals will risk outliving their retirement resources. Retirees who have DB plans take comfort in knowing that their lifetime pension income should continue without fail. There is no need to manage

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<sup>1</sup> “Health, United States 2009, with Special Feature on Medical Terminology”, U. S. Department of Health & Human Services, January 2010 DHHS Publication No. 2010-1232

accounts, make investment decisions, or worry about how to make up for investment losses. That is the responsibility of the plan sponsor in the case of private DB plans.

### **Need for Lifetime Income Security Is The First Priority**

The purpose for DB plans is to provide lifetime income. ERISA established the PBGC as a backstop to DB financial security on behalf of participants. The RFI has noted that the number of insured participants in DB plans has shrunk from 27 million to 20 million. While a large segment of the working populace has a pension, the availability of lump sums and the increase in terminating plans is shrinking the population of individuals who have such insured income plans at retirement. This is coming at a time when millions of workers will retire as the boomer population matures.

### **Disadvantages**

There is very little disadvantage to a lifetime income annuity plan. There are instances in which misfortune may befall a retired worker who is suddenly stricken with a dread disease shortly after retirement. In that instance, the decision to choose a particular annuity income plan can have a material impact upon the well being of the spouse or beneficiaries given possible limitations of plan-based annuity options. It should be noted that DB pensions were never intended to create legacy interests for offspring. It should also be understood that plan-based mortality assumptions are designed to allow for such unfortunate and untimely personal losses while providing for those who also live the longest. One cannot know their own longevity or mortality. Therefore, the choice of an annuity plan or lump sum is always subject to second guessing. If there is a shortcoming to DB plans, it is the lack of robust alternate annuity options to allow for flexible planning by participants.

### **Outperforming a Plan-Based Annuity**

A great deal of controversy surrounds the criticism about annuities paid from DB plans. Financial advisors and investment planners continue to argue that it is easy to outperform a plan-based annuity. While this is asserted, it is certainly becoming more difficult to support given market performance over the past 10 years. The growth in capital and investment over the past four decades has been fueled by the creativity and entrepreneurship of America. It may not be possible to sustain these historic periods of returns. If it is, then perhaps those guided by successful advisors will emerge in their later years having succeeded with that plan. In any event, those who fail to achieve excellent results risk insecure retirement lifestyles.

### **Legacy Interests**

In some instances, individual needs may be met easily with account balance withdrawals. Most likely, those participants will have other resources from inheritance, personal savings or other fortunate circumstances. This is not likely to be the same for the population at large. Planning may demand a need for more financial flexibility and DB plans do not provide such flexibility nor do they offer an account balance during retirement. It must be understood that DB plans are not designed as account balance plans and that they are, in fact, intended as replacement income plans.

### **DB Financial Risk**

During the recent recession, any participant who was eligible for a DB pension has had a heightened concern about the financial solvency of a business which sponsors a DB plan that is underfunded. When plans are taken over by the PBGC, it is possible that some retirement income could be lost if benefits exceed the insurance limits. Therefore, there is a heightened awareness to these risks and retirees are visibly concerned about their benefits. The inability to maintain high investment returns has crippled DB plan finances over the past 10 years.

Retirees are at greater risk if they could otherwise have taken a lump sum and did not. Once a DB plan has been trustee'd by the PBGC, no lump sum is payable. Lump sums are now curtailed in DB plans when a plan falls into "at risk" status under PPA guidelines. While it is crucial to have well-funded DB plans as matter of policy, risky investing styles of plan managers and heavy, regulatory burdens cost American businesses and investors untold sums while participants are left to wonder what may become of their retirement income security.

### **Prior Findings Confirm Conclusions**

A critical review of the advantages and disadvantages of the impact of annuities on retirement security has been performed by the Employee Benefit Research in 2004.<sup>2</sup> This research examined what would happen under different scenarios and measured four different events to find out the consequences of each:

- 1) all DB plans freeze
- 2) all DBs convert to cash balance arrangements
- 3) all cash balance plans ended
- 4) retirees are required to receive annuities

The EBRI concluded:

*"Only the annuity payment scenario yielded a positive result in terms of lowering the amount of retirement savings that individuals need to accumulate during their working lives."*

**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**

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<sup>2</sup> "The Decline of Private-Sector Defined Benefit Promises and Annuity Payments: What Will It Mean?, p.2" Employee Benefit Research Institute, Notes: July, 2004, Vol. 25, No. 7

**the concerns that keep plan participants from requesting or electing lifetime income?**

There are a few sobering reasons for the behavior leading to the selection of a lump sum and the anti selection of lifetime annuities from plans:

- 1) ERISA allowed for the creation of IRA Rollover accounts to provide pension portability
- 2) plan sponsors took the next step and amended their plans to allow for lump sums at a time when interest rates were very high and it was financially advantageous to do so
- 3) equity return performance supported the belief that “you always do better in the market”
- 4) financial service providers took a short term focus of gathering lump sum distributions while ignoring any critical analysis or evaluation to the value of lifetime annuity plans, whether plan-based or arranged with personal assets or IRA accounts
- 5) broker compensation is based in part (and for investment advisors completely) upon assets under management and there is no compensation for advising a client to accept a plan-based annuity; there are no assets under management when client funds are sent to an insurer to purchase such an annuity; there is no compensation paid when advising a participant to start an annuity from a defined benefit plan
- 6) failure to require advisors to provide objective analysis or maintain objective advice
- 7) lack of financial or risk models to assess future costs to annuitization

A recent study by Messrs. John Chalmers and Jonathan Reuter concludes that lump sum distributions are preferred due to these factors:

- 1) “perhaps retirees do not appreciate the value of annuities”; and,
- 2) participants “demand . . . liquidity even in this circumstance.”<sup>3</sup>

**ERISA and Lump Sum Distributions**

The Employee Retirement Income Security Act of 1974 (“ERISA”) created the IRA Rollover account provisions. IRA Rollovers purported to herald the portability of pensions. It’s original intent was to provide for administrative relief to DB plans which had the burden of tracking, maintaining and administering small pensions for many former participants for many years into the future. This Lump Sum Distribution (“LSD”) concept was expanded to ultimately be defined as an “alternate form of an annuity” or “distribution.” Broader use of LSDs was due to the very high interest rates available for discounting distributions on plan terminations and gathered steam as plans realized that offering a lump sum as an “optional form of an annuity” allowed the liability to be removed at a discount. Many plans were financially motivated to take the next step to offer lump sums as an “optional form” in continuing plans. Since then, the underlying interest assumptions for determining LSDs have swung back and forth to both the advantage and

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<sup>3</sup> “How Do Retirees Value Life Annuities? Evidence from Public Employees” John Chalmers, Jonathan Reuter, January 28, 2010, National Bureau of Economic Research in conjunction with the U. S. Social Security Administration

disadvantage of each the DB plan and the participant. After full implementation of PPA, the LSD will likely have more parity with plan funding assumptions and potentially be less attractive to participants.<sup>4</sup>

### **Chasing Lump Sum Distributions**

As more DB plans offer lump sums, wealth planners and advisors pay close attention to such opportunities. Lump sums have almost become an automatic option. Sadly, DB plans are losing their importance and in many instances may no longer fulfill their primary purpose: providing a lifetime replacement income. Inflation is often cited as an additional reason to choose a lump sum instead of a DB lifetime pension income. This argument alone is rather weak in the face of the primary loss of lifetime income security.

The lump sum alternative to a pension is likely always recommended by advisors. After all, advisors get paid nothing to advise a participant to accept an annuity from the plan. Planners and advisors argue that if the individual and spouse accept a lifetime income, and one or the other subsequently dies, they are considered to have made a “bad choice.”

### **Market Performance**

The availability of huge pools of money from LSDs has obviously gained the attention of every financial advisor in the industry as a new market that can be tapped. The motivation for gaining control of these distributions is supported with a single presumptuous and enticing argument:

“You always do better in the market.”

*In the process, millions of workers have been encouraged to forfeit lifetime income security in exchange for capital market exposure.*

There is also a common misunderstanding about the workings of mortality (longevity) and the inherent risk to lifetime income. The argument for taking a lump sum is singular: “you always do better in the market.” There is also the belief that having \$100,000 nestled into an IRA account is far superior to even a \$10,000 guaranteed lifetime income from a pension or annuity.<sup>5</sup> This complete disconnect is a severe failure of the human resource professionals, the insurance and financial services community.

*The lack of understanding of longevity risk creates an environment in which the systemic societal risk of retirement income solvency has been mortgaged for the*

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<sup>4</sup> This conclusion is supported by analysis of various case work performed independently by QAS. These conclusions are based upon theories of replacement costs and have been articulated in numerous papers by Mr. Joseph B. Bellersen, Jr..

<sup>5</sup> Based upon independent analysis performed by QAS involving historical case facts from several terminating cash balance arrangements; the cash balance conversion factor equaled: \$1 annual benefit for each \$10 cash balance at NRD age 65.

*opportunities of capital markets exposure.*

It is unfortunate that arguments for the merits of “insured income” or “longevity protection” draw glassy eyes from audiences and don’t provide the excitement of a day trading. Few financial advisors understand the dynamics of a lifetime income-based product features and rarely, if ever, is a financial assessment performed by or required of advisors who recommend taking a lump sum distribution from a plan-based annuity arrangement.

### **Supreme Court Decision**

In 1994 the Supreme Court held in **Nationsbank of North Carolina, N.A. et al. v. Variable Annuity Life Insurance Co. et al.**<sup>6</sup> that the Comptroller of the Currency was allowed to conduct annuity transactions. The Supreme Court granted rights for banks to sell annuities on the premise that conducting such sales were “incidental” to “the business of banking.” The court went on to cite: “The Court further defers to the Comptroller’s determination that annuities are properly classified as investments, not ‘insurance’ within §92’s meaning.” This decision cleared the hurdles and was a watershed event allowing the sale of annuities by banks and imposing a product driven mentality. This decision eliminated the theory of insurance since it focused solely on the tax deferral aspects of annuity contracts and was supported by professional opinions that “no one ever annuitizes.” Such a bold categorical declaration permitted deferred annuities to be sold on the basis that “one size fits all.” Nothing could be further from the truth.

*The Court’s decision was flawed and ill advised.*

Deferred annuities are intended to provide for a tax favored deferral of an account balance until a future retirement date.

*That date has arrived.*

At retirement, balances are intended to be annuitized. The fact that annuitants continue to want tax deferral does not change at all the characteristics of the annuity as a plan of insurance. The item being insured is the longevity risk of the annuitant.

*Contrary to Nationsbank, insuring longevity risk is the sole function of life insurance companies and it is not a business of banking and is not an investment.*

Now that retirement security seems imperiled by poor investment returns, the Congress and the public may realize the price paid for the ultimate swap.

### **SEC and FINRA**

We entered these words in the SEC website: “immediate+annuity.” This yields a grand total of

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<sup>6</sup> **Nationsbank of North Carolina, N.A. et al. v. Variable Annuity Life Insurance Co. et al.** Certiorari to the United States Court of Appeals for the Fifth Circuit No. 93-1612 January, 18, 1995

16 hits: two hits relate to a filing by Allianz; five hits involve “immediate annuity” as a footnote in the SEC’s recent rule making on index annuities; seven others are notifications involving product filings for exemptions from certain filing requirements; one involves a SEC comment regarding Form N-4 to “better regulate disclosure about immediate annuities”; one involves a civil action penalty on a certain transaction.

We entered the same “immediate+annuity” on the FINRA website which gets two hits: one is a federal tax compliance form and the other takes you to the Deferred Variable Annuity section in which there is not one mention of “immediate annuity.”

It seems incomprehensible that “immediate annuity” is a completely irrelevant and meaningless term in the existing body of regulatory and supervisory oversight within both the SEC and FINRA. However, we offer that this probably will serve as the key to the puzzle:

*Although an annuity is often measured and quantified in financial terms during the deferral phase, this alone does not make it an investment: it is still income insurance for life.*

FINRA merely provides guidance on “Deferred Variable Annuities” and a number of reminders to its members regarding suitability. This stems from an historic view held by retail stock brokerages and financial advisors that no one should ever annuitize. It is a further belief that no one would want (or need) to buy an immediate annuity in the first place.

*This is a serious flaw and an erroneous presumption.*

### **Product Mentality vs. Insurance Function**

As deferred fixed and variable annuities were introduced and became popular, the financial services industry developed a product centric view. It became easy to spreadsheet a few products to determine the differences between offerings. The success of deferred annuity product sales motivated by tax deferral supplanted the inherent insurance element of annuitization. The process of product packaging overwhelmed the need for income planning with annuities. In the minds of most “no one ever annuitizes.” Annuity sales were ubiquitous and one size fits all even at FINRA. When it comes to immediate annuity plans, all of this changes.

### **Lifetime Income Is Insurance**

The financial planner and advisor communities create a fear factor to support their argument that individual pensioners do not want to become the statistic of a “premature death.” Planners discourage lifetime annuities by arguing again that it is necessary to have access to funds, that “the insurer (or plan) always wins” and continue the flawed belief that “you always do better in the market.”

*The availability of lump sums itself drives the appeal for IRA Rollover accounts.  
There is a strong preference for taking personal control. There is no requirement*

*that professionals provide meaningful information, comparison or analysis for what is being forfeit, including relevant economic measures of what is lost.*

### **Future Annuitization Costs**

Rational assessments for annuitization must include methods for assessing the time value of money and future longevity costs. The cost of making a decision to annuitize today or to delay that decision is not well understood. Therefore, prospective annuitants and their advisors need to utilize suitable tools to assess future risks.<sup>7</sup> Over time, annuity prices will increase as longevity increases. We call this longevity extension risk, or more simply longevity risk.

### **Systemic Insurance**

Social Security, DB pensions and immediate annuities for life annuities have a common thread in their collective method of operation:

*Those who live long are subsidized by those who unfortunately die prematurely.*

We note that each of these systems is a system of insurance and shared or pooled risk. In order for the systemic function of insurance to be realized, costs, benefits, burdens, and resources must be shared by and among the insured group.

*The private form of shared (or insured) mortality risk function is the immediate lifetime-based annuity plan offered by life insurers and private sector defined benefit plans. Any step to promote the use of a lifetime based commercial annuity plans within defined contribution or IRA plans add a tool to share the mortality risk within an existing private sector system with a corresponding reduction in the potential need for public dependency.*

### **3. What types of lifetime income are currently available to participants directly from plans (in-plan options), such as payments from trust assets held under a defined benefit plan and annuity payments from insurance contracts held under a defined contribution or defined benefit plan?**

#### **Defined Benefit In-Plan Annuity Options**

The DB plan selects a basic Normal Form option which is based upon the participant's life alone (gender, date of birth) and is usually a Life Only Annuity or Life with Period Certain Annuity (i.e., Life Annuity with 10 Years Certain). Married participants in DB plans must be provided with an automatic Joint & Survivor 50% Lifetime Annuity form.

DB plans generally offer a limited range of Optional Annuity Forms, in some cases offering the aforementioned LSDs. There is no requirement that a DB plan offer a lump sum or a full range

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<sup>7</sup> QAS has developed proprietary tools to measure various types of inherent longevity risks to retirement income planning with annuities. Some of these tools have remained confidential to QAS at this time.

of Optional Annuity Forms beyond those mentioned. However, the range of possible Optional Annuity Forms is very robust and could include many forms which might be considered standard within the commercial annuity marketplace. Any such options are required to be the Actuarial Equivalent (“AEQ”) of the Normal Form Annuity and must be based upon the DB plan’s factors.

### **Payments from DB Trusts**

Most DB plans pay annuity benefits out of invested trust assets. Some DB plans purchase commercial annuities and more DB plans are viewing these arrangements as a means of managing both investment and longevity risks. Hybrid or cash balance plans provide a growth in an account balance over time until retirement, and then offer an annuity as the normal form of a pension. As noted, the actual annuity options available in DB plans can range from a narrow mix to a broad range, including Social Security leveling options. Generally, DB plans do not offer a “balance forward” account with a periodic withdrawal provision. Usually an annuity form must be selected. For a complete overview of various annuity options see Appendix I - “Immediate Annuity Terms Definitions and Options.”

