

2013

## Public Policy and Consumer Disclosure for the Income Annuity Market, 46 J. Marshall L. Rev. 795 (2013)

Kelli Hueler

Paula Hogan

Anna Rappaport

Follow this and additional works at: <http://repository.jmls.edu/lawreview>

 Part of the [Law Commons](#)

---

### Recommended Citation

Kelli Hueler, Paula Hogan, & Anna Rappaport, Public Policy and Consumer Disclosure for the Income Annuity Market, 46 J. Marshall L. Rev. 795 (2013)

<http://repository.jmls.edu/lawreview/vol46/iss3/5>

This Article is brought to you for free and open access by The John Marshall Institutional Repository. It has been accepted for inclusion in The John Marshall Law Review by an authorized administrator of The John Marshall Institutional Repository.

# PUBLIC POLICY AND CONSUMER DISCLOSURE FOR THE INCOME ANNUITY MARKET

KELLI HUELER,<sup>\*1</sup> PAULA HOGAN,<sup>\*2</sup> & ANNA RAPPAPORT<sup>\*3</sup>

## A. INTRODUCTION

We believe that giving participants access to institutionally priced alternatives for converting retirement savings into lifetime income is vital. Providing retirees a cost effective means to “pensionize” their hard-earned savings into a “paycheck for life” is necessary in order to meaningfully improve income sufficiency for millions of American retirees. Without such capabilities being widely accessible, the private retirement savings system has severe limits in terms of serving the public interest and meeting the retirement needs of an aging population.<sup>1</sup>

The goal of this paper is to identify the best possible conditions for the consumer in purchasing income annuities and

---

<sup>\*1</sup> Kelli Hueler is CEO and founder of Hueler Companies, an independent data and research firm providing reporting and systems designed for the annuity and stable value marketplace. Ms. Hueler is nationally recognized as a key contributor on the topic of lifetime income creation. Hueler Companies was founded in 1987 and today the firm’s data, market research, and analytical reporting are considered the industry standard. In 2004, Hueler Companies launched Income Solutions®, a ground breaking automated annuity purchase program adopted widely by large plan administrators, plan sponsors, and key industry associations.

<sup>\*2</sup> Paula H. Hogan, CFP®, CFA is the Founder and CEO of her eponymous fee-only financial advisory firm in Milwaukee, Wisconsin. Ms. Hogan is a nationally recognized leader in the financial advisory field. She has served on the national boards for the Financial Planning Association and for NAPFA, the National Association of Personal Financial Advisors. She is also the author of multiple articles for both the Journal of Financial Planning and for the AAI Journal.

<sup>\*3</sup> Anna M. Rappaport, FSA, MAAA is the founder of Anna Rappaport Consulting. She chairs the Society of Actuaries Committee on Post-Retirement Needs and Risks, and is a past President of the Society of Actuaries. She is an internationally recognized actuary and writes and speaks frequently. She recently served on the ERISA Advisory Council and serves on the GAO Retirement Security Advisory Panel. She will complete 50 years as a Fellow of the Society of Actuaries in 2013.

1. Letter from Hueler Companies to Dep’t of Labor and Dep’t of Treasury, (May 3, 2010), *available at* <http://www.dol.gov/ebsa/pdf/1210-AB33-670.pdf>.

the structure of a regulatory/public policy environment that would support these conditions. In the current economy, retirees and near-retirees are charged with daunting solo responsibility for securing sufficient lifetime income. They do so in part by purchasing lifetime income insurance-based products, often through an employer supported arrangement.<sup>2</sup> In doing so, retirees face complex decisions and barriers to accessing objective education, un-conflicted guidance, and competitive pricing.<sup>3</sup> These retirees and near retirees are highly vulnerable to making costly and uninformed decisions about spending and income product purchases. The authors believe that successful outcomes for consumers depend upon having access to a fair, competitive, and transparent market for lifetime income annuities. This market should include meaningful standards designed to improve product comparability and disclosures to help consumers convert assets into lifetime income more effectively. Understanding the primary points of influence or touch points when decisions are being made as well as the barriers to annuitization is necessary for crafting effective public policy and consumer education.

This paper serves as a call to action to meet the urgent need of Americans who are on the cusp of retirement. We present a Market Based Delivery Platform Model (hereinafter “MBD Platform”) as an effective framework for providing retirees access to lifetime income annuities. The MBD Platform is a private sector, pro-growth model that promotes collaboration between both the diverse companies providing products and services in the retirement market and the government through meaningful oversight. We further envision technology playing a key role in reducing delivery costs and in facilitating transparency, competition, market access, and consumer education.

The overall goals of the MBD Platform include:

- moving the retirement system towards a more unified and effective framework for converting assets into lifetime income;
- integrating the pros and cons, and mechanics of lifetime income annuities into the presentation of trade-offs that pre-retirees and retirees face when making decisions about

---

2. See generally Anna Rappaport and Steve Siegel, *Retirement In the Future: Focusing on the Payout Period*, 26 BENEFITS Q. 2, 20 (2010) (discussing the daunting task of securing sufficient lifetime income for use during retirement).

3. See Anna Rappaport, *Lifetime Income – An Important Focus for Retirement Planning*, PENSION SECTION NEWS (Soc’y of Actuaries) (January 2013) available at <http://www.soa.org/News-and-Publications/Newsletters/Pension-Section-News/2013/january/Lifetime-Income—An-important-focus-for-retirement-planning.aspx> (discussing barriers faced by retirees)

how to secure lifetime income;

- empowering individual investors and improving their purchasing result;
- tailoring public policy and regulation to the consumer interest; and
- assuring access to these benefits regardless of the distribution channel, including for example, individual purchases of retirement income products made with and without personal advice, directly through an employer plan, through an out-of-plan arrangement sponsored by an employer, through a plan administrator, or through a financial services company.

This paper includes a broad discussion of issues as well as data supporting the need for better public policy and consumer disclosure in the lifetime income annuity market. The authors hope this paper will encourage momentum towards bolder, long-term steps as well as prompt action in the short run.

## II. BACKGROUND AND INDUSTRY CONTEXT

### A. *Characteristics of Current Retirement System*

Our current retirement system relies on individuals making big financial decisions effectively despite operating in a marketplace that is complex, confusing, and not closely tailored to their needs.<sup>4</sup> Lifetime financial security is largely in the hands of the individual: it depends on the individual saving enough and making prudent financial choices. Creating lifetime financial security requires the ability to convert savings into sustainable lifetime income. Americans obtain financial security in retirement from Social Security, employee benefits, personal savings, and in some cases, continued full or part time work, particularly early in retirement.<sup>5</sup>

Key features of the current context include:

- Individuals make personal decisions designed to integrate personal savings, employer-supported savings and resources, and Social Security benefits in order to arrange effectively for lifetime income.<sup>6</sup>

---

4. *Id.*

5. See generally Society of Actuaries, *Key Findings and Issues: Working in Retirement*, SOC'Y OF ACTUARIES 1,(2012) <http://www.soa.org/files/research/projects/research-key-finding-working-retire.pdf> (discussing sources of retirement income)

6. See Rappaport and Siegel, *supra* note 2, at 20 (discussing individual

- Employers play a continuing role in the retirement system through sponsorship of retirement plans and associated educational materials and programming.<sup>7</sup>
- Participants make personal choices about what to do with assets from their employer-sponsored retirement plans as they separate from service.<sup>8</sup>
- Longevity risk is real and best addressed by some kind of paycheck replacement, thus making paycheck replacement an essential fundamental component of retirement plans.<sup>9</sup>
- Defined contribution (DC) plans and IRAs are the main source of retirement savings and will continue to grow in importance relative to defined benefit (DB) plans, which are in decline.<sup>10</sup>
- As the DC system continues to grow, the conversion of DC balances to regular income at retirement will also grow in importance. While today's retirees still include many with substantial income from a DB plan, this number has declined and will continue to do so.<sup>11</sup>
- Success in a DC retirement environment means that enough assets are accumulated, and there is a reasonable process for converting them into retirement income.
- The system is voluntary—employers can choose whether to establish plans and how to structure them, and individuals can choose whether to participate and how much to contribute, and whether or not to save additionally on their own.<sup>12</sup>
- Many individuals have limited financial literacy and acumen.<sup>13</sup>
- Income alternatives for post-employment income offered through employer plans must be offered on a gender-neutral basis. Alternatives that involve annuity purchases outside of the plan are offered using gender-specific annuity rates. This is a consideration for both men and women.
- The funds and purchase route for lifetime income annuities are provided through an employee benefit program, other employer-sponsored programs, and/or through an individual interacting directly with the insurance-product

---

retirement decision-making)

7. *Id.* at 21.

8. *Id.*

9. *Id.* at 21-22.

10. *Id.* at 21.

11. *Id.*

12. *Id.*

13. *Id.* at 21.

marketplace.

- A number of insurance carriers offer annuity products designed to provide guaranteed lifetime income, and these companies are regulated at the state level with regard to solvency.
- Managing inflation risk is a main concern when arranging lifetime financial security but few insurance carriers provide fully inflation-adjusted annuities.<sup>14</sup>
- People nearing retirement with accumulated assets need help planning for the post retirement period for securing an efficient solution.
- The form, timing, and framing of advice to individuals about the pros and cons and optimal rates and pace of annuitization are highly influential to individual decision-making but occur haphazardly, not under a thoughtful public policy umbrella for best practices.<sup>15</sup>
- Touch points and sources of advice are important in influencing options considered and decisions. Touch points are when employees come in contact with the retirement system and are considering options about use of retirement resources.
- The bottom segments of the population economically rely primarily on governmental programs. Such issues are beyond the scope of this paper.<sup>16</sup>

In this context, a marketplace characterized by competitive product pricing, balanced education and framing, and effective public policy for creating favorable consumer outcomes is sorely needed.

