

Statement by Rebecca Davis on behalf of the Pension Rights  
Center at the Joint Hearing of the Departments of Treasury and  
Labor on lifetime income options in individual account plans

September 14, 2010

Introduction

Thank you for giving me the opportunity to speak today. My name is Rebecca Davis. I am Legislative Counsel to the Pension Rights Center and Coordinator of the Center's Women's Pension Project. The Pension Rights Center is the nation's only consumer organization dedicated solely to protecting and promoting the retirement security of American workers and their spouses. The Center has long been an advocate of retirement plans that provide lifetime streams of payment, such as defined benefit and money purchase pension plans. That is because we believe a lifetime stream of income in retirement is vital to ensure that retirees do not exhaust their savings. The fact that participants in most 401(k) plans take their benefits in the form of a lump sum increases the risk that older Americans – especially unmarried women – will find themselves in poverty in retirement. I want to thank the Departments of Labor and Treasury for initiating a dialog into how lifetime income options can be brought to 401(k)s and similar individual account plans.

In my testimony today I will address questions posed in the hearing notice regarding participant concerns that impact their choice of benefit options, the disclosure of account balances as monthly income streams and the fiduciary safe-harbor for fiduciaries selecting annuity providers.

I. Participant concerns affecting their choice of benefit options

I want to begin by emphasizing a number of points made in the written statement we submitted in response to the RFI. In our statement we recognize that participants have many concerns when declining to annuitize their retirement savings. Because of these concerns we would support a requirement that all defined contribution plans offer a basic lifetime income option as an optional form of benefit distribution from the plan. A basic offering would be a simple annuity, transparent and subject to the joint-and-survivor rules applicable to defined benefit plans. There should also be an option for partial annuitization to give participants greater flexibility and also to calm the nerves of those who balk at putting all of their nest egg in one basket. Additionally, the mere existence of the benefit option within the plan carries with it an endorsement effect that could encourage some wavering participants to opt for an annuity.

Under the current 401(k) plan structure, participants may withdraw all or part of their savings and purchase an annuity on the private market. Alternatively a small number of individual account plans through service providers offer participants annuity options. Private annuities are problematic primarily because of their high cost and the negligible monthly benefits that small account balances can purchase. For these reasons, an annuity option within a 401(k) plan for participants with low balances would not be a realistic choice for most low- and moderate-income participants yet these are the individuals most in need of lifetime income in retirement. Therefore, we suggest that serious consideration be given to the concept of establishing a

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government sponsored program, ideally administered by the PBGC, where participants with low account balances could purchase low-cost annuities.

### *Spousal consent*

Some of the RFI comments expressed concerns about limitations on death benefits and withdrawal options particularly in the form of a required spousal consent before the plan could pay benefits in certain forms. Under current law the Qualified Joint and Survivor Annuity (QJSAs) protections are triggered in a defined contribution plan once the participant elects an annuity option. A participant wishing to take an annuity in a form other than a 50 percent joint and survivor benefit must obtain a notarized spousal consent before receiving distributions. These protections are vital to protect a spouse's share of the marital property but unfortunately because the protections are only triggered after the participant elects an annuity option, they are meaningless in most cases. A participant wishing to take a single-life annuity without garnering his wife's consent can simply elect to take his benefit in the form of a lump sum and purchase the annuity on the private market. The only way that spouses will be truly protected in 401(k)-type defined contribution plans will be to require spousal consent before any withdrawal from the account other than a joint and survivor annuity option. The burden of obtaining such consent is borne by plan participants and measures similar to those for defined benefit plans could be put in place to address extraordinary circumstances, for example, where a spouse could not be located.

Legislation is necessary to fully protect spouses by requiring spousal consent for any withdrawal of funds in any form other than a QJSA. We have for many years strongly supported and advocated for such legislation and it should be noted that the Federal Thrift Savings Plan currently requires spousal consent for all non-QJSA withdrawals from TSP accounts.