### **Plan Disclosure**

DB plans are required to provide disclosures to participants consistent with the “relative value of annuity”<sup>8</sup> requirements. While the relative value approach may provide some information, we believe that it falls short of providing relevant information. QAS believes that a more appropriate measure would be by application of tools such as The Bellersen Curve ®<sup>9</sup>. The Bellersen Curve ® utilizes a proprietary calculation method to develop a graphical plot of the phenomenon of the increasing Internal Rate of Return on lifetime-based annuities. QAS has developed other proprietary tools to address the longevity risks for annuitization which may provide more meaningful information to participants.

For a comparison of relative pricing differences for annuity options see Appendix II - “How Immediate Annuities Work.”

### **QAS’ Observation**

The purpose of DB plans is to provide a replacement income plan such that a worker lifestyle can continue in retirement without significant change. Many plans now offer LSD as an Optional form of an annuity. We believe that the availability of LSD from DB plans causes them to be viewed as cash bonus plans. DB plans historically provide for the retirement income from two sources: 1) trust assets funded with employer contributions, or 2) purchased commercial annuity contracts from qualifying insurers.

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<sup>8</sup>Title 26: Internal Revenue Code § 1.417(e)-1 Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

<sup>9</sup>QAS has developed proprietary approaches for the measurement and assessment of relative value of annuities. Among them is The Bellersen Curve® which is a graphical plot of the Internal Rate of Return for an annuity and allows the use of any actuarial assumptions or basis in plotting the results.

### **Defined Contribution Plans**

DC plans are funded with contributions to trusts and assets are invested at the discretion of the plan sponsor and participant. Participant choice is usually provided in profitsharing and 401(k) plans and sometimes in money purchase pensions. Profit-sharing plans are sometimes invested in company stock.

DC plans such as 401(k) plans generally do not offer annuities unless the plan is administered by a life insurer. In those instances, lifetime annuity programs are offered at retirement. The participant may be offered lifetime annuity options at early retirement as well. Lifetime annuity benefits are fairly broad and defined by the plans. The Normal Form of retirement benefit is a lifetime-based annuity plan that is generally administered by a life insurance company as opposed to a self insured fund as is the case with most DB plans. Most non life insurer DC plans do not offer lifetime immediate annuities. (For a review of various annuity options see Appendix I - Immediate Annuity Terms Options and for a comparison of relative pricing differences between options, see Appendix II - “How Immediate Annuities Work.”)

### **4. To what extent are the lifetime income options referenced in question 3 provided at retirement or other termination of employment as opposed to being offered incrementally during the accumulation phase, as contributions are made? How are such incremental or accumulating annuity arrangements structured?**

### **Defined Benefit Plans**

DBs plans are supposed to be replacement income plans. As participants reach NRD, the benefits available are expressed in terms of lifetime income options. If participants leave the employ of the company before they satisfy eligibility for retirement benefits, they are provided with statements indicating their accrued benefit for either early or normal retirement. Active participants are usually provided with an annual statement illustrating their benefits as of the plan year end. Such disclosures also communicate the applicable early retirement benefit amounts and may provide projected benefits to a normal retirement date.

If the plan offers a lump sum, there is no reference to a commercial market rate or index which would help communicate the risk/return tradeoff required before accepting a lump sum. As noted, QAS believes that the best method of analysis of various options is by application of The Bellersen Curve ®<sup>10</sup> which can operate as an industry index or barometer to provide information regarding an alternative to relative value of annuity<sup>11</sup> requirements and can be customized for

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<sup>10</sup>QAS has developed proprietary approaches to measure and assess relative value of annuities. Among them is The Bellersen Curve® which is a graphical plot of the Internal Rate of Return for an annuity and allows the use of any actuarial assumptions or basis in plotting the results.

<sup>11</sup>Title 26: Internal Revenue Code § 1.417(e)-1 Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

either plan-based or individual annuity offerings, an immediate variable annuity or for any other annuity pricing scenario.

### **Defined Contribution Plan Options**

In DC plans, the availability of incremental annuity benefits is a fairly new product phenomenon. The purchase of incremental lifetime income with a portion of a contribution serves a very viable need: it places the lifetime income proposition on a time and money scale which illustrates the value of purchasing earlier rather than later. We do not believe there has been a broad reception to these options. There is a tendency to focus upon the accumulation phase of retirement with a diversified basket of assets. Some programs allow for a target income needed at retirement in order to establish a theoretical contribution level. In this regard, these tools are useful. However, the next step, which is converting the account balance into a lifetime or joint lifetime benefit, may continue to fall short due to a lack of information and an inability to evaluate the cost or benefit of selecting such an option. It may be more beneficial to shop for competitive commercial payout rates when considering retirement income options.

### **5. To what extent are 401(k) and other defined contribution plan sponsors using employer matching contributions or employer nonelective contributions to fund lifetime income? To what extent are participants offered a choice regarding such use of employer contributions, including by default or otherwise?**

We are not familiar with any significant efforts to promote the use of employer-based contributions toward a lifetime income arrangement within a 401(k) plan. However, life insurers have developed deferred income annuity arrangements for use within 401(k) participant choice plans. It is possible that a sponsor driven deferred lifetime arrangement could be offered.

Money purchase DC plans provide an automatic option to a lifetime retirement income annuity plan. However, such plans are much less common and generally administered by life insurers. Employers who offer money purchase plans are inclined to offer lump sum distributions from these plans as well. More often, 401(k) plans are provided due to the desire for competitive employment conditions as participants like the opportunity to make their own investment decisions.

It is rare to see deferred annuity arrangements within 401(k) plans unless a life insurer is providing administrative services. In this instance the lifetime annuity option is available at retirement as an option. It may be offered at termination of employment, however, the idea of portability of these account balances is likely to result in IRA Rollovers which allow even greater participant control.

### **6. What types of lifetime income or other arrangements designed to provide a stream of income after retirement are available to individuals who have already received**

**distributions from their plans (out-of-plan options), such as IRA products, and how are such arrangements being structured (fixed, inflation adjusted, or other variable, immediate or deferred, etc.)? Are there annuity products under which plan accumulations can be rolled over to an individual retirement annuity of the same issuer to retain the annuity purchase rights that were available under the plan?**

### **IRA Rollovers and Out-of-Plan Options**

The availability of lifetime income plans is very broad for IRA Rollover accounts or out-of-plan options. Generally, this market is served through financial advisers, retail brokers and insurance agents and brokers. Establishing an Individual Retirement Annuity or IRA Annuity entails the transfer of IRA Rollover balances or direct rollovers from DB and DC plans. In most instances, the IRA Rollover account is established independently from the plan. Once outside of a plan, an IRA Rollover may be managed in any manner and the option to annuitize at any time is always available. It is likely that applicable annuity rates would differ from the same provider for an in-plan purchase or IRA Annuity plan. This is due to the mandated use of Unisex pricing for in-plan purchases versus sex distinct pricing for IRA Annuities. Group versus individual annuity pricing for mortality and interest would also impact pricing from the same provider.

Regulated life insurers actively offer a Single Premium Immediate Annuity (“SPIA”) products in conjunction with efforts to provide service to the IRA Annuity market. SPIA products can be offered in limited option form or may be available as a more robust set of options and benefits. For example, many SPIA providers may not offer Installment or Cash Refund options. Furthermore, Installment and Cash Refunds may be more limited or not available at all from some providers when offered in conjunction with a Joint & Survivor annuity plan. A number of insurers may offer a commutation provision for any remaining Period Certain or Installment Refund when dealing with a death benefit payable to named beneficiaries by reason of death of the annuitant.

Generally insurers who administer DB plans are capable of offering DB annuities to facilitate a very broad range of offerings for DC plan-based annuities. Insurers are able to offer a broad range of lifetime income annuity plans priced either on a group or individual basis. Usually group annuity purchase rates are only available when an annuity is purchased within a plan-based setting. A few life insurers have developed a market presence for offering group pricing for IRA Rollover Annuity plans. Increased sales of individual SPIAs are due in large part to efforts by a few life insurers who have successfully developed niche market entry points and who now serve a broadening base of distribution channels.

### **Inflation Protection and Other Options**

Very few providers have developed full CPI inflation protection products. In many respects, it might be better to select an SPIA with a Guaranteed Percent Increase (“GPI”) over the availability of full inflation protection risk. If the rate of inflation were to increase in the future, then: 1) insurers will be forced to drastically reduce the beginning annuity payout to adjust for the increased cost of full CPI protection, or 2) CPI adjusted product offerings will be pulled

from the market and GPI offerings will be made. The cost of providing either CPI or GPI benefits is compensated by adjusting beginning benefits downward. There are regulatory and compliance issues with regard to GPI or other non-CPI based annuity plans. At the present time only CPI increase plans are permitted for plan-based or IRA Annuity plans.

### **Variable Immediate Annuity Products**

Immediate Variable Annuity (“IVA”) plans offer a middle ground and may become more compelling over time, however, equity market exposure is not currently acceptable to many retirees. Many deferred variable annuities do not even allow for a conversion to an IVA plan. In many instances, the sole conversion is to an Immediate Fixed Annuity plan. Product offerings are very narrow in comparison to guaranteed Immediate Fixed Annuity or SPIA plans.

There has been some new development of IVAs. New efforts include a process to provide some minimum guaranteed downside income level of protection. However, given the misunderstanding regarding the operation of IVAs in general, the successes may be long in coming.

### **Deferred Annuities to Provide Income**

Many independent financial representatives position deferred annuity plans as IRA Account funding vehicles. IRA deferrals are often funded with deferred annuities which provide fixed interest accumulation until an annuitant chooses an annuity payout option or begins systematic withdrawals from the accumulation account. Some deferred annuity plans offer interest growth with attractive features such as interest growth linked to an external index such as the S&P 500.<sup>12</sup> These are known as index annuities. These plans are flexible to the extent that they allow for systematic withdrawal administration as a means to providing periodic income and allow for annuitization as an option. Deferred annuity products to fund IRA Accounts are subject to Required Minimum Distributions beginning at age 70 ½. Once the account balance is converted to a lifetime income, the RMD requirements are deemed satisfied so long as certain conditions are met. If a lifetime annuity owner maintains other IRA accounts, then the present value of the annuitized IRA Annuity plan is combined with the values of all other IRA accounts to determine RMD in any given year.

**7. What product features have a significant impact on the cost of providing lifetime income or other arrangements designed to provide a stream of income after retirement, such as features that provide participants with the option of lifetime payments, while retaining the flexibility to accelerate distributions if needed?**

### **Group Annuity Contracts (“GAC”) with Individual Certificate Plans (Allocated Group Annuities, Terminal Funding Annuities)**

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<sup>12</sup>S&P 500® is a registered trade mark of Standard & Poor's Financial Services LLC, a subsidiary of The McGraw-Hill Companies, Inc.

### **Individual Single Premium Immediate Annuity (“SPIA”) Plans**

Annuity option forms for individual immediate annuities can be very robust. There are basic forms of annuitization: Life Only, Life with 5, 10, 15 or 20 Years Certain; Life with Cash or Installment Refund. These annuity plans allow for inclusion of a spouse creating with a Joint or Contingent Annuitant to create a similar variety of Joint & Survivor (“J&S”) (Contingent “J&C”) Plans with the percent continuing to a survivor (or Contingent) in amounts ranging from 50%, 66 2/3%, 75% or 100%. Many of these J&S (or Contingent) Options also offer a Period Certain such as 10 years or a Cash Refund. Each option, inclusion of a Joint & Survivor or Contingent Annuitant and each remainder interest option will impact ultimate pricing. For an in depth review of these plans see Appendix I - Annuity Options, Terms and Conditions. For an analysis of the impact of pricing on these basic options, see Appendix II - How Immediate Annuities Work.

### **Accelerated Benefit and Commutation**

In the 1990's, life insurers began to offer additional rights to individual immediate annuity or SPIA plans such as the right to commutation or accelerated benefit riders which permit the annuitant to receive a greater sum under certain trigger conditions. Those triggers usually require a nursing home confinement as a condition for receiving an increased benefit. Such benefits are usually temporary in nature (i.e., the benefit being paid is increased by 50% for a limited period of time such as five years) and then the amount reverts to the original base income. The introduction of contractual commutation rights is quite new. This usually requires the annuitant to elect that option at the time an application is taken. Some insurers adjust the benefit for such a privilege.

Individual SPIA plans are experiencing a renaissance in design. Individual SPIA plans are targeted for use with personal after tax monies or for use in establishing an IRA Rollover Annuity plan. More often, commutation is reserved for beneficiaries who may request the balance of remaining period certain or installment refund payments upon the death of the annuitant. A non contractual commutation provision allows the insurer to settle small remaining beneficiary amounts. Insurers often allow such requests, but this is entirely at the discretion of the provider. The introduction of these features is based upon product designs which are intended to capture market share through agent/broker planners and retail distribution. Commutation or accelerated benefit riders are not common or consistent with the issuance of commercial group annuities. Such group annuities are customized to plan-based design requirements, mostly for DB plans, and to a much lesser extent DC plan. However, based upon this RFI and market focus, there may be many reasons to integrate benefit design solutions within what is characterized as the DC/IRA annuitization space.

In many instances, a rider is attached to deferred annuity plans to accommodate some market needs and to provide additional flexibility. The advent of income riders in deferred annuity plans provides a niche for enhanced offerings and facilitates meeting market demands. An accelerated benefit nursing home rider allows an individual who has no LTC coverage to have additional protections. Individuals might find such payout annuity plans with accelerated benefit

to be attractive in meeting their needs.

## **8. What are the advantages and disadvantages for participants of selecting lifetime income payments through a plan (in-plan option) as opposed to outside a plan (e.g., after a distribution or rollover)?**

### **Defined Benefit Plan**

Many DB plans provide annuity-based options using factors which are much more generous than those available in the commercial annuity marketplace. These factors in DB plans are static. They generally do not change. Interest arbitrage can occur when attractive commercial annuity rates exceed static DB plan actuarial cost basis, PPA funding basis, or FAS expense accounting cost basis. In some instances, the embedded plan interest rate can be as high as seven or 8 percent. DB plans also utilize group annuity mortality conversion factors which are likely to reflect more favorable expected mortality of their workforce. In some instances, this mortality may lag the reality: people are living longer.

### **Defined Contribution Plans**

The QAS' Annuity Price Index<sup>13</sup> tracks the relative pricing differential available from commercially available group annuity programs vs. individually priced annuity programs. See Appendix III. The charts evoke these observations: group pricing is dynamic, interest rates are more sensitive, and pricing loads for commission based individual immediate annuity or SPIA plans are generally unfavorable when compared to group plans. In some instances pricing advantage of a group vs. individual immediate annuity plan is as much as 15 per cent.

In-plan-based DB annuity benefits are likely to provide far higher income than an out-of-plan arrangement purchased with a lump sum. To the extent that group annuity mortality and pricing are made available at the DC plan level, those arrangements are likely to provide substantially higher benefits than individual immediate annuity or SPIA products. There are exceptions: Unisex mortality imposed by the Norris decision and the potential for enhanced benefits on an individual SPIA plan due to a shortened life expectancy resulting from admitted health conditions such as smoking or heart disease.

### **QAS' Observations**

DB plans utilize group annuity mortality and interest assumptions in determining various benefit forms at retirement. In many instances, the underlying interest rate in DB plan-based annuities is not equally available in the commercial annuity market. DB plan-based annuity pricing is usually ignored and devoid of any comparability test when a lump sum is made available. The lump sum is simply transferred to an IRA Rollover account without a second thought. It is

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<sup>13</sup> QAS' Annuity Price Index tracks various rates and options from providers and are compiled from both individual and group annuity databases maintained by QAS.

unlikely that an individually priced SPIA could replace the income being forfeit from DB plan-based annuities unless market interest rates underlying commercial annuities have risen substantially to create a disparity.

As a population ages and lives longer, the DB plan's experience is adjusted nominally each year. Interest rate movement creates more dramatic shifts. Abrupt changes in mortality are abnormal. DB plans only realize mortality losses gradually over time. Thus, longevity risk is inherent in DB plans. Participants who select a plan-based annuity or receive a certificate from an insurer rely upon the employer or insurer to continue expected payments regardless of actual longevity experience.