### *B. Accumulation Versus Decumulation Stage of Financial Planning*

Arranging for lifetime financial security requires successful navigation of two distinct financial stages: (1) the stage of accumulating assets; and (2) the de-cumulation stage of living off those assets. In a DC environment, assets are invested in an individual account during the accumulation period. During the spending period, they can be withdrawn from the account completely, gradually withdrawn, or transferred to an insurance

---

14. See generally Society of Actuaries, *Key Findings and Issues: Understanding and Managing the Risks of Retirement*, SOC'Y OF ACTUARIES 1,(2012) (noting that few carriers offer fully inflation adjusted annuities)

15. See generally, Paula H. Hogan and Rick Miller, *Explaining Risk to Clients: An Advisory Perspective* (Pension Research Council, Working Paper No. 2012-07, 2012)(discussing the how advice is given to clients).

16. *Id.*

company to fund annuity payments.

During the spend-down period, if assets are not transferred to buy a financial product, they are commonly withdrawn gradually over a period of time.<sup>17</sup> Withdrawals can be set in different ways. Withdrawal amounts are often set to provide a good probability that funds will not run out prior to the end of an individual's life. Various events can disrupt withdrawal plans including market volatility, inflationary pressures, unexpected withdrawals to meet family or health needs, and longer than expected life spans.<sup>18</sup> While consumers have some knowledge and appreciation of the need for saving for retirement, planning portfolio withdrawal strategies including how to convert retirement savings to lifetime income either in full or in part during retirement is a skill not widely known or taught. In this context, appropriately balanced education, guidance, and public policy can improve the consumer's chance of achieving financial security in retirement.

### C. Importance of Lifetime Income

As the GAO has described, workers who receive lump-sum distributions face several risks related to how they draw down their benefits, including:

*Longevity risk* —retirees may draw down benefits too quickly and outlive their assets. Conversely, retirees may draw down their benefits too slowly, unnecessarily reduce their consumption, and leave more wealth than intended when they die.

*Investment risk* —assets in which pension savings are invested may decline in value.

*Inflation risk* —inflation may diminish the purchasing power of a retiree's pension benefits.<sup>19</sup>

Converting some percentage of retirement assets into guaranteed income increases the likelihood that retirees will not outlive their assets and also allows them to transfer some of the serious financial risks they face in retirement to a qualified third party. Longevity risk is a particularly serious retirement risk since people are living longer but continuing in many instances to retire at traditional ages or earlier.<sup>20</sup> The planning implication is that

---

17. See Rappaport and Siegel, *supra* note 2 at 22 (discussing withdrawal strategies).

18. Zvi Bodie, *On the Risks of Stocks in the Long Run*, 51 FINANCIAL ANALYSTS JOURNAL 3 18 (1995).

19. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 09-642, ANNUITIES WITH GUARANTEED LIFETIME WITHDRAWALS HAVE BOTH BENEFITS AND RISKS, BUT REGULATION VARIES ACROSS STATES (2012).

20. See generally *Understanding and Managing the Risks of Retirement*,

the number of years in retirement is expanding, putting more pressure on the savings accumulated during the working years.<sup>21</sup>

Longevity risk interacts with inflation risk. The longer the time in retirement, the more pressing is the risk of inflation.<sup>22</sup> Even modest inflation can mean a major reduction in buying power over a twenty or thirty year period.<sup>23</sup> While conventional wisdom has stated that investing in equities will produce returns that outpace inflation, this has not worked out well in reality. Stock investing implies the risk of investment losses, a particularly serious risk for retirees since retirees are in most cases not able to replace investment losses with further earned income and savings.<sup>24</sup> In this context, establishing a baseline income level, preferably one that adjusts either partially or fully for inflation guards against the risk of outliving one's retirement savings and increases the likelihood of income sufficiency.

#### D. Retirement Resources

In order to achieve financial security in retirement, consumers must integrate diverse retirement resources, some of which are sponsored by their employer and each of which has its own structure, required choices, and characteristics. These resources typically include Social Security, employer sponsored retirement plans, and personal savings. Advice for optimizing use of these resources typically comes from a variety of diverse and non-integrated sources, including representatives of service providers for employer sponsored retirement plans, Social Security, personal financial advisors, the media and web resources, friends and family. Employer plan representatives provide plan information and may provide access to advice. Appendix VI summarizes key features of sources of retirement resources for consumers.

Integrating these various forms of retirement savings into a coherent plan for lifetime financial security is not easy. With so many different possibilities for replacing a paycheck in retirement

---

*supra* note 16 (noting that people are continuing to retire at traditional ages and often earlier).

21. See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 09-0-642, ALTERNATIVE APPROACHES COULD ADDRESS RETIREMENT RISKS FACED BY WORKERS BUT POSE TRADE-OFFS (2009) (discussing pressure being put on retirement savings).

22. See Society of Actuaries, *Managing Post-Retirement Risks*, SOC'Y OF ACTUARIES 1, 6 (2011)(highlighting the unpredictable nature of inflation).

23. *Id.*

24. See ZVI BODIE AND RACHELLE TAQUU, RISK LESS AND PROSPER: YOUR GUIDE TO SAFER INVESTING (2012) (explaining that investments in equities may not offset losses through inflation). See also Zvi Bodie, *supra* note 18.



and such a complex marketplace, consumers need more help. In this context, updated public policy, distribution channels, and consumer education are needed to help consumers navigate the retirement income marketplace.

#### *E. Variety of Industry Participants*

There are diverse parties operating and interacting in the retirement income marketplace. This creates a confusing array of roles, responsibilities, and motivations that are often not clear to consumers. A brief overview of the various participants and their roles in the retirement income marketplace suggests the resulting complexity.

*Individual buyers:* Individual buyers need to decide whether to take an organized approach to paycheck replacement. If they do, they then make several key decisions about the process and services they will utilize: when to annuitize, at what intervals, how much, which insurance carrier(s) and/or financial services provider to use, and what products/features to consider.

*Personal Financial Advisors:* Consumers may also turn to their personal financial advisor for help with retirement planning decisions and to select specific products or services. How advisors frame retirement planning can greatly influence consumer decision making.<sup>25</sup> An issue in the current marketplace is how advisory business models and training influence the advisors, and therefore, the advice provided. Two relevant industry conditions are: (1) there is no legal definition of the term “financial advisor” thus making it difficult for the consumer to discern the difference between a salesperson and a fiduciary; and (2) advisor compensation is typically transaction-based and/or proportionate to assets under management, creating a potential conflict of interest for the advisor when advising on the pros and cons and mechanics of annuitization.

*Employers:* Employers decide what types of support they will offer for income alternatives, including offering education and planning tools, in or out-of-plan options, and access to purchasing platforms. They also choose default options.<sup>26</sup> If employers offer any form of lifetime income, one of the major decisions they face is whether to offer a single carrier/provider approach or multiple carrier/provider approach that allows for competition. Plan sponsors need to decide whether to hire advice providers and if so, which advice provider to hire, and thus must consider the potential conflicts of interest inherent in the various advisory

---

25. See generally *Explaining Risk to Clients: An Advisory Perspective*, *supra* note 15, (discussing the importance of how advisors frame their advice)

26. Rappaport and Siegel, *supra* note 2, at 21.

compensation models. Recognizing that advice providers are fiduciaries, plan sponsors need to be concerned about the advice providers' approach and particularly whether such advice integrates risk protection with investments, and what compensation issues may be embedded in the option.

*Service Providers:* Plan administration firms typically offer post-employment income alternatives. These firms need to decide which income alternatives they will offer, either directly or through partnering. Where a plan administrator wishes to offer multiple income options, they need to determine how to best support the different alternatives. These firms also decide how actively they will be involved in providing information, guidance and whether to offer advice. Some plan administration companies offer both mutual fund payout options and access to annuities through arrangements with a specific annuity carrier or with multiple carriers. In some cases, the multiple carrier programs offer access to competitive purchasing platforms at institutional pricing levels, whereas others offer higher-priced retail annuity options. Some plan administrators and advice providers also offer managed payout funds as a lifetime income alternative. These funds commonly include payout provisions without integrating a true lifetime income annuity solution, a critical distinction not easily discernible by individual consumers.

*Managed account and advice providers* offer both accumulation investment strategies as well as strategies for the pay-down period. These programs typically rely on a gradual payout of savings allocated over the defined retirement period as a means of addressing paycheck replacement or retirement income needs. Income annuities are commonly not factored into the main paycheck replacement strategy, thus leaving the risks of living longer than anticipated or experiencing unforeseen market shocks with the retiree. Some advice providers only address this risk through the use of late in life or longevity annuities.

*Various regulatory agencies* touch the process of annuity sale and disclosure. Individuals deal with insurance companies through various channels. The insurance companies, their products, and distribution are regulated by state insurance departments.<sup>27</sup> Securities agencies may also be involved. Plan sponsors in the private sector are regulated by the Federal Government and the Employee Retirement Income Security Act.<sup>28</sup>

---

27. See generally *State Regulation of Insurance: History, Purpose and Structure*, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS available at [http://www.naic.org/documents/consumer\\_state\\_reg\\_brief.pdf](http://www.naic.org/documents/consumer_state_reg_brief.pdf) (describing important background information on State regulation of insurance).

28. See *Employment Law Guide*, DEPT OF LABOR, <http://www.dol.gov/compliance/guide/erisa.htm#BasicPro> (last visited April 11,

Employers sponsoring DB plans must deal with the Internal Revenue Service, the Department of Labor and the Pension Benefit Guarantee Corporation (PBGC). Those who have only DC can strike the PBGC from their list of regulators, but depending on investment options, they can add some security regulators. The allocation of responsibilities between multiple governmental entities is beyond the scope of this paper. Suffice it to say that the sale of income annuities and their related disclosures are laden with multiple uncoordinated regulations and regulators. The existence of multiple regulatory agencies creates confusion plus the potential for both duplication and gaps in regulations. For example, although annuity fee disclosures would seem as important as fee disclosures for other financial products, there are at this time no fee disclosure requirements for sales of income annuities. Without effective fee disclosures, consumers are ill-prepared to make cost-effective retirement planning decisions. In this context, the importance of updating regulatory policy and required consumer disclosures becomes apparent.