### *Concerns about limits on death benefits and withdrawal options*

The concerns expressed by some individual comments regarding limitations on death benefits demonstrate that as retirement plans shift from defined benefit to defined contribution, there is also a decisive shift in how people view their retirement savings accounts. Many of the individual comments to the RFI stated that one of their motivating factors in saving in a 401(k) is to provide a nest egg for their children rather than supporting workers and their spouses in retirement – the justification for providing preferential tax treatment for retirement plans. Given that the median 401(k) account balance for private sector workers ages 55-64 before the recession (2006) was \$40,000<sup>1</sup>, it is clear that participant interest in bequeathing assets is a concern of the privileged few who are able to maximize *non-retirement savings* in their 401(k)s. Significantly, in my work providing direct legal services to individuals and their attorneys with pension matters, only rarely has a child contacted me about their potential entitlement to a survivor benefit from a *defined benefit plan*.

## II. Disclosure of account balances as monthly income streams

We support a disclosure regime that would provide participants their account balances both in the form of a monthly lifetime benefit and as a lump sum. To that end we support the disclosure proposed by the Lifetime Income Disclosure Act (S. 2832) which would require 401(k) plans to

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<sup>1</sup> Purcell, Patrick, "[Retirement Plan Participation and Contributions: Trends from 1998 to 2006](#)," Congressional Research Service, January 30, 2009, Table 4. (This figure is for private plan participants as of 2006- before the financial meltdown)

inform participants of the estimated monthly retirement income they could purchase, based on their existing 401(k) account balance. The bill would afford plan participants personalized information about the purchasing power of their retirement savings. This would give plan participants important information about how much income they can expect in retirement.

#### *Additional disclosures*

In addition to the disclosure of account balances in the form of monthly lifetime payments, annuity providers should be required to inform participants of the participant's state of residence's guaranty fund limits on insurance contracts. State sponsored guaranty funds have a maximum guarantee that varies from state-to-state similar to the PBGC guarantee. However the protected amount varies by state from as low as \$100,000 in Florida to \$500,000 in New York.<sup>2</sup>

#### *Mortality rates*

One of the specific questions mentioned in the hearing announcement asked what mortality table should be used in providing the annuity projections. Current law requires that any lifetime income product offered through an employer-sponsored retirement plan must calculate the benefit using gender neutral mortality tables. This requirement provides critical protection to women, and should be retained for any lifetime income product offered directly or indirectly by a 401(k)-type individual account plan.

#### *Importance of education*

I want to add one further comment on the importance of educating plan participants. The individual comments in response to the RFI overwhelmingly expressed a lack of trust in service providers, employers/ plan sponsors, and the government as an administrator of lifetime income benefits. We believe that their fears are best addressed by ensuring that any implementation of a required annuity option in 401(k)-type plans be accompanied by a large public education campaign. The comments demonstrate a lack of understanding of the value of a lifetime stream of income. In particular my eye caught a brief comment submitted by an individual who stated that he is married and chose a lump sum because an annuity would have taken away a percentage of the benefit for his wife if he died.<sup>3</sup> This man is the very demographic a public education campaign must reach, a worker who wants to provide a survivor benefit for his spouse, but believes an annuity diminishes rather than bolsters the likelihood that their savings will last for both his and his wife's lives. If this individual understood that an annuity would enhance his wife's retirement security he (and his wife) might well opt for a lifetime option.

### III. Fiduciary safe-harbor for selection of lifetime income issuer or product.

Current Labor regulations (29 CFR §2550.404a-4) provide a safe harbor for plan fiduciaries in selecting annuity providers. The safe harbor essentially provides that if fiduciaries follow current fiduciary duties, they will be absolved of any wrong doing in the selection of the annuity provider. Some of the comments to the RFI requested that this regulation be clarified to provide an easier method for fiduciaries to meet the safe harbor. We do not have a problem with a modified safe harbor if it requires that plan fiduciaries select among top rated annuity providers,

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<sup>2</sup> <http://www.annuityadvantage.com/stateguarantee.htm>

<sup>3</sup> Public comment to RFI# James Cunningham found at <http://www.dol.gov/ebsa/pdf/1210-AB33-564.pdf>

with high claims paying abilities that are located in states with strong regulatory agencies, and if the products offered do not include investment features. However, we would oppose any proposal that merely diminishes fiduciary duties with respect to the selection of any plan service providers, without ensuring that the selection will be in the best interests of plan participants. Any lessening of the current requirements threatens the established purpose of ERISA which is to protect plan participants.

### Conclusion

Thank you for giving me the opportunity to speak with you today and I will be happy to answer any questions.