**9. What are the advantages and disadvantages from the standpoint of the plan sponsor of providing an in-plan option for lifetime income as opposed to leaving to participants the task of securing a lifetime income vehicle after receiving a plan distribution?**

**Defined Benefit Plans - In-Plan-Based Annuity**

The true purpose of DB plans is to provide such an in-plan option. In this regard DB plans are inherently annuity plans. The provision of the annuity as the means of replacing earned income at retirement is the advantage of the DB plan.

**Defined Contribution - In-Plan Based Annuity**

**Advantages**

The advantages to in-plan based annuities in DC plans would be the introduction of a lifetime income option which may not have been available in the past for a profit sharing, 401(k) or other type DC plan. As noted, significant price advantage can be brought to bear by plan sponsors to arrange a group annuity priced programs for their participants. Introducing such an option could be perceived as an added value from the plan sponsor. Such an enhancement would potentially provide those employers with a value-added benefit and potentially at more attractive pricing than an individually priced plan. For employers without a DB plan, an argument could be made that they are able to offer new enhancements to their individual participant choice profit sharing or 401(k) plans, including the possibility of a variable annuity plan, which might be attractive to many participants.

**Disadvantages**

**Administrative and Liability**

The desire to make a plan-based annuity available would require the plan sponsor to perform a number of tasks:

- 1) review the possible range of available options within the market
- 2) review changes and procedures for administering such plans and options
- 3) determine whether "all or none" or "partial annuitization" can or should be offered and the required administrative changes

- 4) define an annuity program for the participants that is consistent in meeting a range of possible needs
- 5) develop an approach to dealing with “safe harbor” process to 404a-1 or “safe harbor”<sup>14</sup> requirements within the context of “procedural prudence” standards of ERISA per Bussian<sup>15</sup>
- 6) arrange benefit communications
- 7) select providers and services
- 8) amend the plan, if necessary, for such options

These are by no means the full extent of possible administrative needs. Having taken these steps, plan sponsors may yet remain concerned for potential for litigation and must endure rating changes and potential long term consequences for selecting immediate annuity providers. It is very important to clarify the disposition of a DC plan which provides both commercial annuities as in-plan purchases through the trust and the extent to which this qualifies as a distribution which would separate the plan sponsor from further responsibility. There could be implications for any partial annuitization plans which might potentially extend plan sponsor liability further into the future.

### **Issuer Credit Default Risk/State Guaranty Funds**

The most likely disadvantage to an employer would be the potential for liability from repercussions due to the failure of any life insurer which was selected by a fiduciary under such a participant choice plan. If participants are limited as to choice, or if account balances are unprotected once annuitized, then the potential for litigation exists as a result of such failure. As a result, plan sponsors will have to work with various professionals to design a participant choice program, which may include the use of diversification among a group of providers when a participant chooses to annuitize a large account balance. In addition, the plan sponsor will need to maintain information regarding the various provisions of the state guaranty system managed by National Organization of Life & Health Guaranty Association (“NOLHGA”).<sup>16</sup>

Once annuitized, plan sponsors may be compelled to monitor the solvency of the current annuity offerings. If insolvency were to occur, the plan sponsor would be at a loss to do anything about the troubled condition of the provider. Plan sponsors will be required to endure the changing solvency conditions of the annuity offerings and may feel uneasy with that fiduciary function. We note that plan fiduciaries are not compelled to seek expert advice. However, we believe that

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<sup>14</sup> CFR 2550.404a-4

<sup>15</sup> **Bussian v. RJR Nabisco, Inc.**, 223 F. 3d 286 (5<sup>th</sup> Cir. 2000) [“Bussian”]

<sup>16</sup> The National Organization of Life & Health Guaranty Association is a network of state life and health guaranty associations which coordinates a safety net to assure continued coverage in the event of insurer insolvency.

fiduciaries must still satisfy the “procedural prudence” requirements of ERISA.<sup>17</sup> . We still believe that it is important to understand the possible implications by clarifying the status of in-plan based use of commercial annuities, especially when partial annuitization programs would be made available. It is also important to note that individuals can implement partial annuitization at any time once distributions have been transferred to IRA Rollover accounts. Those decisions would be entirely the responsibility of the participant.

**10. How commonly do plan sponsors offer participants the explicit choice of using a portion of their account balances to purchase a lifetime annuity, while leaving the rest in the plan or taking it as a lump sum distribution or a series of ad hoc distributions? Why do some plan sponsors make this partial annuity option available while others do not? Would expanded offering of such partial annuity options--or particular ways of presenting or framing such choices to participants--be desirable and would this likely make a difference in whether participants select a lifetime annuity option?**

We are familiar with some plans which offer a partial lump sum and the balance in an annuity in the DB space. We would expect that DC account balance plans administered by life insurers would have the capability to allow for a partial annuitization plan. This alone may be the rationale for commercial annuities being available in a number of plans. We have already expressed concern for plan sponsor liability, administrative complexity and lack of use by participants as the primary concerns for making lifetime annuity plans available. Administrative issues are intricate and could trigger penalties once Required Minimum Distributions commence at age 70 ½. Partial annuitization could be helpful in getting participants comfortable with the receipt of a regular check. While this step is in the right direction, we do not know if it creates sufficient momentum and may be met with resistance from plan sponsors or administrators who are unwilling or unable to administer the benefits. It also may not be accepted until other previously mentioned obstacles are overcome.

**11. Various “behavioral” strategies for encouraging greater use of lifetime income have been implemented or suggested based on evidence or assumptions concerning common participant behavior patterns and motivations. These strategies have included the use of default or automatic arrangements (similar to automatic enrollment in 401(k) plans) and a focus on other ways in which choices are structured or presented to participants, including efforts to mitigate “all or nothing” choices by offering lifetime income on a partial, gradual, or trial basis and exploring different ways to explain its advantages and disadvantages. To what extent are these or other behavioral strategies being used or viewed as promising means of encouraging more lifetime income? Can or should the 401(k) rules, other plan qualification rules, or ERISA rules be modified, or their application clarified, to**

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<sup>17</sup> QAS provides qualitative assessments which may serve to meet ERISA requirements for “procedural prudence” for DC plans.

**facilitate the use of behavioral strategies in this context?****Defined Contribution Plans**

Regulatory change would be required to develop a default temporary annuitization plan. Such a plan could be implemented through a temporary default annuity income plan at separation from service due to retirement. Such an arrangement could ratchet a portion of income over a period of years. Such a plan might target from 50-100% of annuitization of plan assets depending upon a personal assessment, demographics and profile. This could culminate in full annuitization at age 70 ½. The participant/annuitant would be required to “opt out” of the program.

**QAS’ Recommended Change to Annuity Default Options in DC Plans**

We believe that certain requirements must prevail if a default type arrangement is to be a requirement. Unmarried participants would receive a Life with a refund or could opt out to a Life Only until a final opt out election at age 70 ½. At 70 ½ the participant could also elect a Life Only benefit. Similarly, married participants would receive a Joint & Survivor 100% with a refund and could opt out at a final election age of 70 ½ of the participant. The J&S would have a minimum 50% spouse benefit and would require spousal consent with or without a refund, and spousal consent would be required to elect a single Life Only benefit at attainment by the participant of age 70 ½. We believe that any annuitized balance arrangement must provide protections for spouse, beneficiaries and heirs. Since refund pricing is the most modest form of insurance for account balance protection, and a default annuity could be temporary, a refund annuity should become the automatic annuity form.

After retirement, but before age 70 ½, in the event that the annuity form was to be changed to Life Only or Joint & Survivor, or at any time after the first beginning date and before a final opt in date, that each the participant and affected spouse, if any, would be required to provide an appropriate acknowledgment and waiver for any change to the plan. This may allow for a phased approach up to the point of a final opt in or opt out date. We do not know whether a phased approach with incremental irrevocable steps would suffice.

The same type of arrangement could be implemented within Money Purchase plans or IRA Rollover Annuity plans with similar waivers for affected parties. In this fashion, participants would be encouraged to discuss, analyze, and educate themselves more about the lifetime income risks and differences between account balances and insured income planning. This would also result in developing a basis for standards through which professionals could potentially become more proficient in retirement income planning with immediate annuities.

**All or Nothing vs. Phase in Plans**

Currently, the decision to elect or purchase an insured income plan is driven by a desire to make arrangements at retirement. Certainly, a DB plan annuity election is important in that regard. DB plans are “all or nothing” when there is a lump sum available. We have had experience with some DB plans that allow for some lump sums in a modest amount, i.e., \$10-25,000. The “all or nothing” option in DC plans could be supplanted with a partial or phased arrangement.

## **12. How should participants determine what portion (if any) of their account balance to annuitize? Should that portion be based on basic or necessary expenses in retirement?**

### **Personal Choice and Needs Based**

This is an individualized retirement income planning issue that must be assessed by the participant, their spouse, if any, and with assistance from the benefit department of the administrators or plan sponsors, and through consultation with their professional tax and financial advisors. We believe that it is vital to reinforce the concept of the replacement income as the first priority. This should be demonstrated with the use of an annuity to so that the cost to provide for budgeted necessities, as a first priority, is clearly defined and understood by both the participants and advisors. This is different from targeting a retirement account balance, which may or may not provide the required level of replacement income needed during retirement.

We also believe that there should be required disclosures when a decision is made to take a lump sum or to implement a systematic withdrawal from an account balance plan. This would allow for an assessment of annuitization. As account balances fluctuate, an update to annuitization alternatives might be welcomed. We are not aware of any disclaimers or disclosures required about annuitization for balance withdrawal plans. There is a need to continuously provide participants and their advisors with a comparison between the cost to provide an annuitized income stream and a withdrawal plan.

As an example, if a couple needs \$1,000 per month in addition to Social Security and pension, then the cost for an annuity plan should be provided for a Joint & Survivor 100% Annuity plan with and without CPI increase. If the cost for this is greater than the funds available to commit, then perhaps the retirement plan needs to be redesigned and a different annuity plan would be required in order to secure the needed income. Some personal planning issues would be reviewed and possible changes made to meet objectives. Perhaps the DB pension could be deferred. It is also possible that a forecast for higher interest rates (which underlie annuity pricing) would allow for better annuity pricing within a reasonable time horizon.

### **QAS' Observations**

It is QAS' view that many subtle dynamics about the workings of lifetime-based annuities are not well understood within the retirement income planning and advisory market. There is a critical need for more education and objective analysis which could assure that appropriate retirement income planning standards are established. Historically lifetime-based annuities have been appreciated by many workers and the recent economic turmoil serves to reaffirm this in the minds of many. There are millions of workers who are happy to know that their retirement income is provided by a defined benefit plan. It is unfortunate that the financial solvency of DB plans has now created some degree of concern for retirement security.

## **13. Should some form of lifetime income distribution option be required for defined**

**contribution plans (in addition to money purchase pension plans)? If so, should that option be the default distribution option, and should it apply to the entire account balance? To what extent would such a requirement encourage or discourage plan sponsorship?**

We believe that such a default lifetime annuity income option should be provided for defined contribution plans. In general, it makes sense to do so. We do not believe the ability to opt in or out will not affect sponsorship. There will be considerable debate around this approach. Many other countries have established default income annuity plans at retirement. Some even require mandatory or at least partially mandatory annuitization of account balances. However, there could be significant push back from the public if such arrangements are deemed to be intrusive.

The ability to opt out should be clearly and objectively communicated. The availability of a DB pension might be considered in determining mandates or default provisions. A participant who receives Social Security, DB pension and has a 401(k) is not in the same situation as a participant who expects to receive Social Security and has accumulated minimal 401(k) or other plan assets for retirement. If those individuals do not have a retirement income security plan that provides a baseline replacement income, then perhaps some retirement income annuity default provision would be appropriate.

### **QAS' Observations to Questions 11, 12, and 13** **Financial Selection**

There could be resistance by providers to temporary or opt out arrangements if a default annuitization has an opt out provision in the future. The inherent risks include:

- 1) adverse financial selection - annuitants who accept the default option may later choose to reposition the assets with more attractively priced competitors at final opt out. This places the provider in the dilemma of how to price the terms of such offers. If the annuity is a temporary plan, it may lack attractive pricing. Such an arrangement might create a disintermediation risk if an annuity price is offered by the provider at NRD and interest rates are much higher at the point of final opt out.
- 2) ERISA double jeopardy - plan sponsors may feel on one hand that if a participant chooses a different provider at a final opt out, that this exposes them to extended ERISA liability in spite of the "safe harbor" while on the other hand potentially having some oversight as the credit worthiness of a provider some time into the future. Some DB plans chose providers who failed which led to the purchase of back up annuities or double jeopardy.
- 3) anti selection - annuitants who opt out may do so because they are aware or suspect that their personal health may be changing; this anti selection would likely affect annuity pricing negatively as the awareness factors for longevities and the potential for selection becomes more prevalent. This process continues to erode the objective of providing a longevity solution against a vicious cycle of making offerings so appealing by design that all the value in longevity pricing is lost.

**14. What are the impediments to plan sponsors' including lifetime income options in their plans, e.g., 401(k) or other qualification rules, other federal or state laws, cost, potential liability, concern about counter party risk, complexity of products, lack of participant demand?**

**Defined Contribution Plan-Based Impediments**

**ERISA Liability**

There is likely to be some skepticism by plan sponsors due to limited experience with the relevant rules surrounding the implications of ERISA fiduciary responsibility with offering annuity options. Some may view that mandates for annuities as troubling or invasive to the benefits approach or philosophy. Some companies may feel that their existing plans are “just fine, thank you.” QAS also reiterates the need to define if a “clean break” is established between the plan sponsor and any participant when a commercial lifetime annuity plan commences. It is also important to understand whether any in-plan partial annuitization or phased annuitization establishes a continuation of ERISA liability after such a selection.

Annuity requirements, though somewhat understood, are uncharted territory for many if not most plan sponsors. The standard for selecting the “safest available annuity” in DB plans was defined in IB 95-1 and later limited in scope to DB plans<sup>18</sup>. However, a Fifth circuit Court decision, *Bussian v. R.J.R. Nabisco*, the court held that the appropriate standard is through the more crucial process of applying ERISA’s standards for procedural prudence. In a critical and important essay, Messrs. Joseph B. Bellersen, Jr. and Alfred A. Turco, Esq. articulated the application of ERISA “procedural prudence” as the appropriate standard under ERISA per *Bussian* for DB plans.<sup>19</sup> QAS has modified its DB approach to accommodate the DC plan market.

**Norris Unisex Ruling**

The *Norris Unisex*<sup>20</sup> ruling held that each a male and female participant should be provided with the same annuity income from an account balance plan in which planned contributions were to provide an annuity at retirement. Some insurers have responded by adopting unisex-based rates. If lifetime annuities are to become a significant part of retirement income planning, this ruling must be reviewed. Gender-based mortality is irrelevant for DB plans since the plan sponsor pays the cost. The pension earned, whether for a male or female, is the same, assuming all other things are equal.

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<sup>18</sup>29 CFR 2509.95-1

<sup>19</sup>**Bussian v. RJR Nabisco, Inc.** 223 F. 3d 286 (5<sup>th</sup> Cir. 2000) [“Bussian”]

<sup>20</sup>796 F2d 1119 *Norris v. Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans* State of Arizona, August 11, 1986 (“Norris”)

In DC plans, a female receives a subsidy rate based upon a presumption of unisex mortality. In truth, many providers simply price unisex plans using female rates whether the annuitant is a male or a female gender annuitant rather than adopt actual unisex pricing. This arbitrary tariff is levied upon the male and nullifies the impact of Norris. This creates another method of fairness not envisioned: males are short changed from access to gender-based annuity pricing which lowers the benefits to annuitization. Males, given the option, may not participate in such DC plans and may be better served by transferring their balances to an IRA Rollover Annuity plan if more competitive rates are available. This leaves the insurers with a choice: 1) continue to provide a bonus to females and risk losing male mortality annuitants, or 2) reprice the unisex rates to closely match female rates in order to correct the problem with gender selection invoked by Norris. Either way, a subsidy has been provided and tariffs assessed.