### III. ANNUITIZATION ISSUES

#### A. *The Lifetime Income Paradox*

Paradoxically, annuitization is deemed in theory to be ideal for creating lifetime income in retirement but in practice annuitization is not at this time widely adopted. While economists and actuaries point to annuitization as a practical method of generating reliable lifetime income, individuals and advisors have been slow to annuitize.<sup>29</sup> Behavioral finance provides insights for understanding why individuals might shy away from annuitization. Individuals, including advisors and plan sponsors, often do not make decisions based on a rational economic analysis;<sup>30</sup> the framing surrounding the options has a major impact on how decisions are made.<sup>31</sup>

---

2013) (discussing Federal government regulation).

29. Paula Hogan, *Life-Cycle Investing is Rolling Our Way*, PAULAHOGAN.COM, [http://www.paulahogan.com/images/FE/chain259siteType8/site219/client/2007-05\\_JFPLifeCycleInvest.pdf](http://www.paulahogan.com/images/FE/chain259siteType8/site219/client/2007-05_JFPLifeCycleInvest.pdf) (last visited April 17, 2013).

30. See, e.g., Melissa A. Z. Knoll, *The Role of Behavioral Economics and Behavioral Decision Making in Americans' Retirement Savings Decisions*, 70 SOC. SECURITY BULL. 1 (2010). (illustrating suboptimal economic actions in retirement savings).

31. See generally Jeffrey R. Brown et al. *Why Don't People Choose Annuities A Framing Explanation*, THE RETIREMENT SECURITY PROJECT 1 (2008), available at [http://www.brookings.edu/~media/Projects/retirementsecurity/03\\_choosing\\_annuities.PDF](http://www.brookings.edu/~media/Projects/retirementsecurity/03_choosing_annuities.PDF) (discussing how the way advice is framed can impact decision-making).

One example of research relating to the annuitization decision is a paper by a group of leading financial economists investigating hypothetical annuitization decisions to explore what makes annuitization more or less appealing.<sup>32</sup> They found in two large surveys of annuitization choices that allowing partial annuitization increases annuitization rates. According to this research, self-reported considerations around annuitization decisions include later-life income, spending flexibility, and counterparty risk. The researchers also noted that providing education on the impact of inflation seems to increase the interest in cost of living adjustments.

Note that day-to-day decision-making can also be adversely impacted by various potential conflicts of interests of service providers and advisors.<sup>33</sup> Also, regulatory complexity and confusion, and specifically the lack of safe harbors for annuitization policies, also act as barriers to annuitization. Exhibit I summarizes key details.

#### Exhibit I: Overview of Barriers to Annuitization

BARRIER	APPLIES TO INDIVIDUAL	APPLIES TO PLAN SPONSOR
Negative perceptions	Yes	Yes
Concern about fiduciary and legal liability	No	Major barrier: regulations are complex and come from varied sources leaving plan sponsors confused
Financial advice steering individuals away from annuitization towards proprietary products or advice offerings and strong disclaimers	Yes	Yes (this should be of significant concern to plan fiduciaries)

32. See generally John Beshears, et. al, *What Makes Annuitization More Appealing?*. (NBER Working Paper Series, Working Paper No. 18575, 2012), available at <http://www.nber.org/papers/w18575>.

33. See generally, W. MARK SMITH & BRENDAN M. WILSON, CONFLICTS, FEES, AND DISCLOSURE IN THE RETIREMENT PLAN MARKET: RECENT DEVELOPMENTS, SL043 ALI-ABA 189, 191 (2005).

on plan administrator websites when they are connected to independent portals		given inherent conflicts)
Confusion about products and failure to fully present trade-offs and risks related to other offerings	Yes (causes uninformed decision making)	Yes (again, plan fiduciaries should be very concerned about this lack of balance and inherent conflict)
Requirement that decisions to annuitize be an all or nothing decision in some benefit plans	Yes: Is a deterrent to the individual electing any lifetime income option leaving them exposed to 3 key risks	Annuity options should be presented as partial alternatives.
Individuals generally have too short a planning horizon, and often do not think about the longer term	Yes	Influences plan sponsors view of what their participants need/want
Lack of control and liquidity in life annuity options	Yes: Major issue and must be considered as part of trade-off evaluation	Yes: Major concern of plan sponsors and key reason for supporting partial annuitization options

### B. Personal Preference for Lifetime Income

Life cycle economics suggest that consumers care most about lifetime consumption, not portfolio wealth, and so presumably have a high personal preference for lifetime income.<sup>34</sup> This point of view is increasingly accepted in the financial industry.<sup>35</sup> Society of Actuaries survey data supports preferences for lifetime income.<sup>36</sup>

34. Anna and Siegel, *supra* note 2, at 27.

35. See generally *Explaining Risk to Clients: An Advisory Perspective*, *supra* note 15 (developing alternative paradigms for financial planning and ensuring lifetime financial security).

36. See Mathew Greenwald & Associates, *Retirement Plan Preferences Survey*, THE SOCIETY OF ACTUARIES AND AMERICAN ACADEMY OF ACTUARIES (2004) (exploring which type of plan was preferred by employees when the

Some of the key findings from the Society of Actuaries Retirement Plan Preferences Survey study are as follows:

- Given a choice of equal value, two-thirds of workers overall (57% of workers with a DC plan and 71 percent of those with a DB plan) indicate a preference for taking their retirement income as a life annuity. Just 12 percent say they would prefer to receive a lump sum.<sup>37</sup>
- When choosing a payout option from their retirement plan, workers and retirees say they are primarily concerned with ensuring their money will last throughout their lifetime.<sup>38</sup>
- Control and access are very important to smaller proportions of participants. The features cited as very important by participants are:
  - Receiving a guaranteed monthly income during retirement no matter how long they live (69% of workers and 86% of retirees)
  - Ensuring they do not outlive their money during retirement (69% of workers and 77% of retirees)
  - The ability of the income to keep up with inflation (65% of workers and 75% of retirees)
  - Being able to maintain control of their retirement savings (61% of workers and 54% of retirees)
  - Having money they can access for emergency purposes (38% of workers and 30% of retirees)
  - Being able to leave money to heirs from their retirement savings (31% of workers and 19% of retirees)<sup>39</sup>

The survey also indicated that regardless of whether participants received benefits from a DB or DC plan, retirees were most likely to indicate that a guaranteed stream of lifetime income is a *very* important feature of a retirement plan (85% of those with a DB plan; 71% of those with a DC plan).<sup>40</sup> In this context, it is reasonable to consider the possibility that low annuitization rates indicate structural problems with the marketplace rather than actual consumer preference.

---

separation by plan type was made by describing plan characteristics).

37. *Id.* at 5.

38. *Id.* at 40.

39. *Id.* at 5.

40. *Id.* at 6.

### C. Regulatory Confusion and Complexity for Fiduciaries

Plan sponsors operate in a fiduciary regulatory structure that does not provide clarity or specific safe harbors for post-retirement investment or income options. It is of particular importance that plan sponsors are required to act as fiduciaries and act in the best interest of participants. They have safe harbors with regard to investment options in DC plans for participants who are not yet retirement age, but no such safe harbors for lifetime income options in the post-retirement period.<sup>41</sup> If plan sponsors offer income annuity options, they are subject to requirements with regard to the selection of insurance carriers. They are allowed to provide education on plan investments without it being advice, but the regulations are unclear about whether such information may be provided with regard to post-retirement income options. Testimony provided to the 2012 ERISA Advisory Council set forth the concerns of plan sponsors.<sup>42</sup>

### D. Skewed Communication of Product Features

In the day-to-day marketplace, the framing of information and advice about annuitization greatly influences annuitization rates but is also often burdened with financial conflicts of interest resulting in skewed communication of investment safety, flexibility, control, and cost. Decisions about what strategy, if any, to use to replace a paycheck in retirement are heavily influenced by information or conversations at critical touch points. The individuals involved in this conversation may be a personal financial advisor, the plan sponsor or plan administrator representative, an advice service used by the plan, a financial services organization, a friend, or a family member. Websites may offer information and can be connected to an employer plan, advice provider, or a financial services organization.

There are a number of intertwined issues that can discourage partial annuitization and can move plan sponsors away from offering partial annuitization to their employees:

---

41. See *Default Investment Alternatives Under Participant-Directed Individual Account Plans*, DEPT OF LABOR, (Sept. 2006) <http://www.dol.gov/ebsa/newsroom/fsdefaultoptionproposalrevision.html> (noting qualified default investment options regulated by U.S. Department of Labor).

42. See, 2012 ERISA Advisory Council, *Examining Income Replacement During Retirement Years in a Defined Contribution Plan System*, (2012) <http://www.dol.gov/ebsa/pdf/AC2b.pdf> (providing insights into employer concerns and recommendations with regard to removing some of the Department of Labor focused barriers to employers supporting lifetime income options).

1. *Product Complexity*: “Annuity” and “annuitization” refers to a range of guaranteed lifetime income products. The term “lifetime income,” however, is also used to refer to both annuities and investment products offering a payout that depends on investment results without lifetime guarantees. This terminology about lifetime income can be confusing to the consumer. Some of these products do not transfer longevity, inflation, or investment risk to the financial company but instead keep those risks firmly on the shoulders of the consumer. Further confusion arises from the multitude of non-standardized features and product terms for retirement income investment products.

2. *Faulty Explanations of Trade-Offs*: The conversation about paycheck replacement can be framed to nudge people toward various solutions. When conversations emphasize investment returns, flexibility and control, people are nudged towards favoring a managed portfolio drawdown approach. When discussions are framed in terms of risk management, people are nudged towards a more favorable view about integrating annuitization as part of a broader income plan.<sup>43</sup> In the ideal marketplace, these conversations should be framed to focus on combining different approaches as opposed to promoting a single approach as the best solution.

3. *Negative Framing*: Conversations with a trusted source can move people to or away from annuitization, for example, when such a trusted source presents a single all or nothing approach rather than partial annuitization as part of a balanced solution. Many of these influential touch points are either not prepared or are unwilling to discuss the range of solutions and how they fit differing household situations.

