



May 3, 2010

**FILED ELECTRONICALLY**

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

**Attention: Lifetime Income RFI (RIN 1210-AB33)**

To Whom It May Concern:

Attached you will find information in response to the Employee Benefits Security Administration's Request for Information (RFI) regarding lifetime income options for participants and beneficiaries in retirement plans. This RFI was published in the Federal Register on February 2, 2010.

LIMRA is a worldwide research organization. We conduct a wide variety of research including our membership-sponsored industry performance benchmarking, consumer and strategic research, in-depth consortium studies and customized proprietary research. We access past and present data to report on trends and deliver insights to our more than 850 insurance and financial services companies in 73 countries. Virtually all of the major U.S. retirement plan and IRA providers are LIMRA members. We have 94 years of industry experience, and pride ourselves on our ability to provide independent and objective information to both our members and other interested organizations.

The purpose of the RFI is to collect information and views relevant to the Agencies' efforts to promote retirement security for American workers. At LIMRA, we believe we have information that will be useful to this effort. The information submitted within our response, unless otherwise stated, should be considered facts culled from our research, rather than opinion. We only provided a response for those questions where we had adequate research on that subject. The following questions will be addressed: 1, 2, 3, 8, 9, 12, 20, and 39.

LIMRA is well positioned to provide fact-based research to assist with the Agencies' efforts. Thank you for the opportunity to participate and offer perspective.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert A. Kerzner".

Robert A. Kerzner  
President and CEO  
LIMRA, LOMA and LL Global

# **Response to Request for Information**

Topic: Lifetime Income Options for  
Participants and Beneficiaries in  
Retirement Plans

Department of Labor RIN 1210-AB33

Submission Date: May 3, 2010

## Lifetime Income RFI

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?**

Table 1 – Advantages and Disadvantages of Taking an Annuity

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• No mandatory 20% tax withholding</li> <li>• Avoids 10% early withdrawal penalty</li> <li>• Guaranteed income for life</li> <li>• Taxes spread over a number of years</li> <li>• Provides immediate access to some of the money to meet immediate financial needs or unexpected expenses</li> </ul>	<ul style="list-style-type: none"> <li>• Payments are subject to income taxes</li> <li>• Limited or no flexibility on investment options</li> <li>• Generally no liquidity beyond periodic payments</li> </ul>

Source: (Drinkwater, Matthew 2009)

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

While it is true that the vast majority of individuals who have a lump sum option available from a retirement plan do not take their benefit in the form of annuity, there are many factors that influence this result. First, not all retirement plans offer a lifetime annuity option. Recent surveys of individuals who retired from an employer whose retirement plan offers a lump sum option reveal that two thirds (66 percent) of those with defined benefit (DB) type plans and 42 percent of those with a defined contribution (DC) type plan believed their plan offered an annuity option. By definition, all DB plans offer annuity options, so it is likely that many retirees are not fully aware of the options available in their plans. That said, three quarters (74 percent) of retirees claim they “completely understood” the annuity option in their plan (regardless of whether they chose it). Forty five percent of retirees with DB plans

elected the annuity option<sup>1</sup>, even though a lump sum option was also available. This number increases to 51 percent if only those who knew an annuity option was available are included. Just five percent of retirees with DC plans selected an annuity option. However, among those aware of an annuity option, 13 percent chose an annuity.

The overarching reason retirees select the annuity option is to provide a guaranteed retirement income (74 percent). Retirees from the public sector, education, or non-profits are more likely than those from the private sector to select an annuity option.

Beyond options that may be available from a retirement plan, the majority of retirees with DC plans (55 percent) and one quarter of retirees with DB plans roll their plan balances to an IRA. Four percent of such retirees use most or all of the proceeds to purchase an income annuity and six percent purchase a deferred annuity. Guaranteed lifetime income was among the top reasons these retirees elected to invest in a deferred annuity.

A recent survey of those in or near retirement suggests that lifetime income is a second tier feature when selecting a retirement income offering. Instead, investment preservation and fees and expenses tend to top the list of important features.

Sources: (Drinkwater, Matthew 2009), (Rice, Marie 2009)

### **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?**

We answered this from the employee's perspective in Question 2 above. Here, we will provide the perspective of the plan sponsor, or employer.

In a 2007 survey of plan sponsors of DC plans, nearly half (47 percent) state that retiring employees seeking annuity payouts must take lump-sum distributions from the plan and then purchase annuities on their own. Annuity payouts directly from the same trust or contract of the firm holding the plan assets are the next most common method, and are more likely to occur at businesses with higher median employee salaries. Terminal funding arrangements, in which the plan sponsor directs a transfer of assets to a product of another financial company, are used by only 8 percent of employers.