### **State Guaranty Coverages**

At the present time, information from the National Organization of Life Health Guaranty Associations (“NOLHGA”) indicates a wide disparity of coverages for present value of annuities. The coverage currently in effect ranges from a low of \$100,000 to a high of \$500,000.<sup>21</sup> Currently there is a restriction from agents using the state guaranty coverage to promote the sale of any annuity or insurance product. Yet IB 95-1 advises plan fiduciaries to be fully aware of such coverages. We believe that participants must be given information about risks, including protections available in the event of an insurer failure. This will serve to provide more confidence with the private assurance system that is in place. As an example, an annuitant who retires from a plan with an account balance of \$500,000 in the state of Washington (which provides \$500,000 present value of annuity coverage) with the intention of moving to a warmer climate such as Arizona, would want to know that Arizona provides \$100,000 in present value of annuity coverage at this time.<sup>22</sup> Individuals may be advised to arrange for multiple lifetime immediate annuity plans in those instances when account balances exceed their applicable state guaranty coverage limits. There is no other protection scheme available at this time. It would also be the duty of any service professional to be aware of and to consider those factors in any recommendation regarding such an irrevocable commitment.

### **State Premium Tax on Annuities**

At one time many states imposed a tax on annuity premiums collected at annuitization. This applies to both individual and group annuity plans. Most states have abolished such taxes. This is not likely to discourage annuitization in a few remaining states.

### **Lack of Demand**

If there is a weakness, it is this: lack of demand. We identified significant market impediments in our responses to Qs 1 and 2. Having cited this, we are compelled to reiterate that there is a severe prejudice toward lump sum distributions from DB plans without regard whatsoever for

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<sup>21</sup> State Benefit Limits - tables compiled by QAS from NOLHGA

<sup>22</sup> Source: Liability limits: National Organization of Life Health Guaranty Associations (“NOLHGA”)

any fair assessment or accountability for the values of lifetime-based income security provided by those plans. It is crucial to provide more information in regard to the risk of long term income security and the role that immediate lifetime annuities play. The financial service community has failed the process of objectively meeting client needs and, as noted, actively promoted trading out of lifetime retirement income security for equity risk taking.

**15. What are the advantages and disadvantages of approaches that combine annuities with other products (reverse mortgages, long term care insurance), and how prevalent are these combined products in the marketplace?**

**Advantages**

The advent of PPA introduced funding solutions for funding Qualified Long Term Care insurance. Annuity withdrawals meeting certain conditions for payment of such LTC costs are excluded from income tax to the extent that the withdrawal would otherwise be taxable. We believe that combining such arrangements with lifetime annuity plans may be good policy. However, each such approach must be considered with due regard to overall objectives, including more means-based testing.

The use of individual immediate annuity or SPIA products to fund IRA Rollover Annuities allows for additional alternative product like features to be included. We noted the availability of a 50% increase in monthly annuity income when annuitants are confined to a nursing home facility. More experience with these types of features could expand the reach of an insured retirement income solution, including these supplemental benefit features. Note: individualized underwriting flexibility is available in individual SPIA plans and absent in group annuity plans.

There are strong arguments for and against individual SPIA mortality and selection. Underwritten SPIAs allow for an increase in benefits if an individual should be eligible due to health conditions. Enhanced SPIAs are not yet adopted within the US while they account for nearly 25% market share in the UK.<sup>23</sup> Enhanced annuities are offered in other European countries. This approach is lost within a group annuity mortality setting as group pricing assumes broad population segment participation and low risk for anti selection.

**16. Are there differences across demographic groups (for example men vs. women) that should be considered and reflected in any retirement security program? Can adjustments for any differences be made within existing statutory authority?**

We already discussed the implication in of Norris decision in Q 14. We strongly encourage a review due to the disruptive pricing using a unisex blend. Applying Norris requirements for the

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<sup>23</sup> “Enhanced annuity sales fall marginally - market share maintained”, December 15, 2009, Towers Watson

Unisex mortality results in a subsidy for females which is provided at the expense of males. While the court noted that it is unclear whether a particular male or female age 65 will live the longest, it is actuarial science which has determined that the female gender will survive longer than a male. We believe that sex distinct mortality should apply in DC plans. We also note that when commercial annuities are purchased, a male and female gender are ultimately combined in determining a benefit for a Joint & Survivor plan, the most likely plan to be adopted by a married couple at retirement.

It is important to clarify whether gender-based mortality should apply in those plans where a participant chooses a deferred annuity plan as part of their choices. We understand the need for equitable treatment and fairness. If a defined benefit plan provides a promised benefit, that benefit is not gender dependent.

We believe that Norris Unisex decision precludes access to otherwise competitive group annuity mortality pricing. We acknowledge that unisex-based calculations are used for systematic withdrawals of account balances. However, the choice to annuitize is a personal choice based upon personal circumstances weighed by the individual. This is further supported by the fact that not all participants are married and have a spouse that would benefit from a Joint & Survivor benefit. We reiterate that there is no difference in defining a contribution for a male or female worker of the same age and earning the same income. While an account balance for each may be projected to be the same at a future normal retirement, actuarial science has determined that a male is not likely to survive the female thereafter. This is not discriminatory; it is actuarial science.

## **PARTICIPANT EDUCATION**

**17. What information (e.g., fees, risks, etc.) do plan participants need to make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement? When and how (i.e., in what form) should it be provided? What information currently is provided to participants, who typically provides it, and when and how is it provided to them?**

### **Risks**

#### **Longevity**

Although not mentioned, we believe that longevity risk should be weighed against the retirement income needs of the participant. At the present time, it may seem unwise to purchase a commercial annuity due to current historically low interest rates. This argument can be persuasive when one believes in the possibilities for very high interest rates in the future. This decision alone has a tremendous impact upon the financial security of a participant.

### **Fees and Disclosures**

It is important to evaluate fees, loads and expenses for products offered in the market. We

believe that all fees, compensation, commissions, and related costs should be disclosed to a participant in dealing with their plan assets. It may be difficult to assess or evaluate the costs of various products within the annuity market which may contain complex options and conditional riders. QAS believes that methods of assessing such fees and expenses aside, the best available pricing could be secured in terms of obvious numbers. When joint annuitants, refund provision, CPI, and GPI options are included, the dynamics of the proposition change dramatically. The easiest method for evaluating elements of “insurance” is to quantify the economic value of any such annuity plan. QAS’ proprietary modeling tools: The Bellersen Curve<sup>®</sup> provides relevant information. While a difference in absolute numbers may seem modest, the economic cost can be extracted with The Bellersen Curve to serve as a measurement device.<sup>24</sup> A baseline analysis could easily be compared to arrangements having other features. The relative change in economic value could easily be weighed against a baseline option.

### **Participant Education**

Participants must be encouraged to look at lifetime income plans as insured income arrangements. In this regard, we believe that the entire profile of the potential annuitant must be understood. For example, an annuitant who comes from family of long-lived descendants may be ideally suited for such longevity protection. An annuitant who has smoked or may have had health concerns at an early age, or comes from a family with a history of such occurrences, is likely to be a candidate for a lifetime income plan that has, at a minimum, a refund feature associated with the plan. This conclusion would change if the annuitant has minimal personal assets and is likely to rely solely on the annuity for their retirement income.

### **18. Is there a need for guidance, regulatory or otherwise, regarding the extent to which plan assets can be used to pay for providing information to help participants make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement, either via an in-plan or out-of plan option?**

We believe that a significant effort should be made to educate all parties involved in the decision process. In some regard, this might come within the scope of benefits communications once standards are established. Lack of education stems in part from the decline in the use of DB plans as a means of providing retirement income security. The problem rests with a lack of understanding as to longevity, secure returns, and adequate understanding regarding the long term costs of providing a secure retirement income for life. QAS has developed a robust set of tools to achieve those goals. These tools interface with quotation systems and asset planning systems. However, as noted, the financial incentive for professional advisors lies with gathering the distributions and managing the account balance during retirement. The positive merit to a

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<sup>24</sup>QAS has developed proprietary approaches to measure and assess relative value of annuities. Among them is The Bellersen Curve<sup>®</sup> which is a graphical plot of the Internal Rate of Return for an annuity and allows the use of any actuarial assumptions or basis in plotting the results.

lifetime immediate annuity plan is muted.

### **QAS' Recommendation for Required Disclosure**

We believe that a required disclosure approach would be an appropriate first step. Such a required disclosure would include various factors to be weighed by a participant, spouse, and other advisors at retirement. A required disclosure could also be an important first step in establishing oversight to the participant advisory process and create some accountability for communicating the longevity risks of retirement. Such a disclosure would establish baseline minimum costs for achieving certain levels of retirement income security. That baseline process would include a personally designed retirement income assessment in terms of current annuity plans. It would entail a comprehensive survey, including information about the retiree and spouse prospects for longevity. This baseline cost would be compared to available retirement fund assets and sources of income. The baseline would determine the extent to which the retiree has endowed their retirement. This means that the assets can be positioned in dividend paying stocks and coupon bonds without market risk to provide sufficient retirement income. An “at risk” retirement is dependent upon a scenario forecast that assets would need to grow in order to assure that all future retirement income. This process would be evaluated yearly after retirement. The process should be linked to real annuitization costs whether in-plan based or out-of-plan based so that the differences are measured, understood, and evaluated.

### **19. What specific legal concerns do plan sponsors have about educating participants as to the advantages and disadvantages of lifetime income or other arrangements designed to provide a stream of income after retirement? What actions, regulatory or otherwise, could the Agencies take to address such concerns?**

We view this concern similar to Q. 17 since it important to encourage retirement income planning in general. Some of this falls into a plan sponsor's domain as its fiduciary capacity under ERISA in offering retirement income plans generally. We reiterate the need for defining when a separation of responsibility has occurred between a plan and its participants.

### **Disinherited Legacy Interests**

We have stated our concerns that the concept of disinherited beneficiaries may pose a significant hurdle for many plan sponsors. We also reiterate that QAS' recommended approach for annuity options cited in Q. 11 could substantially mitigate this risk.

### **20. To what extent should plans be encouraged to provide or promote education about the advantages and disadvantages of lifetime annuities or similar lifetime income products, and what guidance would be helpful to accomplish this?**

It is paramount that plan sponsors, professional advisors, plan benefits personnel understand the use of the lifetime income annuity proposition. We can appreciate magnitude of that task given

that the number of private sector DB plans has dwindled to less than 29,000. We believe tools such as The Bellersen Curve® can have profound impact upon understanding the use and benefit of lifetime income annuity plans.

QAS has worked exhaustively to develop tools which are designed to present various operational aspects to lifetime income plans. The tools allow for an in depth analysis of annuity offerings and are designed to create intuitive approaches to planning and implementing a lifetime income annuity plan. It is QAS' belief that there is a need for professional training and educational materials which could help overcome the obstacles associated with grasping the concepts of lifetime annuity planning. At the present time, such educational tools and processes are lacking. It is also necessary to build upon experiences for defining best practices for professionals serving critical needs that affect so many retirees.

### **DISCLOSING THE INCOME STREAM THAT CAN BE PROVIDED FROM AN ACCOUNT BALANCE**

#### **21. Should an individual benefit statement present the participant's accrued benefits as a lifetime income stream of payments in addition to presenting the benefits as an account balance?**

Yes. The careful assessment of a retirement income plan includes the convergence of two powerful risks and forces that are inherent in planning for a future income:

- 1) mortality or life expectancy - we understand that longevity is increasing; however few acknowledge how it impacts annuity costs, such as lifetime-based annuities
- 2) interest rates - which constantly change and can materially impact the amount of income available for a lifetime, especially when incomes could have been locked in at rates in excess of 8.00% or more for life.<sup>25</sup>

The convergence of mortality and interest forces drive compelling arguments for understanding that there are significant price movements over time. The QAS' Annuity Price Index historical comparison provides a view to the disparities in lifetime immediate annuity rates between group versus individual programs. See Appendix III - QAS' Annuity Price Index.

During the past two decades, interest declined from historical highs. Immediate annuity prices are continuously getting higher. It costs more to buy \$1 of income than it did 10 years ago. Most, but not all, of this price movement is interest rates. If an individual were to understand the potential long term interest rate trends, their ability to plan periodic purchasers of minimum income tranches would help to secure their lifetime retirement income needs.

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<sup>25</sup> See "The Bellersen Curve®" within Appendix II "How Immediate Annuities Work" for a rate applicable in 1998

The use of a forward account balance or implied economic value of an annuity can provide a material component of information which would be helpful in meeting two needs:

- 1) provide a value from which to provide information for planning distributions from other accounts such as IRA Rollover and other DC account balances
- 2) provide information to that effectively quantifies the value of an annuity
- 3) provide a rational means of assessing the changed in value over time resulting from a) advanced age and b) changes either up or down in the interest rates to illustrate a value in periods of rising and falling interest rates

### **QAS' Recommendation for Valuing Lifetime Annuity Plans**

We believe that lifetime annuity benefits should be presented as an Economic Value of Annuity ("EVA"). We believe this is entirely consistent with DB plan protocols applicable to retiree populations and would be easily communicated. Such a valuation is currently based upon the Federal Mid Term rates for discounting and valuing irrevocable IRA Annuities when an individual maintains IRA Rollover accounts as well. Such IRA Annuity values are combined with other IRA accounts to determine Required Minimum Distributions.

Certain disclaimers as to the determination of this value would be needed. However, the present worth of the future benefits would be communicated in a way that provides tangible information about the continued value of the immediate annuity plan, particularly throughout a long lifetime as well as throughout volatile interest markets. We believe that the actual valuation for distributions should be fixed as of the date of commencement of an annuity rather than the current revaluation method which would potentially affect the withdrawal rates, particularly in times of extremely low interest rates. There is no reason that a valuation calculation could not be communicated in current market terms.

**22. If the answer to question 21 is yes, how should a lifetime stream of income payments be expressed on the benefit statement? For example, should payments be expressed as if they are to begin immediately or at specified retirement ages? Should benefit amounts be projected to a future retirement age based on the assumption of continued contributions? Should lifetime income payments be expressed in the form of monthly or annual payments? Should lifetime income payments of a married participant be expressed as a single-life annuity payable to the participant or a joint and survivor-type annuity, or both?**

QAS believes that a benefit statement should express the conversion of the account balance into a standardized set of lifetime annuity options. We believe that the baseline income should be expressed as a Life or Joint & Survivor with a refund. The earliest date for displaying the lifetime income plan would be the early retirement date under the plan. At a minimum, dates could be bracketed in five year segments. Key dates would be the individual's NRD under the plan, age 59 ½ and age 70 ½ at a minimum. It may be very beneficial to include all dates beginning with early retirement through age 70 ½. We also believe that income could be

expressed monthly and annually depending on principles established for the methods of overall presentation. Such a presentation should include the income replacement amount provided with the annuity expressed as a percent of current income. It would be helpful, though not necessary, to include a forecast of salary and cost of living. We believe that a snapshot approach will serve a useful step in communicating the individual status.

For example, if the lifetime annuity plan provides \$1 monthly at age 65 and the annuity factor is \$150 the monthly value may easily be converted to an annual amount of \$12. The benefit can be based upon an Accrued Balance at an assumed rate and a Projected Balance assuming continued contributions. We believe that it would be useful to express lifetime income in terms of both Single Life and J&S 100%. As noted, we believe that automatic options should be cash or installment refund annuity plans.

### **QAS' Proposed Disclaimer**

A sample of such a disclaimer form of communication could provide:

“Lifetime annuity options are based upon mortality, which reflects trends in life expectancy, interest, and expenses, which are not guaranteed and may vary over time until an annuity option plan is put into effect. Once a fixed annuity plan is put into effect, it is generally irrevocable. The amount you choose to annuitize, the option you select, and the provision for spouse continuation in part or in full, may affect the ultimate income available from any such plan. You should consult with your professional advisors in determining the option that is most suitable for meeting your needs.”