4. *Financial Conflicts of Interest*: The financial interests of some of the parties are served by specific solutions. For example, managed account firms and those advisors compensated based on assets under management benefit financially from managed payout solutions.<sup>44</sup> A second example is service provider/plan administration firms that offer or manufacture income options with retail level fees. These examples show how such firms can have a conflict of interest when advising retiring employees about the pros and cons of integrating annuitization or using low-cost competitive platforms when they receive greater compensation when recommending their own products and services.

---

43. See Brown et al., *supra* note 31 (discussing the push to include annuitization into an income plan).

44. Fees for managed accounts might be .5 percent in employer sponsored plans according to discussion at the 2012 ERISA Advisory Council. Managed account fees for individually managed accounts without employer sponsorship could be higher.



5. *All or Nothing Product Solutions:* Currently product offerings often available through plan sponsors and administrators require all or nothing participation in a paycheck replacement option and do not accommodate partial annuitization or offer a reasonable means of splitting assets between options.

6. *Poor Disclosure:* Some of the financial products that are presented as lifetime income alternatives provide no risk transfer for the three keys risks: market volatility, longevity, and inflation and no clear statement about the risks to the consumer. Provider websites make statements in fine print, such as: "we'll monitor and adjust your portfolio for as long as you want us to while making sure your money lasts" or income "could last a lifetime" and then footnote that the income is expected to last into the nineties, without any discussion of risk or likelihood of failure.

When all of these factors are considered together, it is not surprising that plan sponsors in the current marketplace are more likely to focus on managed payout approaches rather than lifetime income.<sup>45</sup> While plan sponsors view these approaches in terms of reducing their fiduciary risk, they may overlook or minimize the risks of bad outcomes for the participant. Therefore, it is critical that fiduciaries receive guidance with respect to providing education about paycheck replacement considerations to participants to help them carefully evaluate the programs they choose for post-retirement income alternatives. Focus is also needed on how alignment of incentives influences behavior. Recent research demonstrates the results of misalignment of stakeholders' interests. For example, a review of the mutual fund investment offerings in 401(k) plans by fund families acting as trustees found that fund families favor their own funds, including poorly performing funds, and these offerings were costly to plan retirement savings.<sup>46</sup> Another study audited the work of financial advisors, focusing on the question, "Do financial advisers undo or reinforce the behavioral biases and misconceptions of their clients?"<sup>47</sup> Trained auditors met with financial advisers and

---

45. See Aon Hewitt *supra* Appendix III (noting evidence on the greater interest in managed payouts by large plan sponsors).

46. See Veronika K. Pool, Clemens Sialm & Irina Stefanescu, *It Pays to Set the Menu: Mutual Fund Investment Options in 401(K) Plans*, 2-4 (2013), available at <http://ssrn.com/abstract=2112263> (investigating whether mutual fund families acting as trustees of 401(k) plans display favoritism toward their own funds by using a hand-collected dataset on retirement investment options).

47. See Sendhil Mullainathan, Markus Noeth & Antoinette Schoar, *The Market for Financial Advice: An Audit Study* 1-4 (Nat'l Bureau of Econ. Research, Working Paper No. 17929, 2012), available at <http://www.nber.org/papers/w17929> (finding results that suggest advisers encourage bad financial choices based on individuals' behavioral biases).

presented different types of portfolios.<sup>48</sup> These portfolios were split between options that were aligned with the financial interests of the advisers or that ran counter to their interests.<sup>49</sup> The audit revealed that advisers made recommendations aligned with their interests, including those with higher fees, and that advisers pushed for actively managed funds.<sup>50</sup> Additional research is needed to understand how plan administration firms differ in their guidance or advice depending on their connection to internally managed fund options or retail options versus competitive purchasing.

As mentioned above, there are various financial incentives to different parties imbedded in each of these options. The issues of financial incentives and payout options are further complicated by the variety of advisors and financial professionals and the various regulatory standards and professional codes of conduct they must follow.<sup>51</sup> Consumers are often unaware of the various interests due to a lack of effective disclosure, placing them at risk if they assume they are dealing with a fiduciary or trusted source hired by their plan sponsor or employer to offer objective professional advice. In this context, improved public policy, regulation, and financial education is badly needed in order to support a marketplace where consumers can make appropriate lifetime income decisions in retirement.

#### *E. Lack of Meaningful Competition*

Although not yet widely acknowledged, annuity pricing has significant variability. If the consumer is to be assured of receiving the best the market has to offer, price variability is a central reason that purchasing through a competitive bidding platform is

---

through an audit study that investigated the quality of advice in the retail market).

48. *Id.* at 6-8.

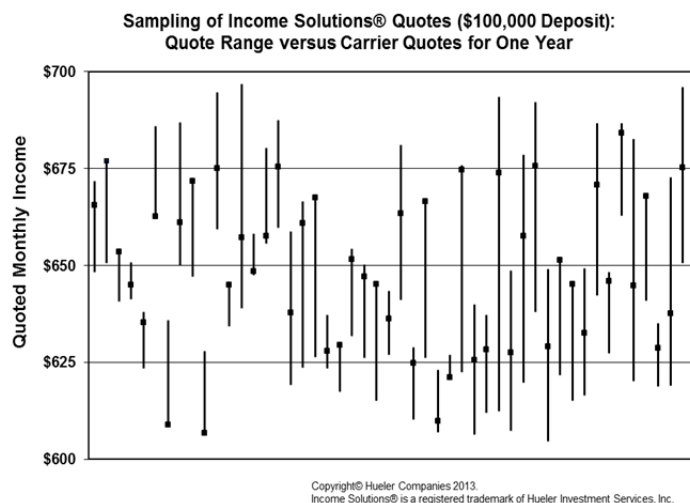
49. *Id.*

50. *Id.* at 3-4.

51. See generally Jason Bromberg & Alicia P. Cackley, *Regulating Financial Planners: Assessing the Current System and Some Alternatives* (University of Pennsylvania, Wharton School Pension Research Council, Working Paper No. 2012-18, 2012), available at <http://pensionresearchcouncil.org/publications/document.php?file=1001&download=1> (providing a description of current regulatory systems and the benefits of potential alternative approaches); John A. Turner & Dana H. Muir, *The Market for Financial Advisers* (University of Pennsylvania, Wharton School Pension Research Council, Working Paper No. 2012-06, 2012), available at <http://pensionresearchcouncil.org/publications/document.php?file=997&download=1> (providing an overview of the market for financial advice and the evolution of regulatory systems in response to conflict of interest concerns).

distinctly preferable to any single source.<sup>52</sup> This section presents data from an institutional platform currently active in the United States<sup>53</sup> that uses competitive bidding for all annuity quotations. The data shows that, at any given point in time, different insurance carriers will be competitive for different quotation scenarios, and results change over time. The analysis of several thousand annuity quotes indicates that the difference in monthly income between the high and low quote averages eight percent; in some instances, it may be greater than 20 percent although spreads greater than 15 percent are unusual.<sup>54</sup> The analysis also examined individual insurance carriers' positions on annuity quotes relative to peer companies.

### Exhibit II



52. See Kelli Hueler & Anna Rappaport, *The Role of Guidance in the Annuity Decision Making Process* 16-17, (Pension Research Council, Working Paper No. 2012-11, 2012), available at <http://www.pensionresearchcouncil.org/publications/papers.php> (discussing price variability and its impact on purchasing decisions).

53. Data is provided by Hueler Income Solutions®, Minneapolis, Minnesota. See *The Role of Guidance in the Annuity Decision Making Process*, *supra* note 52, at 6-10 (demonstrating similar data for an earlier time period); see generally *The Retirement Income Challenge: Making Savings Last a Lifetime: Hearing Before the Senate Special Committee on Aging*, 111th Cong. (2010) (written statement of Kelli Hustad Hueler, President & CEO, Hueler Companies).

54. See *The Role of Guidance in the Annuity Decision Making Process*, *supra* note 52, at 17 (demonstrating the range of annuity quotes).

The analysis shown is based on a sample of fifty individual quotations during 2012, each with a \$100,000 annuity purchase price. One specific insurance carrier's quote position is plotted against multiple peer companies across different annuity types over a twelve month period. Each vertical line in the figure represents the range of the high to low annuity quotes across the various providers for each annuity quotation scenario. The box represents the same individual insurance carrier across each quote scenario. In the period shown, this carrier had the high result for some quotes and the low result for others; it quoted in the middle range for the remaining cases. Over time, similar variability results have been found to be consistent. The spread between the high and low quotation varies by scenario.

Exhibit III shows spreads as dollar amounts. It also shows a few examples of quotes for a \$100,000 purchase price and illustrates the income amounts from the highest and lowest quotation. The data demonstrates how consumers increase their retirement income by using a competitive platform to purchase income annuities.