In an earlier survey, we found that seventy percent of all 401(k) plan sponsors offer a lump sum cash payment as the normal form of distribution — the form a participant will receive if no other option has been elected by the time distributions are required — in the 401(k) plan. Fewer than 3 in 10 plans have any type of annuity as the normal form of distribution. Just

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<sup>1</sup> Retirees with defined benefit plans claiming they took installment payments were assumed to have taken an annuity since non-lifetime installment payments are not typically available from these plans.

over half (52 percent) of 401(k) plans offer one or more annuity options.<sup>2</sup> However, a very small proportion of retirees from 401(k) plans are receiving both access to, and a recommendation for, annuity payouts. Since 52 percent of 401(k) plans offer an annuity payout, and only 12 percent of employers sponsoring such plans actually recommend annuity distributions, then only about 6 percent of all plan sponsors are actively promoting annuity payouts to their retirees. This suggests there is an opportunity to educate employers about annuity options, especially when plan sponsors see themselves as the primary source of distribution option guidance, and the fact that many employees want advice from their employers.

Sources: (Drinkwater, Matthew 2007), (Drinkwater, Matthew; Swanson, Mary; Byrne, Nicole 2005)

**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)?**

Advantages: The following are some reasons participants might consider electing a lifetime income option through their retirement plan:

- Provides a guaranteed lifetime income, similar to a DB pension plan that can serve as a foundation (along with Social Security or any other guaranteed sources) for retirement income planning.
- Protects benefits against equity market risk.
- Allows for “dollar-cost-averaging” approach in which units of income are purchased periodically at different guaranteed interest rates, thereby spreading interest rate risk over time.

Disadvantages: The following are some potential challenges or objections in electing a lifetime income option through their retirement plan:

- Provider risk – the risk that the insurer backing the annuity will be unable to make income payments in the future.
- Complexity/confusion – there is a risk that some lifetime income offerings may be confusing or complex in nature. In addition, plan participants may not fully understand the equivalence of a lifetime income payment and the principal amount.
- Distrust – Some plan participants may not trust the guarantee or trust their employer is thinking of their best interests.

Source: (Rook, Kathleen 2009) Disadvantages only.

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<sup>2</sup> Includes those who claimed that taking money out of the plan and purchasing an annuity constitutes “an annuity option.”

**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?**

Advantages: The following are some potential reasons plan sponsors might consider offering income options in their retirement plan:

- May ease transition from a DB pension to a DC plan scheme. If the employer is freezing/terminating the DB plan, employee sentiment could be improved if the DC plan “replaces” the guaranteed income benefit formerly provided by the DB plan.
- May prevent future recriminations from employees who selected an annuity provider that subsequently became insolvent.

Disadvantages: The following are some potential challenges or objections of plan sponsors in electing a lifetime income option through their retirement plan:

- Increased fiduciary risk.
- Communication challenges. Related to fiduciary risk, plan sponsors will feel responsible for ensuring plan participants understand the options available to them.
- Portability. Many plan sponsors would favor portability of lifetime income options that can be elected during the accumulation phase.
- Complexity/confusion – there is a risk that some lifetime income offerings may be confusing or complex in nature.

Source: (Rook, Kathleen 2009) Disadvantages only.

**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?**

It is a widely accepted premise among financial professionals to consider creating enough lifetime income to meet one’s basic or necessary expenses in retirement and to fund discretionary expenses from other sources such as asset withdrawals, employment earnings, etc. In determining how much lifetime income needs to be generated from investments, existing lifetime income sources such as Social Security and employer-based pensions must first be subtracted. Then, the resulting income needed is converted to the amount of assets (i.e., lump sum) required to purchase an annuity. Individuals or couples then need to consider all their available assets that could be converted into lifetime income. This may or may not result in assets from a particular defined contribution plan, in whole or in part, being used to purchase an annuity. In considering lifetime income, it is also desirable to ensure that the annuity income has some type of growth built into it so the payments do not lose their purchasing power over time due to inflation.

**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?**

Rather than suggest what plan sponsors should do or if they should be encouraged to do, the following information sheds light on existing plan sponsor practices and interests regarding retirement phase guidance in general and, more specifically, education about creating lifetime.

Retirement Phase Guidance: Just 37 percent of plan sponsors offer retirement phase guidance and another 30 percent are interested in doing so. Those offering annuities as the normal form of distribution are twice as likely to provide retirement phase guidance as those without any annuity payout options, regardless of plan size. In addition, plan sponsors that offer annuities are more likely to offer each of four main types of guidance: booklets; access to advisors; access to third-party web site(s); and seminars.

Lifetime Income Education: Only 30 percent of plan sponsors provide education for their participants on how to convert a 401(k) account balance into a stream of payments that will provide lifetime income. Plan sponsors that offer an annuity option in the plan are more likely to provide this type of education for their participants. Nearly three quarters of plan sponsors that offer annuities as the normal form of distribution either provide or are interested in providing lifetime income education. In contrast, only 1 in 5 plan sponsors that do not have an annuity option provide this education for their participants.

When an annuity is the normal form of distribution, plan sponsors are almost three times as likely to offer both retirement phase guidance and lifetime income education as when no annuity distribution option is available.

Source: (Drinkwater, Matthew; Swanson, Mary; Byrne, Nicole 2005)

**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?**

Please see our response to Question #2 above.

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