**23. If the answer to question 21 is yes, what actuarial or other assumptions (e.g., mortality, interest, etc.) would be needed in order to state accrued benefits as a lifetime stream of payments? If benefit payments are to commence at some date in the future, what interest rates (e.g., deferred insurance annuity rates) and other assumptions should be applied? Should an expense load be reflected? Are there any authoritative tools or sources (online or otherwise) that plans should or could use for conversion purposes, or would the plan need to hire an actuary? Should caveats be required so that participants understand that lifetime income payments are merely estimates for illustrative purposes? Should the assumptions underlying the presentation of accrued benefits as a lifetime income stream of payments be disclosed to participants? Should the assumptions used to convert accounts into a lifetime stream of income payments be dictated by regulation, or should the Department issue assumptions that plan sponsors could rely upon as safe harbors?**

Many of the tools necessary to communicate values and benefit amounts are currently available in the market. However, we believe that there is a need to adopt a broad market index like QAS' Annuity Price Index or its derivatives such as The Bellersen Curve ®. It is important to illustrate the value and maintain reference points for such a vital part of this process. Having clear and

definitive methods for establishing valuations is an important step in crafting useful tools for use by the professional community and provides more meaningful information to participants.

It is important to note that such indices would be representative of executable transactions in the market and not theoretical formulas which may not be realized. Dynamic tools provide information, communicate opportunities and drives transactions.

For those reasons cited above, we are strongly opposed to the establishment of a Department-based conversion system. We believe that there is no need for such a system. Such a system creates an abstract value which has no relevance in a real market based pricing system. We believe that a Department-based conversion system would only serve to add confusion to an already complex process of understanding the personal choice implications about one's own retirement income planning needs. Market based pricing is relevant, meets informational needs, and is useful in terms of communicating about planning opportunities. Most important, market-based conversions can be transacted, implemented, and realized. We do not believe that it is helpful to establish an unrealistic or unattainable process which provides theoretical pricing while market forces will in the end determine actual benefits to be received.

### **Safe Harbor**

We do not believe it is necessary to establish "safe harbor" confines to a commercial market. The market will define itself upon financial and economic conditions. It may be helpful to distinguish between guaranteed conversion pricing and indicative or projected pricing. Although future longevity impacts lifetime annuity pricing, interest rate volatility is most relevant. Perhaps this could change: a cure for cancer or heart disease, diabetes or hyper tension could send annuity prices soaring, meaning that it might cost substantially more in the future to purchase \$1 of monthly benefit. We believe that it is crucial now to be able to communicate in relevant terms to all interested parties: plan sponsors, administrators, professionals, and participants. QAS tools are intended to reach this goal.

**24. Should an individual benefit statement include an income replacement ratio (e.g., the percentage of working income an individual would need to maintain his or her pre-retirement standard of living)? If so, what methodology should be used to establish such a ratio, such as pre-retirement and post-retirement inflation assumptions, and what are the impediments for plans to present the ratio in a meaningful way to participants on an individualized basis?**

Yes. See responses to Q. 21, 22, and 23.

We began our comments with the statement that a DB plan is supposed to provide a replacement income at retirement. We see important reasons for continuing that approach. QAS believes that including a replacement income ratio within statements crucial to gaining relevant understanding about the risks of lifetime retirement income and the features inherent with

lifetime income annuity plans. It is important to establish a baseline income system and then to explore features and benefits such as inflation protection or nursing home riders. The use of an inflation factor will help participants to understand the risks to retirement income. An important analogy may be made to the CPI component within Social Security which provides some inflation protection. The application of a CPI risk component makes good sense. The development of a baseline risk profile for securing future income needs is essential. Building platforms to communicate these benefits and allow for the implementation of such options is essential.

### **401(k) AND OTHER PLAN QUALIFICATION RULES**

#### **25. How do the 401(k) or other plan qualification rules affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income? Are there changes to those rules that could or should be made to encourage lifetime income without add prejudice to other important policy objectives?**

There should be minimal impact with existing rules and qualification requirements. The policy objectives should be to amend DC plans to require that a lifetime-based annuity plan be the default Normal Form of distribution from these plans. In this manner, the lifetime annuity plan option would become a central focus at issue as people begin to review their retirement security needs. As a matter of policy, we also believe that DB annuity plans should be permitted to become annuity only plans by allowing for the elimination of lump sum distributions as an “alternate form of an annuity.” We believe that this will ultimately better serve the retirement income needs of participants. As noted, EBRI found the annuity option to be the most advantageous in providing retirement income security for participants.<sup>26</sup>

We believe that it is crucial to require mandatory disclosure as noted in responses to Q. 18. By requiring some relevant disclosure, we believe that both advisors and participants will be compelled to review annuity plans in an objective manner. We note again that there is no fee earned by an advisor to recommend accepting an annuity from a DB plan instead of the lump sum, if it is available. The interests of the advisors are not aligned with participants. It is this lack of objective advice in the retirement income space which is the problem to begin with. Unless this is corrected, advisors will continue to recommend taking lump sums and swinging for the fence.

#### **26. Could or should any changes be made to the rules relating to qualified joint and survivor annuities and spousal consents to encourage the use of lifetime income without compromising spousal protections?**

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<sup>26</sup> “The Decline of Private-Sector Defined Benefit Promises and Annuity Payments: What Will It Mean?, p.2” Employee Benefit Research Institute, Notes: July, 2004, Vol. 25, No. 7

Yes. See responses to Q. 11 - **QAS' Recommended Change to Annuity Default Options**

We strongly encourage the adoption of the changes as outlined in Q. 11. At a minimum, there should be a mandate for either an Installment or Cash Refund Annuity option as the required form of an annuity in DC plans. The use of a spousal waiver in the event of the election of a Single Life Only or Single File with Refund is a necessary component and will serve to promote appropriate scrutiny to the individual circumstances facing the retiree or retiree and/or spouse. We believe that the implementation of such rules could be implemented without materially affecting or compromising participants or spouses whatsoever regarding appropriate protections. Plans should be required to adopt a multitude of optional forms to meet potential needs of the market.

**27. Should further guidance clarify the application of the qualified joint and survivor annuity rules or other plan qualification rules to arrangements in which deferred in-plan insurance annuities accumulate over time with increasing plan contributions and earnings?**

We believe that it should be mandatory to provide to include spousal allocations of benefits for married participants. At a minimum these plans should illustrate the implications of changes in interest rates and contributions over time and reflect this for the participant and spouse. We believe that the necessary systems to provide this information in many instances are already in place or could be easily adapted to meet this need.

**28. How do the required minimum distribution rules affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income? Are there changes to those rules that could or should be made to encourage lifetime income without prejudice to other important policy objectives? In particular, how are deferred annuities that begin at an advanced age (sometimes referred to as longevity insurance) affected by these rules? Are there changes to the rules that could or should be considered to encourage such arrangements?**

We believe that the RMD rules should be changed to allow for the exclusion from calculation of any individual account balance plan that for its part meets the requirements for a lifetime annuity plan. This would apply to individual and group annuity pricing and would also apply to variable annuitization. We believe that the current inclusion of IRA Annuity plans and other account balance lifetime annuities creates a complex set of administrative burdens. We do not believe that administration systems are fully capable of providing for these needs. We agree that the use of longevity-based annuity plans as a fall back or fail safe mechanism does make sense and that reasonable rules and guidelines could be established for use.

**QAS' Recommendation Regarding Changes to RMD Rules**

We believe individuals who decide to pool their lifetime risk in a lifetime annuity plan should be

afforded some administrative relief. We do not believe that such changes in reporting requirements would be considered prejudicial. We believe that simplification here is noteworthy. In this regard, lifetime-based annuities would be allowed to satisfy the RMD requirements in the first year only in the case of a single participant and for the initial year and subsequently in the year of death of either a participant, spouse or beneficiary. The suspension of continuous RMD rules would be permitted for qualifying annuity plans which would be defined.

Special rules should be adopted to allow for the purchase of a longevity annuity plan. Such rules would consider current and future RMD requirements and would permit limited suspension of RMD rules until the commencement date of such a longevity plan. The longevity annuity plan would be required to meet certain guidelines to retain its explicit longevity function. This could mean the elimination of deferred cash, surrender or death benefit values for remainder or legacy interests as a condition for suspending continuous RMD testing. A deferred spouse income benefit would be preserved. Again, event triggers involving any other lifetime party to the contract would require reevaluations at the time of death and later at the time of income commencement.

There would be some permitted use of contingent risk assumption in the plans such as the inclusion of a CPI indexation component or a nursing home confinement rider which would trigger earlier payments for a deferred longevity annuity plan.

**29. Are employers that sponsor both defined benefit and defined contribution plans allowing participants to use their defined contribution plan lump sum payout to “purchase” lifetime income from the defined benefit plan? Could or should any actions be taken to facilitate such arrangements? Should plans be encouraged to permit retirees who previously took lump sums to be given the option of rolling it back to their former employer's plan in order to receive annuity or other lifetime benefits?**

This is a significant issue. It is not currently a common practice to accept the purchase of an annuity with a DC balance in those instances in which a plan sponsor maintains a DB plan as well. We also believe that plan sponsors may resist the expansion of balance sheet risk by the inclusion of a transfer from a DC plan to a DB plan. It is necessary to understand the basis for the assumption of adding more risk to the remaining DB plan mechanism. Some plan sponsors may believe that offering their DB plan as a conversion system could serve a number of purposes. However, we would be surprised if a number of DB plans would actually permit such arbitrary increases in balance sheet risks.

We also believe it is important to underscore important opportunities within this concept. Such an arrangement would need to be defined for purposes of PBGC coverages, considerations as to how this would affect participants differently, and the extent of protections needed to eliminate interest arbitrage. Given the current views toward DB plans, we do not understand how this

concept would work. We also question the intent of this concept. We can agree that consideration could be given to allow account balances withdrawn from a DB plan to be reapplied, although the chances for disintermediation risk would potentially increase dramatically.

We agree that allowing for a return of lump sum distributions might seem attractive. But how would one determine the amount to be returned? Would this potentially be an unlimited “put” upon the plan? We believe clarity is needed and purpose is required.

### **QAS’ Opinion**

We believe we must pause to ask these questions:

- 1) Why have DB plans been permitted to be come cash bonus plans?
- 2) If DB plans are cash bonus plans, then why expend efforts on making DC plans income replacement plans?

There seems to be inherent contradiction with regard to the retirement income policy. This is a paradox. The point is this:

*Should DB plans also be revisited at least in respect to policy as a part of this initiative?*

We believe that it is necessary to revisit certain regulatory and legislative matters in order that ERISA actually “protect” worker pensions. Maintaining private sector DB plans is a necessary first step in this direction.

*Unless the Congress acts to actually correct the massive regulatory framework of ERISA and PPA, we believe this will result in failed objectives and further alienate and aggravate an already serious systemic retirement income problem.*

### **SELECTION OF ANNUITY PROVIDER**

#### **30. To what extent do fiduciaries currently use the safe harbor under 29 CFR 2550.404a-4 when selecting annuity providers for the purpose of making benefit distributions?**

QAS does not believe that 29 CFR 2550.404a-4 has yet been adequately defined or adopted through a discipline by many DC plans. We believe that the inherent limited use of annuities in DC plans has caused this to be the case. It may also reflect a belief that if an annuity provider is administering the DC plan, that such a provider would likely satisfy the safe harbor requirements. Unfortunately, this view is supported by the limited adoption if annuitization in these DC plans thereby diminishing its consequence. It could be that many DC plans have been serviced by a particular provider and having that historical relationship is satisfactory to the

sponsor. We believe that any expanded scope of availability of such lifetime annuity information within DC plans may cause a shift in the sponsor's view toward more fully addressing the matter.

**31. To what extent could or should the Department of Labor make changes to the safe harbor under 29 CFR 2550.404a-4 to increase its usage without compromising important participant protections? What are those changes and why should they be made?**

We believe that the purpose of 404a-4 was to bring some clarity to the process for selecting an annuity provider within the DC space. Previous guidance likely created more questions. We believe that 404a-4 was potentially crafted without regard to deferred annuity accumulation plans. The safe harbor does not address the need for a definitive separation of responsibility which may continue with a phased annuity purchase arrangement. We note that a phased annuity purchase approach retains a potential monitoring function. The safe harbor could also facilitate an adoption of the ERISA requirements for diversification if implemented correctly for annuities.

It is reasonable to conclude that DC plan sponsors may be perceived to have continuous duties and responsibilities even after an irrevocable annuity commitment has been made. There may be some who believe that if an annuity provider were to default, that some plan fiduciary culpability would apply. This creates an instance for perceived double jeopardy. We also believe that if phased annuitization takes hold, DC plan fiduciary risks would continue for some time. In the DB space, a plan sponsor can extinguish its responsibilities to participants through the purchase of annuities. The subtle difference in DC plans is the possible continuation of benefit service and administration while effectively having transferred the fixed annuity obligations to an insurer. Combining a partial annuitization with additional account balances may be viewed as a singular relationship which would cause the entire process, inclusive of annuitization, to be subjected to ERISA for purposes of fiduciary responsibility far into the future. Finally, we note that the longevity annuity plan could also fail far into the future leaving a participant with no income resources. Thus, long dated financial solvency would become a matter of concern.

**32. To what extent could or should the safe harbor under 29 CFR 2550.404a-4 be extended beyond distribution annuities to cover other lifetime annuities or similar lifetime income products? To which products should or could the safe harbor be extended?**

We wish to clarify that lifetime-based annuities are the focus point of our comments. Retaining an account balance within a deferred annuity plan in an IRA Rollover does not establish an irrevocable commitment to an annuity purchase. A systematic withdrawal of amounts within a deferred annuity account balance contract is not a form of annuitization nor is it a lifetime risk transfer. As such, we recommend that the rules be established that focus upon true or real lifetime based immediate annuity plans where longevity risk transfer is actually achieved.

It is likely that deferred locked or longevity annuity plans should fall into this category. It may be necessary for deferred accumulation products to be included in the scope of 404a-4. These arrangements usually provide for a surrender and transfer to another provider prior to annuitization. At the same time, if a participant chooses to accumulate significant balances into such arrangement, then we wonder if this might pose other considerations as ERISA plan assets. The accumulation of large deferred or immediate lifetime annuity balances may come under scrutiny for purposes of satisfying ERISA's requirements for diversification. Since this is a relatively new view, it should be given considerable attention and the principles of diversification might weigh heavily

### **ERISA SECTION 404(c)**

**33. To what extent are fixed deferred lifetime annuities (i.e., incremental or accumulating annuity arrangements) or similar lifetime income products currently used as investment alternatives under ERISA 404(c) plans? Are they typically used as core investment alternatives (alternatives intended to satisfy the broad range of investments requirement in 29 CFR 2550.404c-1) or non-core investment alternatives? What are the advantages and disadvantages of such products to participants? What information typically is disclosed to the participant, in what form, and when? To what extent could or should the ERISA 404(c) regulation be amended to encourage use of these products?**

We have no relevant information on this question.

**34. To what extent do ERISA 404(c) plans currently provide lifetime income through variable annuity contracts or similar lifetime income products? What are the advantages and disadvantages of such products to participants? What information about the annuity feature typically is disclosed to the participant, in what form, and when? To what extent could or should the ERISA 404(c) regulation be amended to encourage use of these products?**

We have no relevant information on this question.

### **QAS' Observations**

We note that immediate variable annuity plans are supported by an underlying separate account of invested assets. As such, IVAs would actually provide a level of protection beyond state guarantee funds which are intended to protect the guarantees or fixed immediate annuity plans. That portion of an IVA which is allocated into a guaranteed income would be eligible for such state guarantee fund coverage. That portion of a deferred VA or an IVA allocated among separate accounts should be fully protected. We say "should" because we do not know either the method or the extent of protection limits for IVAs which might suffer from significant mortality losses. This must be examined in depth. However, it may supply an advantage to utilizing

immediate variable annuity plans.

### **QUALIFIED DEFAULT INVESTMENT ALTERNATIVES**

**35. To what extent are plans using default investment alternatives that include guarantees or similar lifetime income features ancillary to the investment fund, product or model portfolio, such as a target maturity fund product that contains a guarantee of minimum lifetime income? What are the most common features currently in use? Are there actions, regulatory or otherwise, the Agencies could or should take to encourage use of these lifetime income features in connection with qualified default investment alternatives?**

We have no relevant information on this question.