*Exhibit III*

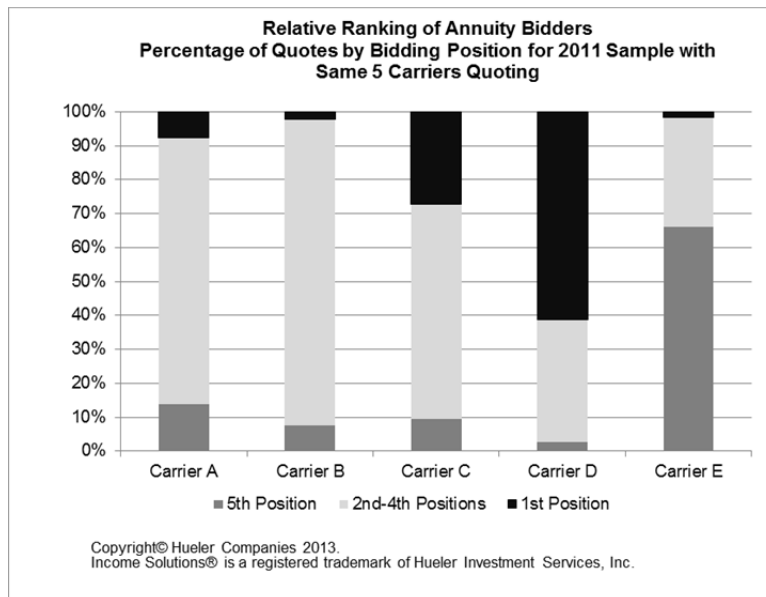
*Example of Annuity Quotes and Spread  
\$100,000 Quotes (2010)*

TYPE	HIGHEST ANNUAL INCOME	LOWEST ANNUAL INCOME	% DIFFERENCE
<i>WIDE SPREAD</i>			
Joint and Survivor	\$6,050	\$5,056	20%
Single Life	\$5,794	\$4,716	23%
<i>MID-RANGE SPREAD</i>			
Joint and Survivor	\$6,768	\$6,044	12%
Single Life	\$10,118	\$9,376	8%
Joint and Survivor Life with 10 Year Certain	\$6,688	\$6,392	7%
<i>NARROW SPREAD</i>			
Joint and Survivor Single Life	\$8,478	\$8,071	5%
Single Life	\$6,819	\$6,567	4%

A further analysis focuses on competition versus single insurance carrier programs. Plan sponsors may select a single insurance carrier or they can access a competitive purchasing platform.<sup>55</sup> The data indicates that single carrier programs can produce sub-optimal income results for a potentially significant percentage of individual purchasers. Given the consistent variability of carrier pricing behavior this remains true regardless of how competitive the single carrier may have been when initially selected. If a single carrier program establishes a set pricing formula for a multi-year period, and the competitive pricing reflects current market prices, then the single carrier program will be relatively more or less costly as the market prices change. The MBD Platform requires carriers to compete to win business. Internal review of over a decade of an MBD Platform data suggests competition drives improved pricing within the carrier group as a whole and even positively influences pricing by carriers outside the group.

*To demonstrate the impact of a competitive platform, an analysis was performed on a sample of annuity quotations received from the same five bidding insurance carriers in 2011 and 2012.*

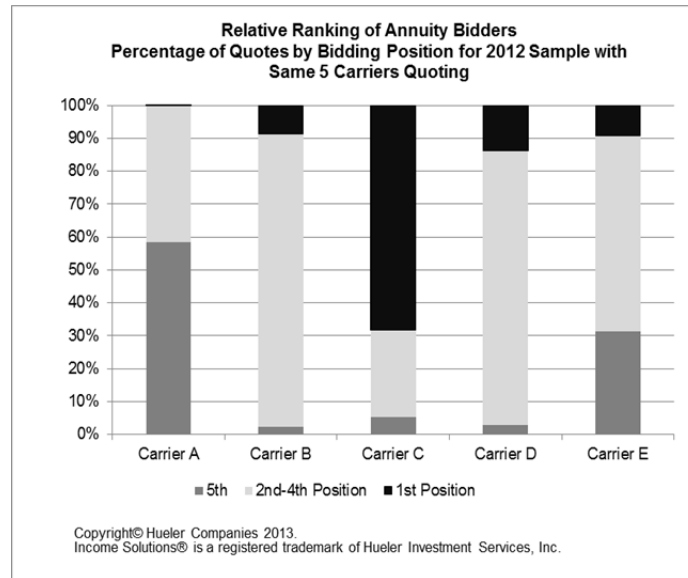
*Exhibit IV*



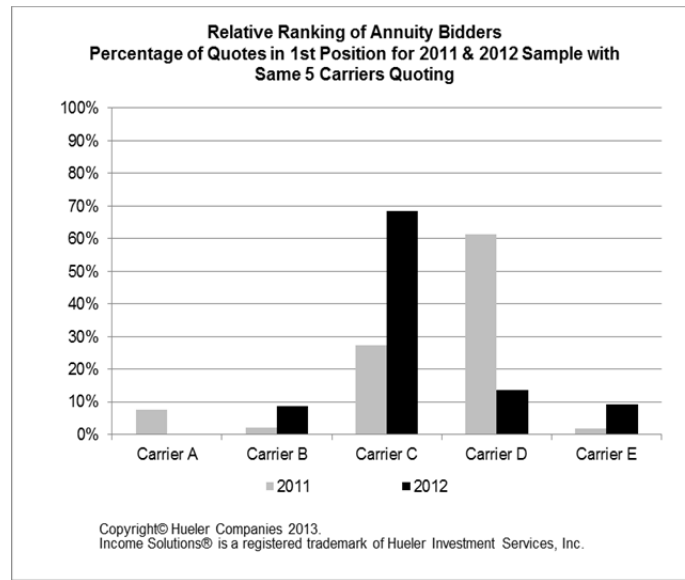
55. *Lifetime Income*, *supra* note 3.

The 2011 results shown here indicate the percentage of quotes on which they were first, the percentage on which they were in fifth or last position, and the percentage in which they were in the middle for each insurance carrier. During this time period, Carrier D had the greatest number of first positions in the quote sample, but it was also in the last position in other quotations. Carrier E had the greatest number of last positions, but it also had times when it quoted in the first position. If any one of the insurance carriers were chosen as a single source, a significant percentage of the total buyers would have paid higher prices and received lower monthly income amounts. The same process was completed for a 2012 sample and similar results were found.

*Exhibit V*

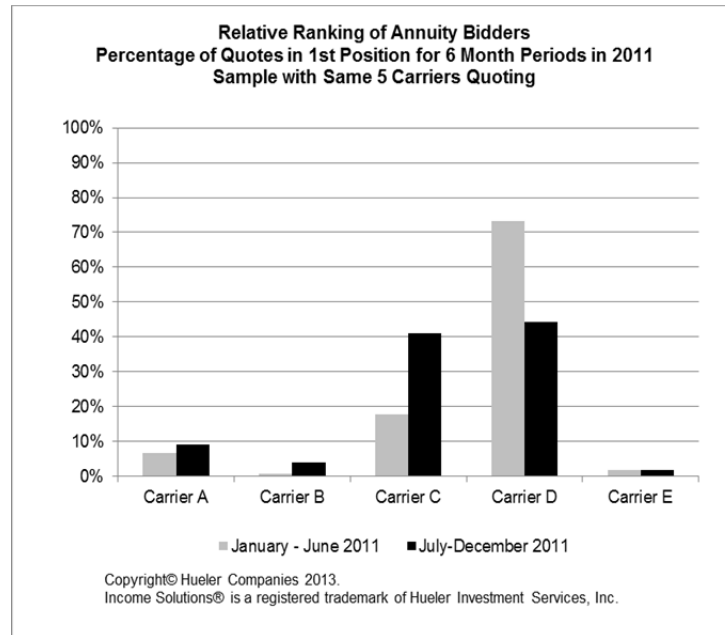


However, in 2012, Carrier C had the greatest number of first positions compared to Carrier D in the prior year. A comparison of first positions between the two years was prepared.

*Exhibit VI*

This comparison shows the shifting of the market leader. It also shows that three insurance carriers had more first positions in 2012 and two had more in 2011. A further analysis looked at shorter periods and found that an insurance carriers' quoting position could shift month by month. This could be the result of insurance carriers updating their pricing assumptions and/or models on a different schedule. Results for the first and second half of 2011 show a different market leader.

## Exhibit VII



The data supports the conclusion that any system used to select a single insurance carrier will lead to higher prices and lower monthly income for some purchasers. Furthermore, it is impossible to predict which insurance carrier will produce the best results for consumers in future periods. Real-time, meaningful competition is necessary in order for consumers to obtain best available pricing for lifetime income annuity purchases.

Data analysis on the results of competitive bidding in the United Kingdom shows that the spread for United States buyers is not as large as those found in the United Kingdom.<sup>56</sup> In the United Kingdom, individuals have been required to annuitize most of the pension wealth, whether from DB plans or DC plans by age seventy-five.<sup>57</sup> They had the right to shop the marketplace by using an open market option (OMO) since 1978, but the majority still used their pension provider to supply the annuity even though

---

56. See Gonzalo Reyes & Fiona Stewart, *Transparency and Competition in the Choice of Pension Products: The Chilean and UK Experience* 4-5 (Int'l Org. of Pension Supervisors, Working Paper No. 7, 2008), available at <http://www.oecd.org/site/iops/41269756.pdf> (discussing results from the United Kingdom, a country currently building centralized information and quotation systems for annuity products to help individuals select the right retirement product at the right price).

57. *Id.* at 4.



they may not have gotten the best deal.<sup>58</sup> In fact, the difference in income between the best OMO rate and the existing pension provider was found to be as much as 30%, but only one in three individuals switched to a new provider.<sup>59</sup>

#### IV. A MARKET-BASED DELIVERY PLATFORM MODEL (THE “MBD PLATFORM”)

A Market-Based Delivery Platform Model (“MBD Platform”) serves as an effective framework for providing retirees with accumulated savings access to lifetime income annuities and is central to the solutions presented in this paper. The MBD Platform is a collaborative pro-growth private sector model accompanied by meaningful oversight from government. This Platform envisions all segments of the investment marketplace at the table with opportunity to grow and expand products and services within a competitive, low cost, and transparent framework that embraces innovation and improved delivery. The MBD Platform model is intended to encourage a robust provider market designing products structured to easily integrate with capital market investment alternatives, as well as to promote collaboration and innovation among manufacturers and distributors. This Platform facilitates efficient low cost delivery of lifetime income annuities to consumers and supports a balanced approach to securing lifetime income by facilitating a strategy of gradual partial annuitization with other sources of retirement income. This platform assumes that consumers use an integrated approach to managing their retirement resources including Social Security, all employee benefits, personal savings and housing wealth.

##### *A. Benefits to Consumers*

Consumers need access to a flexible purchasing model for lifetime income annuities that offers choice about when and how much income to buy, competitive pricing, and screening of insurance carriers without any purchase obligation. Under such a Platform, individuals would have a flexible proposition that offers them:

1. The option to decide how much money to set aside for lifetime income payments using only a portion of their savings and leaving the balance in their plan or other savings accounts;
2. The freedom to choose when to begin receiving payments;

---

58. *Id.* at 14.

59. *Id.*

3. Competitive low cost quotes available either through the employer plan or other market access points;
4. Access to free tools designed to help determine the most desirable annuity quotes with no limit on the number of quotes that can be requested;
5. Multiple insurance carriers to choose from with quotes that reflect personal income needs and corresponding financial ratings of each carrier;
6. Product choices, including inflation protection as an option;
7. The choice to buy from more than one insurance carrier and at more than one time over a desired period;
8. No obligation to purchase.

### *B. Purchasing Platform Guidelines*

An effective MBD Platform is part of an integrated approach to evaluating lifetime income alternatives that meets certain requirements with regard to competition, disclosure, financial incentives and transparency to ensure the integrity of a conflict-free delivery process. The following is a description of the framework that might be included for such a purchasing platform guideline:

The purchasing platform is integrated into a larger whole, via partnerships with financial companies, employee benefit sponsors, financial advisors, and others. The integration is designed to support individuals strengthening their total lifetime income results and recognizing that generally an annuity purchase reflects only a part of the portfolio, often 20% to 30%.

Transparency is required. Fees and relationships between parties involved in the transaction are fully disclosed. Distribution costs are the same regardless of insurance carrier and are disclosed.

There is meaningful competition. Comparable products and their costs are presented simultaneously in a format that provides consumers the opportunity to compare and consider the various purchase options. (Product features in each comparison should be similar and ideally there would be standardized product features to reduce complexity.)

Product providers (insurance carriers) are screened for financial stability and service capability. Part of the role of the purchasing platform is to establish standards for inclusion and to perform ongoing evaluation and monitoring of carriers.

Product features meet important consumer needs. For example, with income annuities, they include access to lifetime income guarantees for the purchaser and joint annuitant and access to inflation protection.

Buyers have flexibility about when to annuitize and they can annuitize in steps over a time horizon consistent with their income needs.

The platform accommodates splitting the purchase between multiple insurance carriers.

The platform accommodates use of both qualified plan funds and personal savings. It can handle both pre-tax and after-tax funds.

Financial stability data or ratings are published with the price data and organized alongside corresponding carriers.

“Pay-to-play” arrangements with carriers are prohibited and all fees are leveled to remove the potential for conflicts. “Leveled” means using the same fees regardless of insurance carrier.

The integrated system facilitates access to other resources including objective generic advice and personal guidance for retirement income planning, both of which are important for supporting effective consumer decision-making. The importance of touch points and the availability of guidance from a trusted source is recognized.

The other alternatives for retirement income beyond the purchasing platform vary by organization making the platform available. Examples of other alternatives include installment payments, offering transfer of defined contribution balances to defined plans to payout lifetime income and use of managed payout plans.

### *C. Role of Technology*

Technology and automation of the quotation process is central to the operation of the MBD Platform. Under this Platform, technology plays a key role in reducing delivery costs and facilitating transparency, competition, and access. Technology helps ensure individual retirees have access to low cost, competition driven pricing of lifetime income annuities and provides the tools to customize an income stream to match individual financial circumstances. Technology can also help facilitate integrated decision making regarding broader retirement income planning.

With purchasing platforms, buyers can easily get prices and information from multiple insurance carriers and do fair comparisons. With feedback from the platform provider about the quotations, the carriers are able to see how they compare from a competitive point of view on a continuing basis.

Most Americans are not yet accustomed to buying financial products through competitive exchanges, but they are very accustomed to making financial transactions such as trading securities over automated platforms. The implementation of the Affordable Care Act will introduce health insurance exchanges into the normal process for buying health insurance for many

Americans, and it will likely make consumers more familiar with the use of competitive exchanges or purchasing platforms for important purchases.<sup>60</sup> This may also drive an interest in having better competitive information more readily available during the consideration and purchase of financial products.

#### D. Role of Consumer Guidance

Structural guidance built into technology and active guidance working in partnership with technology are vital to the implementation of an MBD Platform. Selecting an approach for lifetime income is a complex and important decision, both because of its long-term impact and because of the significance of the dollars committed. For some people, it will be the most important financial decision of their lives. The choices involved are complex, and there are significant trade-offs with a variety of product features to consider, and individuals are greatly influenced by framing of information and decision architecture.<sup>61</sup>

The authors' research indicates that guidance is very important in the selection of an approach for post-retirement income and that the vast majority of income annuity buyers seek out active guidance and take advantage of it.<sup>62</sup> Messages provided in connection with employee benefit programs can serve to increase interest in guaranteed lifetime income or encourage individuals to move away from it.<sup>63</sup> Guidance can be built into the architecture of the program and such "structural guidance" can include other features the options built into programs, the information on plan sponsor and plan websites, and the type of information supplied when quotes are presented.<sup>64</sup> Guidance can also be provided one-on-one in a personalized way.<sup>65</sup> Such "active guidance" includes answering participant questions and explaining advisory options if the program in question permits advice.<sup>66</sup> Research from a well-established purchasing platform

---

60. See *The Health Insurance Market Place*, HEALTHCARE.GOV (Feb. 14, 2013), <http://www.healthcare.gov/law/features/choices/exchanges/index.html> (explaining that under the Affordable Care Act, health insurance will be provided through exchanges starting in 2014).

61. See generally RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISION ABOUT HEALTH WEALTH AND HAPPINESS* (2009) (offering an overview of key ideas in behavioral finance and how they affect financial decision making).

62. See generally, *The Role of Guidance in the Annuity Decision Making Process* note 50 (analyzing immediate annuity purchases and finding that the vast majority of purchasers secured some type of active guidance).

63. *Id.* at 1-2 (discussing the concepts of structural and active guidance).

64. *Id.* at 2.

65. *Id.*

66. *Id.* at 2, 10.

used across employer plans, plan administrators, financial services firms, and advisors, indicates that the vast majority of immediate annuity buyers seek out active guidance and take advantage of it.<sup>67</sup> More details about the types of guidance available by an existing MBD Platform are in Appendix I.

The importance of active guidance has also been found in other research. Experience with the market in Chile also demonstrates that guidance and incentives matter.<sup>68</sup> The Chilean system differs from the purchasing platform example described in this paper because it is connected to a mandatory government program.<sup>69</sup> Further, retirees have a choice of taking programmed or phased withdrawals, or buying an annuity.<sup>70</sup> This differs from the U.S., where lump sums are a common form of DC plan payout.<sup>71</sup> In Chile, “workers’ assets are accumulated in private pension funds (AFPs) which also provide the programmed withdrawals.”<sup>72</sup> “Insurers compete to provide quotes for annuities.”<sup>73</sup> The system also includes minimum benefits, and when accounts are less than needed to fund the minimum benefit guarantee, the participants are not allowed to buy annuities.<sup>74</sup> “Currently, most. . . retirees have elected annuity payments.”<sup>75</sup> The SCOMP, a government sponsored computer based competitive bidding system, was introduced in 2004.<sup>76</sup> SCOMP quotations can be secured by a retiree or a broker working with the retiree.<sup>77</sup> “[I]f a broker is used, an intermediation fee of up to 2.5 percent can be charged.”<sup>78</sup> “Members are allowed to request up to three quotes with or without the assistance of a broker or sales agent.”<sup>79</sup> Upon receipt of the quotes, “the plan member can accept one of the quotes, request more offers, or rebid the account.”<sup>80</sup> “In Chile, although thirty-four percent of the individuals who enter the bidding system do so directly via the Internet, only 12 percent finalize the process without a commission.”<sup>81</sup> Only a small fraction of the total

---

67. See *Id.* at 14 (analyzing immediate annuity purchases and finding that the vast majority of purchasers secured some type of active guidance).

68. See *Id.* at 20 (analyzing the situation in Chile).

69. *Id.* at 18.

70. *Id.*

71. *Id.* at 5.

72. *Id.* at 18-19.

73. *Id.* at 19.

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* at 19.

79. *Id.*

80. *Id.*

81. *Id.* at 20.

participants choose to get a competitive bid.<sup>82</sup> The Chile experience showed that incentives matter.<sup>83</sup> “Where brokers were involved in the process of reviewing annuities, 75 percent of the individuals got the best. . . payout. Only 43 percent did so when the retirees used the AFP for advice and 3 percent when a life insurer was consulted.”<sup>84</sup>

Another U.S. study indicates that professional guidance matters.<sup>85</sup> In a survey of retirees with at least \$200,000 of DC plus IRA assets, the results made clear that professional advice matters.<sup>86</sup> “Over one-half of the retirees who have not annuitized have worked with a financial advisor and most of these tend to follow the advice received.”<sup>87</sup> Of the group who had not annuitized, only five percent had received advice to annuitize.<sup>88</sup> In contrast, seventy-one percent of the annuitized retirees reported working with a financial advisor in deciding to purchase an annuity or in implementing their buying decision.<sup>89</sup>

### *E. Regulatory Structure and Public Policy*

The consumer will be best served by a unified public policy and regulatory structure supporting the operation of a broad system of private sector MBD Platform entities. A unified policy approach to support a feasible and sustainable private sector solution for lifetime income would address: (1) the direct needs of the consumer; (2) the concerns of the employer/plan sponsor; and (3) the dynamics and incentives of the service providers.