### **COMMENTS REGARDING ECONOMIC ANALYSIS, REGULATORY FLEXIBILITY ACT, AND PAPERWORK REDUCTION ACT**

**36. What are the costs and benefits to a plan sponsor of offering lifetime annuities or similar lifetime income products as an in-plan option? Please quantify if possible.**

We have summary comments on this question. We believe that the analysis presented regarding the pricing differentials in the QAS' Annuity Price Index available from a group annuity arrangement versus an individual annuity arrangement is compelling and speaks for the advantage of group pricing. This is offset by the implications from the Norris unisex decision. There are also many opportunities afforded in individually designed SPIA space with regard to optional triggers. It is also important to note the lack of an enhanced annuity market in the US, whereas it represents nearly 25% of market share in the UK.

**37. Are there unique costs to small plans that impede their ability to offer lifetime annuities or similar lifetime income products as an in-plan option to their participants? What special consideration, if any, is needed for these small entities?**

Yes. At this time there are a number of infrastructure requirements and compliance issues relating to product offerings which may place some burdens upon the small plan marketplace. For example, if a requirement is established to provide a broad range of options from a broad range of providers, the need for some consistency between a plan based and non plan annuity options and product offerings must be overcome. Small plans may find it a burden to comply with yet another set of mandates or ranges of options which require administrative attention and great detail.

**38. Would making a lifetime annuity or other lifetime income product the default form of benefit payment have an impact on employee contribution rates? If so, in which direction and why?**

We do not believe that the introduction of a lifetime-based annuity plan default option would have a material affect upon the contribution or participation in DC plans. Money purchase plans may not be popular in design. However, we do not expect that there is resistance to MP plans by participants. There may be a preference for choice of investments in 401(k) plans. This difference might serve as a form a competition in the benefit space. Plan sponsors who do not sponsor DB plans are likely to support change of this type.

**39. For plans that offer lifetime annuities or similar lifetime income products, what percentage of eligible workers elect to annuitize at least some of their retirement assets and what percentage elect to annuitize all of their assets?**

We have experienced approximately 90-95% lump sum distribution elections as opposed to annuities when DB plans terminate. We believe that this number would be higher or worse for DC plans.

## CONCLUSIONS

We have attempted to provide our Observations, Conclusions and Recommendations within this document. We have indicated some very elementary reasons for the lack of the use of immediate annuities within and outside of DB and DC plans. We continue to believe that significant work must be done to correct the perceptions and processes within the financial services industry. This must begin with fundamental change in the form of education. Even then, it is important to find a means of overcoming the obstacle of compensation for advice that is not objective. It is also paramount that an insurance function which is yet perceived as an investment opportunity, must actually be transferred to another party, the insurers, who are licensed and capable of taking the systemic longevity risks of the retiree population.

The tools needed to educate both retiree and advisor already exist. They are not readily available due to marketplace resistance. FINRA does not even mention the term “immediate annuity” in its regulatory resources nor does it acknowledge the reol of immediate annuities in retirement income planning.

The Bellersen Curve ® is a tool which illustrates the ever increasing IRR in a lifetime immediate annuity. Although no one knows their exact life expectancy, the IRR continues to grow without any performance except continued survival.

Defined Contribution annuity options can be robust and can provide for some legacy needs.



However, immediate annuities were never intended as wealth building vehicles while deferred annuities did so.

Everyone wants to be the master of their own universe. Societal retirement income risk is born by everyone. Promoting and maintaining the private sector risk sharing solutions may require some acceptance that not everyone will make just the right market calls nor will everyone live to a ripe old age of 100. There are differences in decisions that we make and opportunities in our lives.

Insurance is a good thing in principle. It's a necessary part of the solution and cannot be designed nor can it function so that everyone wins a retirement endowment fortune. The cost would be prohibitive.

Sincerely,  
*Qualified Annuity Services, Inc.*



Joseph B. Bellersen, Jr.  
President

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## **Appendix I**



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## *Qualified Annuity Services, Inc.*

### GUIDE TO

## **IMMEDIATE ANNUITY TERMS, DEFINITIONS AND OPTIONS**

### **IMMEDIATE ANNUITY TERMS:**

**SINGLE PREMIUM IMMEDIATE ANNUITY** - A series of periodic payments that commence on a specified date.

**ANNUITY OWNER** - May be an individual, corporation, estate or trust. The annuity owner names the payee, annuitant and beneficiary. The annuity owner may also be designated as a third-party payee.

**ANNUITANT** - Must be an individual on whose life the annuity payments are based. The Annuitant may be the Payee and may have the right to receive periodic payments according to the option selected.

**SURVIVOR OR CO-ANNUITANT** - The individual designated by the owner to receive payments after the primary annuitant's death.

**PAYEE** - The individual or entity designated by the Annuity Owner to receive the income for the option selected.

**BENEFICIARY** - The individual or entity that has the right to receive payments if the Annuitant or Payee dies during the any period certain.

**ANNUITY COMMENCEMENT DATE** - The date income payments begin.

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## **IMMEDIATE ANNUITY PAYOUT OPTIONS**

**SINGLE LIFE ANNUITY** - This annuity provides periodic payments starting on the annuity commencement date and continuing for life. The Single Life Annuity provides the largest periodic payment, but does not provide benefits after the annuitant's death.

**Example:**

If the annuitant dies just a few months after the annuity commencement date, no further payments would be made to anyone. A Single Life Annuity is ideal for maximizing income from accumulated assets during a remaining life. A Single Life Annuity is usually appropriate for someone who has no dependents relying on future income from these annuity payments.

**LIFE ANNUITY WITH PERIOD CERTAIN** - This annuity provides periodic payments that continue for the annuitant's life, but with a guaranteed minimum number of payments (e.g., 60, 120, or 180). A Life Annuity with 10 Year Period Certain provides at least 120 monthly payments if death occurs before the minimum number of payments is made.

**Example:**

A Life Annuity with 10 Year Period Certain will provide at least 120 monthly payments whether or not the annuitant is living. If death occurs before 120 monthly payments have been received by the annuitant, the periodic monthly payments will continue to the designated beneficiary until the specified number of payments has been received. This annuity option provides a guarantee for beneficiaries when the annuitant is interested in providing a remainder interest at death. Generally, a longer the Period Certain guarantee results in lower annuity payments.

**LIFE ANNUITY WITH CASH REFUND** - This annuity provides periodic payments commencing at the annuity commencement date and continuing for the life of the annuitant. If the total periodic payments received during the annuitant's life is less than the amount invested, the difference is paid in a single lump sum to a designated beneficiary.

**Example:**

If an annuitant purchases a \$100,000 Life Annuity With Cash Refund and death occurs after periodic payments have totaled \$60,000, the balance of \$40,000 would be payable to a designated beneficiary in a single lump sum.



**LIFE ANNUITY WITH INSTALLMENT REFUND** - This annuity provides periodic payments commencing at the annuity commencement date and continuing for life. If during the annuitant's life the total periodic payments received is less than the amount invested, the difference is paid in periodic installments to a designated beneficiary.

**Example:**

If an annuitant purchases a \$100,000 Life Annuity With Installment Refund and death occurs after periodic payments have totaled \$35,000, the balance of \$65,000 would be payable to a designated beneficiary in installments in the same amount that was being paid to the annuitant. A Life Annuity With Installment Refund is generally purchased when an annuitant wants the highest annuity income and also desires to assure the best chance for getting a "money's worth" annuity. This option provides beneficiaries with a remainder interest equal to the premium less what was received by the annuitant.

**TEMPORARY LIFE ANNUITY** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the shorter of the life of the annuitant or a specified period of time (e.g. 15 years). A temporary life annuity for 15 years will guarantee payments for the 15 years, so long as the annuitant is living, but a not longer than 15 years.

**Example:**

If an annuitant purchases a \$1,000.00 monthly Temporary Life Annuity, the payments begin immediately. If the annuitant dies prior to the end of the Term, the annuity ceases; it also ceases if the annuitant is alive at the end of the Term.

**JOINT AND SURVIVOR LIFE ANNUITY** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the annuitant's life and, upon the death of the primary annuitant first, for the life of a joint or survivor annuitant. It provides that upon the death of the primary annuitant, the secondary annuitant will receive a designated percentage (such as 100%, 75%, 66 $\frac{2}{3}$ %, or 50%) of the current payment for the rest of their life as the survivor. Upon the death of the joint annuitant, payments cease.

*(Note: This annuity option reduces upon the death of primary annuitant only, and not upon the death of the secondary annuitant.)*

**Example:**

This option is particularly useful when the primary annuitant wants to assure that payments will continue for as long as the primary annuitant lives and at death the annuity will continue to the designated joint or survivor annuitant. The secondary annuitant will receive the amount designated to continue for their life, such as 100%, 75%, 66 $\frac{2}{3}$ %, or 50%. The amount of the periodic payment under this option is less than under a Single Life Annuity. Payment amounts depend on the age of the both the primary annuitant and the designated secondary annuitant and the reduction percentage selected.



**JOINT AND SURVIVOR LIFE ANNUITY WITH PERIOD CERTAIN** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the annuitant's life and, upon the death of the primary annuitant first, for the life of a joint or survivor annuitant. It provides a percentage of payments (such as 100%, 75%, 66⅔%, or 50%) to a designated secondary annuitant for life. A Joint and Survivor Life Annuity with 10 Year Period Certain also provides that if the death of the primary annuitant and secondary annuitant occurs before the designated period certain has elapsed, then the periodic payments will continue to the designated beneficiary for the remaining period certain, such as 10 years. Periodic payments are made for at least 10 years from the annuity start date.

*(Note: This annuity option reduces upon the death of primary annuitant only, and not upon the death of the secondary annuitant.)*

**Example:**

This option is useful when beneficiaries are being considered in overall long-term planning involving retirement assets, accumulated wealth, and planning for the future income needs of a primary annuitant who may become incapacitated, and when a spouse is not expected to be able to handle their own financial affairs. This option would result in a reduction in the periodic payment amount when compared to the amount available under the Joint and Survivor Life Annuity. This option also provides some security for beneficiaries if both the primary annuitant and secondary annuitant die before the designated period certain has elapsed. The Period Certain portion of the annuity allows for the continuation of benefits to the designated beneficiary until all of Periodic Certain payments have been received.

**JOINT AND SURVIVOR LIFE ANNUITY WITH CASH REFUND** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the annuitant's life and, upon the death of the primary annuitant first, for the life of a joint or survivor annuitant. It provides a percentage of payments (such as 100%, 75%, 66⅔%, or 50%) to a designated secondary annuitant for life. A Joint and Survivor Life Annuity with Cash Refund also provides that if the death of the primary annuitant and secondary annuitant occurs before the total periodic payments received during both their lives is less than the amount invested, the difference is paid in a single lump sum to a designated beneficiary.

*(Note: This annuity option reduces upon the death of primary annuitant only, and not upon the death of the secondary annuitant.)*

**Example:**

This option is useful when the primary objective is to plan for a income for life for joint annuitants and beneficiaries are being considered in overall long-term plan. This option would result in a reduction in the periodic payment amount when compared to the amount available under the Joint and Survivor Life Annuity. This option also provides security for beneficiaries if both the primary and secondary annuitant die before payments equal to the premium have been received. The Cash Refund portion of the annuity would provide a refund in a lump sum to beneficiaries.



**JOINT AND SURVIVOR LIFE ANNUITY WITH INSTALLMENT REFUND** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the annuitant's life and, upon the death of the primary annuitant first, for the life of a joint or survivor annuitant. It provides a percentage of payments (such as 100%, 75%, 66 $\frac{2}{3}$ %, or 50%) to a designated secondary annuitant for life. A Joint and Survivor Life Annuity with Installment Refund also provides that if the death of the primary annuitant and secondary annuitant occurs before the total periodic payments received during both their lives is less than the amount invested, the difference is paid in the same installment amount to a designated beneficiary.

*(Note: This annuity option reduces upon the death of primary annuitant only, and not upon the death of the secondary annuitant.)*

**Example:**

This option is useful when the primary objective is to plan for a income for life for joint annuitants and beneficiaries are being considered in overall long-term plan. This option would result in a reduction in the periodic payment amount when compared to the amount available under the Joint and Survivor Life Annuity. This option also provides security for beneficiaries if both the primary and secondary annuitant die before payments equal to the premium have been received. The Installment Refund portion of the annuity would provide a refund in installments to beneficiaries.

**JOINT AND CONTINGENT LIFE ANNUITY** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the either annuitant's life and, upon the first death of either the annuitant, the continuation of payments for the life of the contingent annuitant. It provides that upon the death of either a primary or secondary annuitant, the contingent annuitant will receive a designated percentage (such as 100%, 75%, 66 $\frac{2}{3}$ %, or 50%) of the current payment for the rest of their life. Upon the death of the contingent annuitant, payments cease.

*(Note: This annuity option reduces upon the first death of either the primary annuitant or the secondary, or contingent, annuitant.)*

**Example:**

This option is useful when beneficiaries are being considered in overall long-term plan involving retirement assets, accumulated wealth, and planning for the future needs of a spouse who is unable to handle their own financial affairs. This option is useful when an adjustment in the amount continuing upon first death is consistent with the likely decrease in maintaining a life style of one annuitant versus two. This option provides a slightly higher initial periodic payment because the percentage reduction can occur upon the first death of either the primary or secondary annuitant.



**JOINT AND CONTINGENT LIFE ANNUITY WITH PERIOD CERTAIN** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the either annuitant's life and, upon the first death of either the annuitant, the continuation of payments for the life of the contingent annuitant. It provides that upon the death of either a primary or secondary annuitant, the contingent annuitant will receive a designated percentage (such as 100%, 75%, 66 $\frac{2}{3}$ %, or 50%) of the current payment for the rest of their life. A Joint and Contingent Life Annuity with 10 Year Period Certain also provides that if the death of the primary annuitant and contingent, or secondary, annuitant occurs before the designated period certain has elapsed, then the periodic payments will continue to the designated beneficiary for the remaining period certain, such as 10 years. Periodic payments are made for at least 10 years from the annuity start date.

*(Note: This annuity option reduces upon the death of primary annuitant only, and not upon the death of the secondary annuitant.)*

**Example:**

This option is useful when beneficiaries are being considered in overall long-term plan involving retirement assets, accumulated wealth, and planning for the future needs of a spouse who is unable to handle their own financial affairs. This option is useful when an adjustment in the amount continuing upon first death is consistent with the likely decrease in maintaining a life style of one annuitant versus two. This option provides a slightly lower initial periodic payment when compared to the amount available under the Joint and Contingent Life Annuity. If the death of both annuitants occurs prior to the designated period, the beneficiary receives payments for the balance of the remaining period certain.

**JOINT AND CONTINGENT LIFE ANNUITY WITH CASH REFUND** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the either annuitant's life and, upon the first death of either the annuitant, the continuation of payments for the life of the contingent annuitant. It provides that upon the death of either a primary or secondary annuitant, the contingent annuitant will receive a designated percentage (such as 100%, 75%, 66 $\frac{2}{3}$ %, or 50%) of the current payment for the rest of their life. A Joint and Contingent Life Annuity with Cash Refund also provides that if the death of the primary annuitant and secondary annuitant occurs before the total periodic payments received during both their lives is less than the amount invested, the difference is paid in a single lump sum to a designated beneficiary.

*(Note: This annuity option reduces upon the death of primary annuitant only, and not upon the death of the secondary annuitant.)*

**Example:**

This option is useful when the primary objective is planning for lifetime income of joint annuitants while considering beneficiaries in overall long-term plan. This option would result in a reduction in the periodic payment amount when compared to the amount available under the Joint and Contingent Life Annuity. This option also provides security for beneficiaries if both the primary and secondary annuitant die before payments equal to the premium have been received. The Cash Refund portion would provide a refund in a lump sum to beneficiaries.



**JOINT AND CONTINGENT LIFE ANNUITY WITH INSTALLMENT REFUND** - This annuity provides periodic payments beginning on the annuity commencement date and continuing for the either annuitant's life and, upon the first death of either the annuitant, the continuation of payments for the life of the contingent annuitant. It provides that upon the death of either a primary or secondary annuitant, the contingent annuitant will receive a designated percentage (such as 100%, 75%, 66⅔%, or 50%) of the current payment for the rest of their life. A Joint and Contingent Life Annuity with Installment Refund also provides that if the death of the primary annuitant and secondary annuitant occurs before the total periodic payments received during both their lives is less than the amount invested, the difference is paid in the same installment amount to a designated beneficiary.

*(Note: This annuity option reduces upon the death of primary annuitant only, and not upon the death of the secondary annuitant.)*

**Example:**

This option is useful when the primary objective is to plan for a income for life for joint annuitants and beneficiaries are being considered in overall long-term plan. This option would result in a reduction in the periodic payment amount when compared to the amount available under the Joint and Contingent Life Annuity. This option also provides security for beneficiaries if both the primary and secondary annuitant die before payments equal to the premium have been received. The Installment Refund portion of the annuity would provide a refund in installments to beneficiaries.

**TERM CERTAIN ANNUITY** - This annuity provides periodic payments from the commencement date and continuing for a pre-determined period or number of payments.

**Example:**

This option is useful when a known income stream is needed, when filling in a gap between other sources of income which will start at a future date, when designing a wealth transfer program, or when annuitizing deferred annuity balances. It is also useful to assure that values in an estate will be appropriately managed for beneficiaries as a means of spend thrift protection.



## **ENHANCEMENTS AVAILABLE TO IMMEDIATE ANNUITIES**

**RATED AGE ANNUITY** - This annuity will provide an increased income for a qualifying annuitant by decreasing the standard life expectancy with proper medical documentation provided by the annuitant. This enhancement may be appropriate for individuals diagnosed with terminal or chronic illnesses. Suitability becomes more relevant in these cases.

**CONSUMER PRICE INDEX BENEFIT - CPI** - This option allows for a benefit to increase based upon a published index, such as the Consumer Prices Index which is maintained by the Department of Labor, Bureau of Labor Statics. Such a provisions would allow for a pension income or annuity benefit to increase in accordance with the index. The plan can provide either an annual increase from the original base income or compound the result over time.

**GUARANTEED PERCENT INCREASE BENEFIT - GPI** - This option allows for payments to increase on an annual or compound annual basis. This option must be elected at the time of purchase and typically allows for increases between 1% and 12%. An annual increase would provide for the beginning amount to be continuously increased annually, however not on a compound basis. A three percent increase per year of a \$1,000 monthly benefit (\$12,000 annualized) would provide an increase to \$1030 monthly. The second year benefit would be \$1,060 since the percent is from the original base of \$1,000. This is non compounding plan. A compounding increase would provide a second year monthly benefit of \$1,060.90 and continue to compound over time.

**NOT-TRANSFERABLE PROVISION** - This rider states that the annuity cannot be sold, assigned, borrowed against or used as collateral for a loan. A popular option for Medicaid eligibility planning.

**NON -ASSIGNABLE PROVISION** - This provision is required for any annuity arrangement which is being used to fund either a pension, profit sharing, or IRA account. It prohibits the annuity plan from being converted to cash as a settlement. It is intended to provide a protection against the value of the annuity being received and taxed at once. The annuity income or proceeds from a qualified plan have never been subject to tax. The rider alerts any party to this and protects the amount from being considered in “constructive receipt” and thus fully taxable when available.

**COMMUTATION PROVISION** - This provision is available either at the purchase as a contractual right or most often at the death of the annuitant. It allows for limited acceleration of benefits. When contractual, an allowance may be charged for the exercise of the provision; or, when discretionary, it is generally at the option of the provider when requested by the annuitant or, in most cases a beneficiary who has rights to guaranteed remaining certain benefits.

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## **Appendix II**



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*Qualified Annuity Services, Inc.*

GUIDE TO

# HOW IMMEDIATE ANNUITIES WORK

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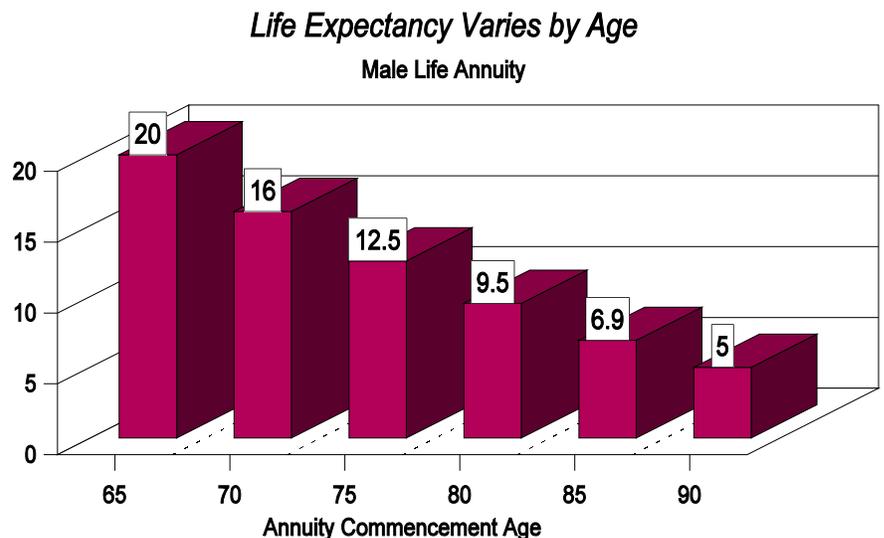
## Life Expectancy Varies by Age

As people grow older, their life expectancy decreases. This becomes an important factor in evaluating different retirement income strategies. Retirees must deal with income planning needs that may require capital to be depleted in order to maintain life styles or to satisfy continuing income needs in later years. Age (and remaining life expectancy) become crucial factors as a part of retirement income planning and may result in wealth depletion over time. Other factors are material in developing a sound retirement income plan: sources of income, health, historical family longevity, interest rates, and the desires for leaving wealth to offspring.

A number of income resources are available to retirees: defined benefit pension, 401(k) balances, IRA and IRA Rollover accounts, and personal savings. The sources of retirement income are just as important as other factors and become a vital part of determining which income options to select and how to structure them. Guaranteed retirement income is arranged through a commercial annuity known as a Single Premium Immediate Annuity (“SPIA”) plan.

When evaluating needs for lifetime income, a key factor is understanding life expectancy. As a person ages, careful consideration must be given to relevant economic and personal factors. Purchasing a lifetime income annuity is based upon actuarial tables. If an insurer (or a pension plan) knows from its actuarial tables that an annuitant who is age 70 will live for 16 more years, it must price the income (payout) for that annuitant differently (more conservatively) than for an annuitant who is only expected to live 12.5 more years. The Male age 70 will be expected to receive payments for 3.5 more years than a 75 year old Male purchasing an income annuity at the same time. That is why the income quoted is lower for a 70 year old than for a 75 year old.

*A Male or Female age 70 is expected to live for 16 more years to age 86, however, a Male or Female age 75 with a 12.5 year life expectancy is expected to live to age 87.5<sup>1</sup> (Table V Ordinary Life Annuity - Expected Return Multiple)*



**Takeaway: Life expectancy decreases, but at a decreasing rate.**

<sup>1</sup> IRS Table V Ordinary Life Annuity - Expected Return Multiple

## **Income Differs by Age of Purchaser**

The amount of income available to an annuitant is based upon a number of factors: mortality, (life expectancy), interest and expenses. The age of that annuitant at the time of purchase weighs heavily, however high versus low interest rates make a significant difference as well.

A Male age 70 will receive an income for life of approximately \$936 monthly, whereas a Male age 85 will begin receiving over \$1416 per month. (This assumes the same option: Life Only and premium tendered: \$100,000.) As noted in the previous illustration, the insurer uses actuarial tables to determine the life expectancy of an annuitant. If the annuitant will receive income payments for a longer time, the insurer must return a smaller portion of principal to the annuitant with each payment because there are likely to be more payments to that annuitant.

This fundamental difference in pricing is based strictly upon the actuarial tables maintained by the insurer. If a lifetime annuity is purchased and the annuitant outlives life expectancy, the insurer is required to continue payments for as long as that person lives. This is the "insurance" aspect of Single Premium Immediate Annuities that pay for the lifetime of the annuitant.

*This chart illustrates the difference in the amount of monthly income by age of purchaser for the same investment of \$100,000 and for the same Life Only option.*

**Male Age:** 70, 75, 80, 85  
**Initial Investment:** \$100,000  
**Base Option:** Life Annuity

Deciding when to start a lifetime based annuity is not always clear. However, consider this: "...the annual number of deaths in the US dropped by 50,000 in 2004, the biggest decline in nearly 70 years."<sup>2</sup> U.S. Population based upon year of birth mortality has improved:

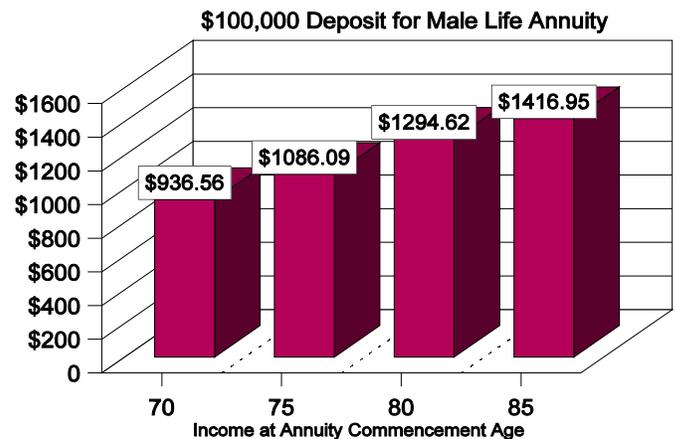
2000: 76.9 yrs\*\*\* +2.9 in 6 yrs<sup>3</sup>

2004: 78.0 years\* +1.1 in 4 yrs<sup>4</sup>

If you are 70 today, by the time you reach age 80, things will change: most importantly interest rates and mortality.

**Takeaway: You can only be one age at one time.**

**Income Differs by Age of Purchaser**



<sup>2</sup>National Center for Health Statistics - April 19, 2006

<sup>3</sup>Centers for Disease Control

<sup>4</sup>National Center for Health Statistics - April 19, 2006

## **Income Differs by Option**

Each option available to an annuitant has elements of "insurance" coverage. In meeting income planning needs with SPIAs, the estate and beneficiary requirements of the annuitant need to be considered. Each annuity option is designed to fulfill different needs of the annuitant. Since these needs vary greatly, the goal is to evaluate the various options, and then, based upon those individual requirements, select a suitable annuity option for that set of circumstances. SPIAs were never intended to be tools for creating or leaving wealth. However, some legacy or inheritance wants can be met with refund or money back options.

Cash refund annuities make sense if the beneficiary has the ability to manage assets or there is a desire plan to transfer some assets to beneficiaries. Period certain guarantees are used when a beneficiary can benefit from a remainder portion of the annuity but the beneficiary may not be able to manage assets on their own. If married, an annuitant usually might consider using joint and survivor annuity option which pay to either annuitant as long as one is living.

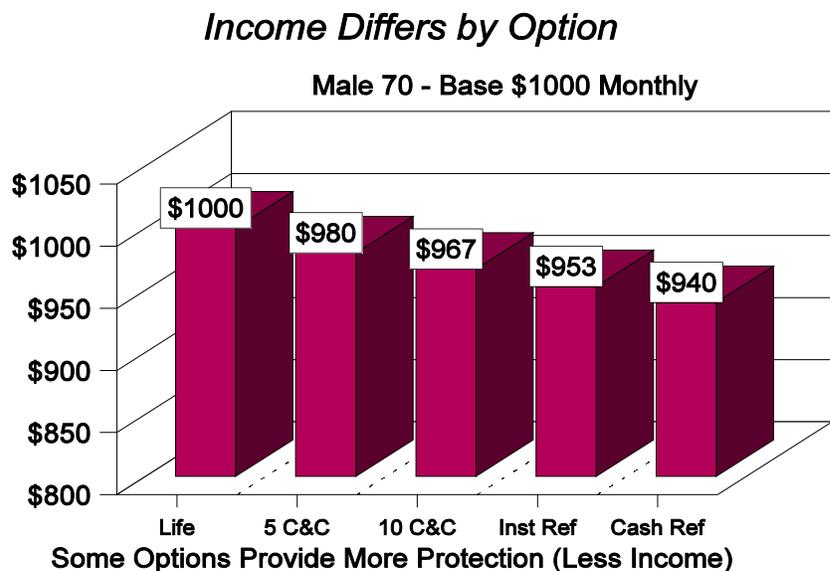
*This chart illustrates the difference in annuity income for a particular individual annuitant Male age 70. Based upon different payout options available, providing more protection will result in a lower income at commencement date. The assumptions used in this example are:*

**Male Age: 70**  
**Base Income: \$1000**  
**Base Option: Life Annuity**

It is important to consider longevity or health of the proposed annuitant. If the annuitant comes from a line of long lived family members, then there could be an advantage to considering lifetime based annuities for meeting retirement income needs. For the same reason, some life insurers are now offering to evaluate health conditions in order to provide a greater income for some individuals who may have a shortened life expectancy. This reinforces the insurance function of a lifetime based annuity plan.

SPIAs or lifetime income annuities are not intended to create or provide for wealth or an estate. The primary purpose is to insure or assure, that an income will never be outlived.

***Takeaway: Lifetime based income annuities are insurance plans, not investments.***



### *The Upside to Immediate Annuities*

THE BELLERSEN CURVE®<sup>5</sup> is a proprietary approach to evaluating the long term Internal Rate of Return (IRR) of lifetime annuities. It computes IRR from the commencement date and plots the result usually to age 100. The IRR at life expectancy is easily determined for any annuity plan being contemplated or previously purchased. This illustrates the economic benefit to Single Premium Immediate Annuities that pay for life. THE BELLERSEN CURVE® graphically illustrates the phenomenon of the ever increasing IRR of lifetime annuities without any performance requirements whatsoever, other than continued survival of course.

*In this example, THE BELLERSEN CURVE® is based upon a Male age 75 purchasing a Life Annuity.*

*The chart shows that the IRR is approximately 8.34% at life expectancy.*

*The factors used are:*

***Life expectancy:***

***12.5 years***

***Monthly Income:***

***\$1101***

***Initial Investment:***

***\$100,000***

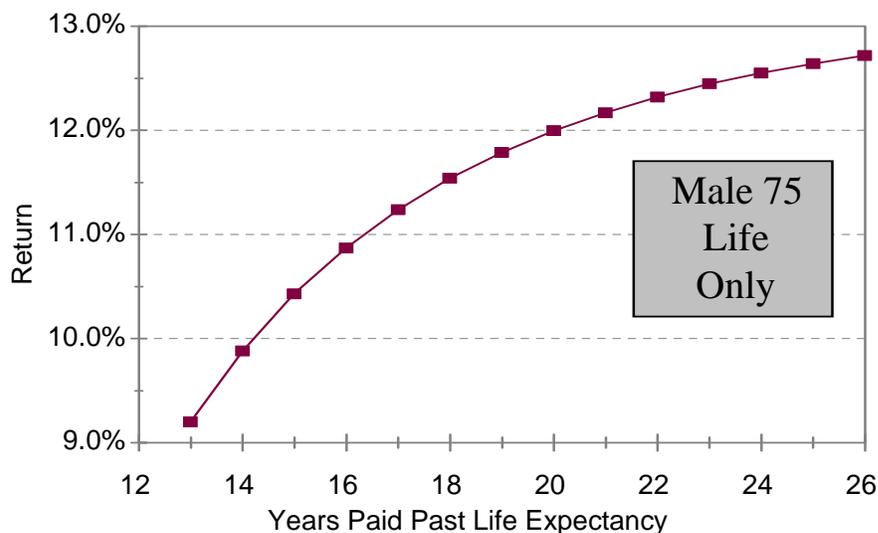
*This example shows how the IRR continues to increase every year. Thus, as the annuitant survives, the IRR is higher. By*

*living just one year longer than life expectancy measured from the annuity beginning date, the IRR has increased from 8.34% to 9.20%. As the annuitant continues to survive, the IRR continues to increase, but at a decreasing rate.*

*The economic value of a lifetime annuity can only be fully measured if the annuitant's life expectancy is known. Of course, this is impossible to determine in advance. THE BELLERSEN CURVE® graphically evaluates the "insurance" aspect of such an annuity by measuring the IRR throughout life. The possibility for greater IRR based upon a longer life may be of interest to some individuals when considering the purchase of a life annuity. The IRR measured in THE BELLERSEN CURVE® is for illustrative purposes only. THE BELLERSEN CURVE® is not meant to provide any reference to guarantees or future values of any policy or contract.*

***Takeaway: IRR increases for every year of future life.***

**THE BELLERSEN CURVE sm**  
Internal Rate of Return



<sup>5</sup> THE BELLERSEN CURVE® was designed and developed by Joseph B. Bellersen, Jr., President of Qualified Annuity Services Agency, Inc.