The underlying policy goal is a regulatory framework that supports a competitive market-based system while at the same time protecting consumers. Regulatory content needed to achieve a broad based system of properly constructed, licensed MBD platforms that best serve the public interest would include:

*Provider Financial Stability Standards:* Regulation would set the

---

82. *Id.*

83. *Id.*

84. *Id.*

85. Paul J. Yakoboski, *Retirees, Annuity and Defined Contribution Plans*, TRENDS AND ISSUES, (Apr. 2010) at 5, available at [http://www.tiaa-crefinstitute.org/ucm/groups/content/@ap\\_ucm\\_p\\_tcp\\_docs/documents/document/tiaa02029462.pdf](http://www.tiaa-crefinstitute.org/ucm/groups/content/@ap_ucm_p_tcp_docs/documents/document/tiaa02029462.pdf). The TIAA-CREF Institute surveyed two groups of retirees, one group who had elected life income and one group who had not chosen life income. *Id.* at 2. Retirees had to be retired for three years or more, had \$200,000 or more in DC and IRA assets at retirement, were not working and had less than \$200 per month in DB income. *Id.* Ninety percent had no DB income. *Id.* at 2.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

required minimum standards relative to solvency and financial stability of insurance companies. In addition, regulation would set the requirements regarding disclosure of financial stability information pertaining to the organization providing lifetime income products. Requirements would guarantee that participating insurance carriers meet minimum financial requirements, understanding that buyers may wish to choose insurance carriers based on financial standings higher than the minimum standard. Public disclosure of the nature and extent of guarantees provided by state guarantee funds or other third party guarantees would be encouraged. Consumer education should supplement disclosures so that they can be understood.

*Purchasing Platform Operational Standards:* Regulations would establish operational standards for any entity seeking compliance with the “MBD Platform” designation and would provide a framework of rules for the operation of the compliant purchasing platforms. The regulations would define disclosure requirements and require that the marketplace entities provide comparisons of product offerings in such a way to ensure consumers can see a comparison of income levels on comparable products together with an understandable description of the product. It is fundamental to the regulation that there are requirements for full disclosure of fees or compensation embedded in the products and paid to the MBD Platform entity.

*Conflict of Interest Standards:* Under the regulations, “pay-to-play” or preferential arrangements with carriers would be defined and prohibited.

*Product Labeling Definitions:* Regulations would provide definitions of permissible product structures. Ideally these definitions would allow for a range of offerings, but would require products fit within a structure compatible with direct, easily understood comparisons being presented to consumers. Innovation of new features should be encouraged. Terms used to describe product features should be standardized to permit comparison and understanding of product operation. Comparisons should disclose risks and the extent to which an income approach provides guaranteed lifetime income versus reliance on an expected payout of the retirement account.

*Retirement Plan Safe Harbors:* Plan sponsors of tax preferred retirement vehicles would be able to offer access to lifetime income alternatives delivered through compliant MBD Platform entities in accordance with safe harbors. The use of compliant MBD platforms would not increase fiduciary liability or cost to the plan sponsor. Safe harbors specific to compliant MBD platforms would allow plan sponsors to be comfortable taking action.

*Taxation Neutrality:* Taxes would not be a barrier to optimal retirement income choices. If both pre- and post-tax retirement savings are available, consumers can use either pre- or post-tax funds to purchase annuities. Such annuities should be available

inside or outside of tax deferred retirement funds.

*Advisor Fiduciary Standards:* The requirements would mandate that all who give financial advice will disclose, in a clear and standardized format, their relationship to the providers of any products proposed for purchase and whether or not they are legally required to act in the interest of their clients. Consumer education should supplement the disclosure so that it is understandable.

*Regulatory Goals:* Regulations will support and not interfere with public, employee, and buyer education about various types of income alternatives, their features, risks related to these choices, and the trade-offs between various options. Regulations would also be consistent and unified across agencies and governmental levels.

#### *F. Fiduciary Guidance*

Clarification is needed with respect to fiduciary guidance, paycheck replacement, education and offering lifetime income options for the post-retirement period. Fiduciaries have a great deal of experience with choosing investment managers, plan administrators and advice providers, and doing so in a way that addresses fiduciary concerns. However, it appears that most of this experience is within the context of the accumulation period, and that less has been done to identify whether there are specific concerns with regard to the spend-down period. There are several specific policy issues worthy of careful attention with regard to the spend-down period, the most obvious of which is how to handle the potential conflict of interest that annuitization presents when advisory fees are based on total assets under management. A related concern is whether third party fiduciaries or their representatives are required to provide consumers an objective presentation of spend-down alternatives, or whether it is appropriate to present only their proprietary income product or service. Additional questions arise about whether they are permitted to limit their lifetime income offerings to their proprietary products and services when a plan fiduciary would prefer broader alternatives. There are further issues related to ERISA fiduciaries and supporting paycheck replacement for employees. Another area worthy of further consideration is highlighted by the 2012 ERISA Advisory Council discussions, making clear that safe harbors for investment education do not apply to the income-related issues of the spend-down period. This also raises the question of how the safe harbors for investment advice are intended to apply to the spend-down period and how they are applied in practice.

Guidance is needed for fiduciaries about what constitutes prudence with regard to lifetime income options. The authors are



not aware of any such guidance at present. Some important questions that might be considered include:

- Do the comparisons of asset management strategies relative to lifetime income address the three key risks (longevity, inflation, and investment loss) of the spend-down period?
- Are participants offered unbiased guidance on how to consider annuitization as part of their retirement income plan?
- Where support is offered for lifetime income planning, is there an explanation of the generic range of options and the risk/benefit trade-offs?
- Will participants receive clear information about the risks and downsides as well as the advantages of each option offered?
- Are the options offered to participants structured so that they can be used for part of the total retirement account, or are they an all-or-nothing offer? If an all-or-nothing offer, are the implications of the offer explained?

### *G. Next Steps*

An action plan is necessary to move forward. The MBD Platform model outlined in this paper would offer widespread access to a cost-effective, well-structured marketplace for retirement income alternatives and a new and welcome level of consumer protection. However, in the current environment, many consumers do not have access to such a marketplace. To encourage the adoption of the tenets of the MBD Platform, the authors propose that public policy initiatives focus on the following:

- Defining the regulatory definition and requirements for the MBD Platform
- Developing appropriate disclosure requirement for marketplace participants
- Implementing a safe harbor regarding access to competitively priced lifetime income alternatives, including a specific safe harbor if a compliant MBD Platform model entity is used
- Ensuring consumers have flexibility with regard to the amount of assets to be annuitized, the timing of the purchases, and the counterparties with whom to do business
- Developing guidance for plan sponsors with regard to fiduciary requirements and the choice of an MBD Platform
- Facilitating access to the MBD Platform to individual

purchasers who are not connected to an employer benefit plan

- Supporting the development of effective financial education and guidance

## V. CONCLUSION

In today's world, retirees and those nearing retirement have many important financial decisions to make. Lifetime income is an important part of successful retirement planning, and often this means considering the purchase of an annuity after retiring. Making informed financial decisions as a consumer requires access to a well-structured marketplace. Such a marketplace exists where:

1. Prices are set through a process of meaningful competition, including multiple parties, real time quotes, and standardized terms and contracts.
2. The trade-offs between one course of action or product and another are presented fully and accurately.
3. Big decisions can be made gradually and in coordination with the rest of the consumer's financial life.
4. Safe counterparties can be distinguished from poor credit risks and counterparty risk can be diversified.
5. Information, education, and advice are not only available but are also unbiased and helpful in understanding the optimal course of action.
6. Distribution and other sales costs are fully disclosed.
7. The solutions for retirement income that are offered are well matched to the problems they purport to solve, for example, for retirement planning addressing inflation, longevity, and counterparty risk.

We believe that making progress towards these goals is timely, possible, and necessary.

## APPENDICES

*Appendix I: An Example of an Established Operational MBD Model Entity*

Income Solutions®, Hueler Companies<sup>90</sup> institutional purchasing platform in the United States offers an example of a competitive pricing platform for the United States. This is a non-exclusive, web-based competitive bidding platform for immediate and deferred income annuities. The platform is offered through multiple program partner channels. It is designed to produce the best market result for each individual and to bring the benefits of group purchasing to the individual in a way that is fitted to each person's goals. This platform can be implemented as a distribution option within a qualified retirement plan or as an IRA rollover alternative. It can be used for annuity purchases using tax deferred funds or using taxable funds. The platform relies on participating insurance companies' willingness to offer annuities through a low-cost competitive distribution channel. There is no incentive to use one product versus another. Program partners include employee benefit plan sponsors and administrators, financial advisors, and financial service companies.

The platform has been in operation since 2004, is widely accepted, and it is currently available to millions of plan participants. Today, thousands of plans have been provided access to the Income Solutions® program in order to make lifetime income alternatives available to *transitioning employees*. It is important to note that, while the program was designed to facilitate implementation as either an in-plan distribution option or a voluntary IRA rollover, ninety-eight percent of plans choose the voluntary IRA rollover distribution alternative. Adoption is generally facilitated through large plan administrators, as integration with the existing benefits portal is optimal. It is also available to independent financial planners and advisors and to the public through certain financial services firms.

The platform and surrounding information as well as the sponsor information provides un-conflicted structural guidance to the prospective purchaser. The platform offers individual competitive quotations for every purchase. Individuals are allowed to secure as many quotations as they wish.<sup>91</sup> Standardized information is shown for every quotation including the monthly

---

90. INCOME SOLUTIONS®, <http://incomesolutions.com/> (last visited April, 13, 2015) The platform referenced is Income Solutions®, Hueler Companies institutional delivery platform.