***Principal is Recovered Over Time***

This chart is designed to illustrate how a Single Premium Immediate Annuity provides a systematic repayment of the original premium paid for a contract. It graphically depicts the amount and term over which the recovery of principal is made. The assumptions used are:

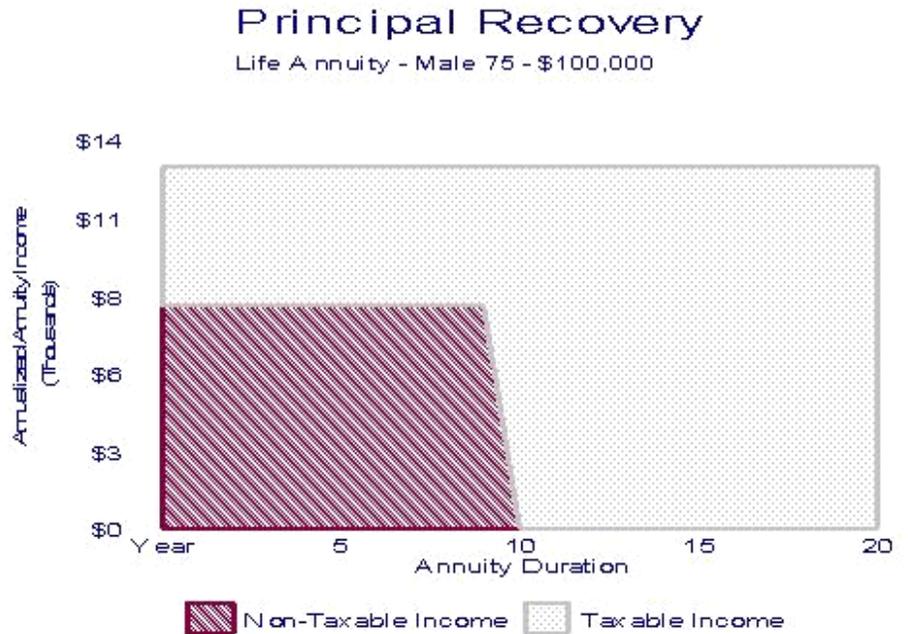
**Male age:**  
75

**Option:**  
Life Annuity

**Initial Investment:**  
\$100,000

**Life Expectancy:**  
12.5 years

*This illustration shows that an amount of each payment received by the annuitant is a return of principal.*



***Recovery of Basis***

In the case of qualified plan, the recovery of basis is somewhat irrelevant as all amounts are taxed. In personal plans, basis is recovered over life expectancy which is measured from the date of commencement of the annuity benefit. Basis is recovered tax free in non qualified plans.

***High Cash Flow***

The amount of annual cash flow received from a lifetime annuity plan is much higher than stock dividends or coupons from bonds. Stock dividends are the same for a male age 65 or a female age 80. However, income from lifetime annuity plans is based on the individual's gender, date of birth, and other factors. So, prices, or annuity benefits, will vary as will the rate of recovery of original premium.

***High Withdrawal Rate - Based Upon Age - Gender - Health***

It is important to note that based upon a life expectancy of 20 years at age 65, an immediate annuity plan provides 5% per year in withdrawal with no investment downside risk. Also note that the withdrawal rate for an annuitant is based upon age, gender, and even health in some instances. An individual who has a life expectancy of 10 years will recover (withdraw) 10% per year, whereas an individual who is expected to live for 20 years will recover (withdraw) 5% per year. Age is withdrawal leverage embedded in an immediate annuity.

***Takeaway:***

***Recovery (withdrawal rate) is determined by expected future life at the date of purchase.***



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## **Appendix III**



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*Qualified Annuity Services, Inc.*

GUIDE TO

# QAS' ANNUITY PRICE INDEX

<http://qualifiedannuity.com>

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## **QAS Annuity Price Index**

The QAS Annuity Price Index illustrates the pricing levels for various immediate annuity offerings. Over the course of time, the factors affecting immediate annuities, i.e. morality, interest and expenses, will change.

### **Price Differentials**

It is most likely that interest reserve requirements and available market rates for investments will drive pricing dynamics more than mortality. There is no question that individual annuity pricing loads, which include individual commission loads, are not nearly as attractive as group annuity pricing arrangements. Group annuity pricing arrangements are generally structured without commissions. (Note: insurers will provide commission load quotations in the group annuity market upon request by licensed agents, brokers and other financial representatives.)

Pricing patterns for immediate annuities change over time. Differences may arise as providers continuously re-balance their investment portfolios, respond to changing interest rates, and implement refinements to mortality tables as life expectancy changes. Price differences are driven by a host of market forces. Decisions may be based upon organic business growth objectives, economic factors during recessionary times, and a multitude of other conditions. This may cause providers to withdraw from markets or product lines, including the issuance of commercial lifetime based annuity plans. For example, some providers were more heavily weighted with investments in the financial services sector. Financial company failures caused significant counter party risk and liquidity concerns. Some providers reduced financial sector investments which may have resulted in pricing changes during the liquidity crises in 2008.

### **Group vs. Individual Pricing**

Group annuity pricing is very sensitive to changes in interest rates over time. Modest swings in interest rates during a given day or week can result in a change in pricing. Individual immediate annuity pricing is usually determined monthly, subject to change at any time.

### **Market Transactions**

individual SPIA quotes are usually priced so that they can be honored for up to a week or, in some instances, for up to 30 days from the date of issuance. Group annuity quotes are usually priced for acceptance of up to a two weeks, however, they can also be priced using daily rates. Pricing patterns for both individual and group include compensation for the time allowed for acceptance of such quotations, even for a day.

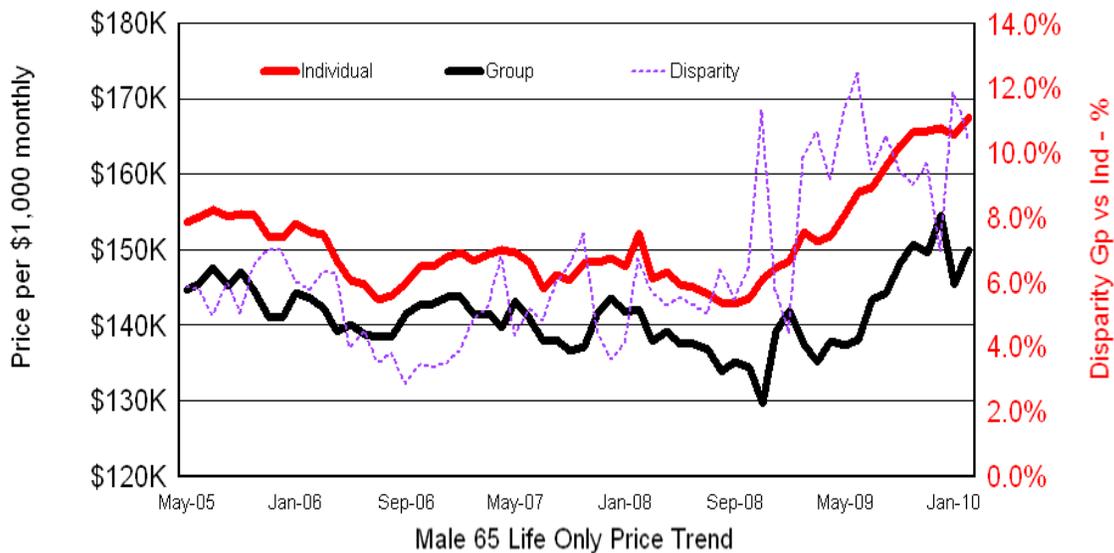
The pattern of pricing sensitivity for individual SPIAs has changed over time. One factor in the individual SPIA business is 1035 like kind exchanges which are usually processed by a surrendering provider within 60 days. The SPIA provider may offer to issue on the better of a rate basis as of the application date or upon receipt of the funds exchanged subject to the 60 day maximum. This accommodation assists in facilitating a smooth transition for 1035 exchanges. A trustee to trustee transfer usually occurs much more quickly, such as from an IRA Account to an IRA Rollover Annuity and similarly with a plan based trustee to IRA Annuity plan.

## Price Disparity Differs by Age

There are number of factors which impact price disparity between group and individual products. These charts provide some insight to the dynamics of the market. The greatest disparities occur during periods of market disruption and at year end. It appears that group annuity pricing is much more attractive for a purchase made at plan level instead of as an individual. The reasons for this clear: group annuity pricing generally excludes commissions and sales loads. We believe that this market is dynamic and periods of time when there may be perceptions as to changes in interest rates and for annuity reserves in an upcoming business year. Insurers attempt to compensate for such rate conditions which are determined each July 1.

### QAS' Male 65 Annuity Price Index

#### Group vs. Individual



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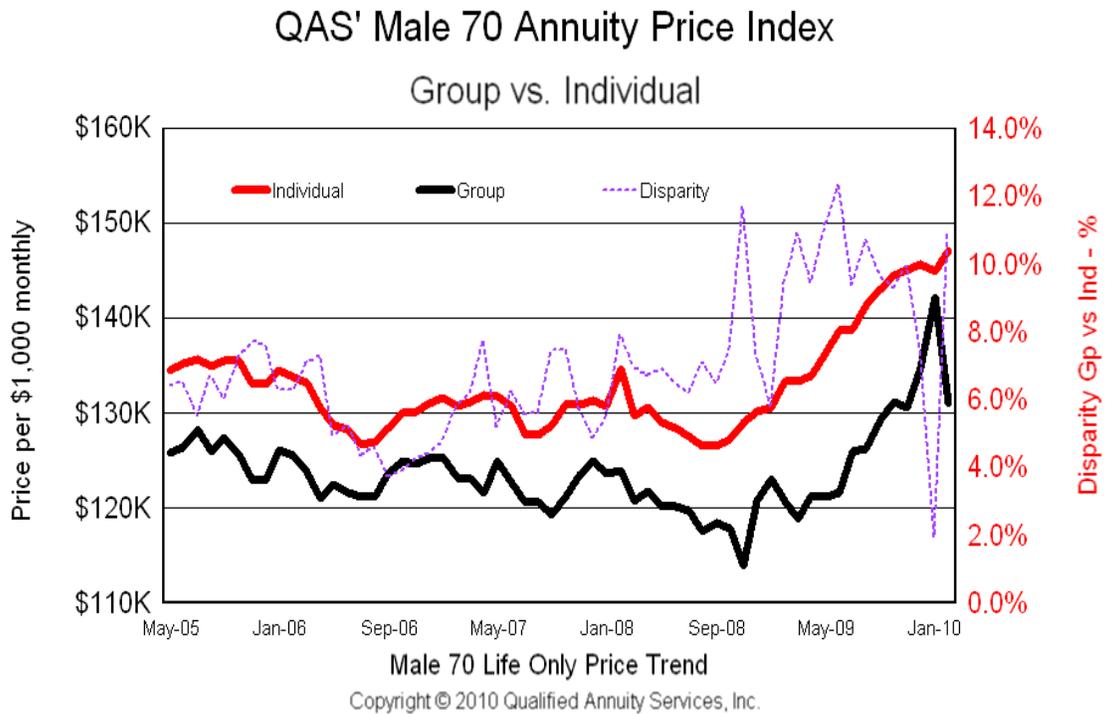
## Age Price Disparity

Age difference seems to impact the degree of price disparity as the spread differential in plans widened to as much as 15 per cent at the end of 2009 for a male age 75. When price disparity expands, there are usually external forces driving the process. We observe that providers are in different camps at year end: some want to meet or fill business goals and some want to suppress sales. This may cause more volatility at times and is not necessarily at year end alone.

This is evidenced by pricing in September 2008, when Lehman Brothers, Inc. failed. That event stoked serious liquidity concerns and also caused investment departments to take appropriate measures. Investment departments were compelled to purchase only the highest quality investments. Some may have believed it was an opportunity to buy the highest quality bonds at potentially significant discounts. Some may have been driven to sell in order to obtain cash to fill a hole left by a default. We conclude that this was a significant event in fact.

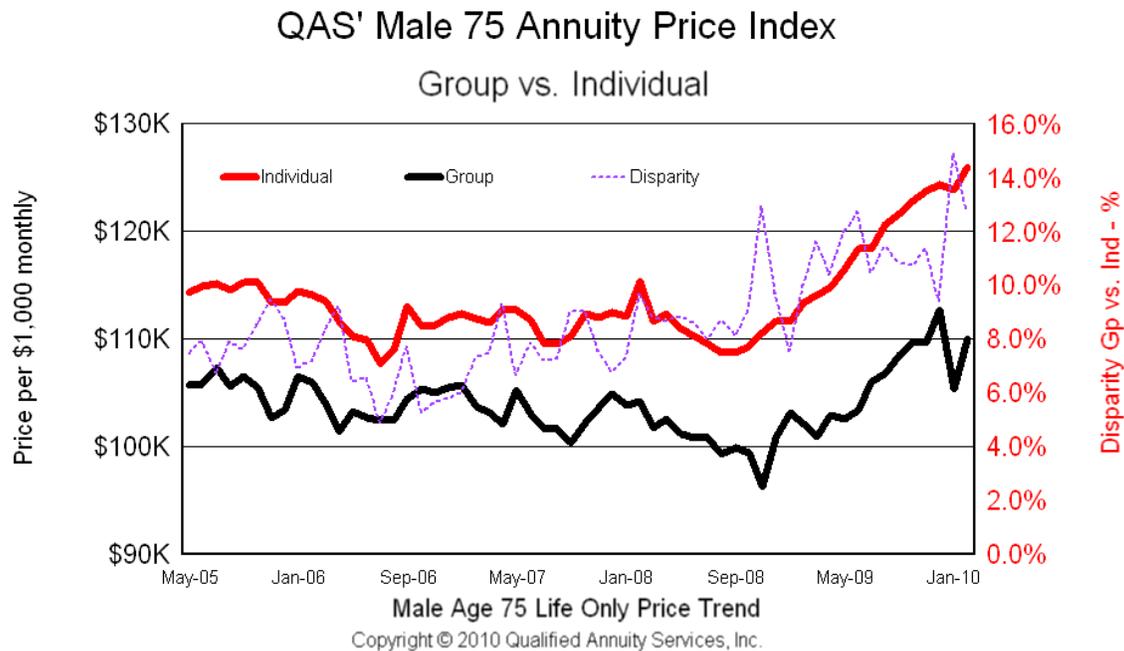
**Age 70 Price Disparity**

QAS' Male 70 Annuity Price Index shows similar price volatility as observed in the Age 65 Index. There is a modest dispersion in rates as the gap between Age 65 and Age70 in the Group vs. Individual seems to be wider during the same periods. There may be some tendencies to price more aggressively around the age 70 annuity buyer. This is the point when many retirees may be looking to begin withdrawals from their IRA accounts.



## Age 75 Price Disparity

Price dispersion between group and individual widens in this analysis as the gap between Age 70 and Age 75 appears more profound. We believe this may reflect a somewhat inefficient market at this point. It also may reflect subtle but significant theories about future mortality for each group and individual pricing. It does not seem clear to expect such a disparity unless one looks a bit closer. The slope of the yield curve likely has a more dramatic impact on a fully commission loaded annuity price for a later age individual thus causing a greater gap in pricing. This is the most rational way to explain the increase price disparity between group and individual markets.



## Observations

Significant price disparity exists in the lifetime annuity market place. As more attention is focused on lifetime income plans, more providers will plan entry to this market. The expansion of the universe of providers will have an impact on pricing and competition that had not previously existed. As larger providers seek market share, it will be met by creative design or innovation from smaller providers. This bodes well for fully realizing the potential of the lifetime income market place.

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