91. See *The Role of Guidance in the Annuity Decision Making Process*, *supra* note 52 (discussing structural guidance).

income that can be provided by the deposit and the ratings of the carriers offering the coverage. Up to ten carriers are shown, depending on the program partner and what type of payout is requested. Not all carriers offer all forms of payout. The platform also provides general information about annuitization, tools to help individuals determine the gap between expenses and income, and financial information. The structural guidance offers education about annuity options, figuring out how much income is needed, lower costs, and standardized fees, but it does not recommend whether to buy an annuity or how much to buy. The structural guidance is supplemented with active guidance. Income Solutions® salaried employees are available to program partners and prospective purchasers to answer questions and provide additional information, but they do not provide advice. Some program partners have salaried representatives who help buyers access the platform. The platform can be accessed directly by the individual, with the help of a facilitator from the program partner, and through a financial advisor. The facilitator is an employee of the program partner. The financial advisor would be hired and paid by the individual. The following exhibit offers a comparison of some key features of the program guidance depending on access method

*Comparison of Guidance Models by Delivery Channel*

	<i>Individual access</i>	<i>Partner uses salaried facilitator</i>	<i>Advisor is program partner</i>
<i>Structural Guidance</i>			
Information about program availability provided by	Program partner	Program partner	Advisor
Who secures quotes and executes purchase	Individual	Facilitator or individual	Advisor
Selection of insurance carriers to quote	Done automatically by platform*	Done automatically by platform*	Done automatically by platform*
Tools available	Competitive quote, insurance company	Same as for individual access, plus partner may	Same as for individual access, plus advisor

	ratings, tool to calculate income gap	offer additional tools	evaluation or other tools, varies by advisor
Ability of individual to directly access website	Yes	Yes	Yes
Education of buyer and development of pros and cons	Website	Website, plus partner may offer additional information	Website, plus advisor may offer added information
<i>Active Guidance</i>			
Questions answered for individual buyer	Hueler employee	Program partner or Hueler employee	Advisor backed by Hueler employee
Advice provided	No, information and question answering only	No, information and question answering only	Probably yes

\*Participating carriers vary by sponsor

The structure of the platform allows for purchases to be made at any time, and in any amount. Purchases are more often made after retirement, but they can be made before retirement, or at the time of retirement. Some purchasers choose to split their purchases between multiple insurance carriers, thereby diversifying carrier risk. Some choose to buy at several different times. This can be viewed as similar to dollar cost averaging.

An analysis of the experience of the purchasing platform shows that many buyers secure multiple quotations. Of the purchases studied, 78 percent of purchases were completed within four weeks of the first quotation. At the other extreme, some people take as long as two years to complete purchases.<sup>92</sup> Sixty-eight percent of the purchases were from tax-qualified plans, 28 percent from non-qualified assets and 4 percent are exchanges for other annuity contracts. Seventy percent of the purchases were by individuals reported as already retired.<sup>93</sup>

---

92. *Id.* at 16.

93. *Id.* at 14.

*Appendix II: Issues Related to Purchase Process and To Whom They Are Important*

<i>Issue</i>	<i>Individual</i>	<i>Employer and plan administrator</i>	<i>Advisor</i>
Meaningful competition and up-to-date pricing	Yes	Depends on goals – helps better meet employee needs	Yes
Availability of solutions that can be direct compared on an apples-to-apples basis	Yes	Depends on goals	Yes
The ability to determine how much to annuitize	Yes	No	Yes
Good education about retirement payout solutions, trade-offs, good purchase habits, what to look for in a buying platform	Yes	Depends on goals – may offer some education	Yes
Means of sorting out a strong vs. weak financial services company*	Yes – likely to rely on advice or rating agencies, or in employer single source program, choice by employer	Depends on goals- linked to fiduciary responsibility	Yes
Means to diversity counterparty risk (e.g. risk that financial services company will fail)	Yes	Depends on goals	Yes
Access to product features such as spousal and inflation protection, and ability to choose them	Yes	Depends on goals	Yes

Ability to choose timing of annuitization and to annuitize gradually	Yes	Depends on goals	Yes
Understanding how all parties to the arrangement are compensated and whether there are partnerships between multiple parties	Yes	Yes	Yes

\*Note that testimony presented at the 2012 Department of Labor ERISA Council indicated that this is a major concern for plan sponsors.

Source: Author analysis

### *Appendix III: Plan Sponsor Roles in Supporting the Post-Retirement Period*

Plan sponsors vary with regard to the extent to which they support the post-retirement period and with regard to what they do when they do support the post-retirement period.<sup>94</sup> Roles that employers can play include the following:

1. Throughout working years:
  - Provide illustrations that focus on paycheck replacement during working years
2. Throughout working years and at time of retirement:
  - Create a culture focused on the importance of paycheck replacement
  - Offer education with regard to options and considerations, both before retirement and at time of retirement
  - Offer advice either through an advice service, or by hiring advisors to work individually with employees
3. As people near and reach retirement:
  - Offer in-plan income options: Lifetime income can be offered through competitive purchasing platforms or through choice of a single insurance carrier
  - Serve as purchasing agent: Offer purchase of lifetime income through use of competitive purchasing platform

---

94. See *Lifetime Income*, *supra* note 3 (discussing plan sponsor involvement in the post-retirement period).

- If DB plan is offered, permit rollover of DC money to the DB plan
- Permit employees to leave their funds in the plan post-retirement and offer investment options, and/or managed accounts, and installment payouts; investment options that work well pre-retirement may not work well post-retirement, and vice-versa
- Ensure that plan administration providers understand employer's philosophy and are supporting it in implementation

These roles are not mutually exclusive. An employer may choose to implement several of these steps to create an integrated program. Note that DB and DC plans are very different. In either type of plan, the structure of the plan and the surrounding administrative structure influences the outcomes with regard to lifetime income. Lifetime income is the legally required default benefit payment requirement in DB plans in the United States, but it is often not provided at all from DC plans.<sup>95</sup> Where lump sums are available in DB plans, the rates of election vary depending on the type of plan, and age and length of service of the participant.<sup>96</sup> Older, longer service employees in traditional plans are more likely to choose income.<sup>97</sup> There is no consensus in the benefits community about what should be the default distribution options in DC plans or how much support the plan sponsor should offer with regard to post-employment income strategies.

A recent Aon Hewitt study provides insights into what solutions for retirement income are being offered or planned for 2013 by large employers.

*Employers Offering Solutions for Retirement Income in 2012 & Percentage of Those Not Offering Who Are Planning to Offer in 2013<sup>98</sup>*

<i>Solution for Retirement Income</i>	<i>Percentage Already Offering</i>	<i>Percentage of Not Offering Likely to Offer*</i>
On-line modeling tools or mobile apps to help	61%	58%

---

95. Sudipto Banerjee, *Annuity and Lump-Sum Decisions in Defined Benefit Plans: The Role of Plan Rules*, EMP. BENEFIT RES. INST, 17 (Jan. 2013).

96. *Id.*

97. *Id.*

98. *2013 Hot Topics in Retirement: Focusing on Financial Wellness*, AON HEWITT (2013) available at [http://www.aon.com/human-capital-consulting/thought-leadership/retirement/surveys\\_2013\\_hot-topics-in-retirement.jsp](http://www.aon.com/human-capital-consulting/thought-leadership/retirement/surveys_2013_hot-topics-in-retirement.jsp)



participants determine how much they can spend each year in retirement		
Distributions from plan/automatic payment (participant elects an automatic payment from the plan over an extended period of time)	37%	24%
Within the plan: professional management (managed accounts) with drawdown feature (managed account provider allocates participant assets for income and manages the annual amount paid from the plan)	19%	26%
Facilitation of annuities outside the plan as options for plan distributions	13%	15%
Within the plan: managed payout funds (those with a specific annual target payout percentage with no guarantees)	12%	19%
Within the plan: annuity or insurance products as part of fund lineup (e.g., minimum annuity payout, fixed annuities, other)	10%	14%
Ability to transfer assets to a defined benefit plan in order to receive an annuity	3%	5%

\*Includes those very likely and somewhat likely to offer

More plans offer managed payout funds and payouts from managed accounts than annuity options. These options leave the mortality and investment risk with the plan participant, although the investment is generally shifted. These options generally include an annual charge levied against assets by either the offerer of the managed payout fund or the manager of the managed accounts.<sup>99</sup> The annuity options transfer the mortality

---

99. See *A Look at 401(k) Plan Fees*, DEPT OF LABOR, (October 2010) [http://www.dol.gov/ebsa/publications/401k\\_employee.html](http://www.dol.gov/ebsa/publications/401k_employee.html) (discussing plan fees).

risk and investment management to an insurance carrier. Depending on the form of the annuity, the investment risk may also be transferred. The expenses that are paid to the insurance company are included in the quoted price and not explicitly defined.

*Appendix IV: Questions for Plan Sponsors to Ask When Exploring Lifetime Income Options*

Some of the issues that the plan sponsor may wish to explore in comparing managed payout funds and annuity options include the following:

- How is the investment risk treated? Who gets the benefit of the market upside and who bears the risk of market losses?
- How is mortality risk treated? Can a participant run out of money?
- Is the income provided inflation indexed? Can a participant elect such protection?
- What benefits remain on death?
- Is any liquidity available? What impact does this have on long term income?
- Is an advice model included in the service you provide?
- If so, does it integrate guaranteed lifetime income during the spend-down period? How?
- What is the relationship between providers of advice and the organization offering the lifetime income alternatives?
- Are financial incentives paid to the plan administrator by any organization managing assets, or providing advice? Is there any revenue sharing?
- Does the arrangement offer a variety of lifetime income alternatives? Can individuals make partial allocations to the different alternatives?
- How are risks, alternatives and trade-offs described to participants? What formats are used to promote fair comparisons?
- If annuities are offered or purchased, is a competitive market approach used?
- Are retail products included in the retirement income alternatives provided?
- What due diligence is used in the selection or structuring of the retirement income alternatives offered?
- What fees and expenses are embedded in the options used? Are they disclosed to the plan sponsor with an analysis?

Are they disclosed to participants and how?

*Appendix V: Employer Perceptions of Barriers*

A new Aon Hewitt study offers input about what larger private sector employers are saying are the barriers to offering solutions for retirement income including annuities to their DC plan participants.<sup>100</sup>

*Barriers to Solutions for Retirement Income Reported by Large Employers<sup>101</sup>*

<i>Barrier</i>	<i>Percentage of Employers</i>
Operational or administrative concerns	54%
Fiduciary concerns	51%
Waiting to see market evolve more	50%
Participant utilization concerns	44%
Difficulty with participant communication	34%
Not interested in offering solutions for income within the plan at this time	27%
Portability concerns	23%
Cost barriers	23%
Preference for participants to leave the plan at termination	11%

---

100. *2013 Hot Topics in Retirement*, *supra* note 98, at 27. Aon Hewitt surveyed human resource professionals, and received responses from more than 400 private sector employers representing eleven million employees. *Id.* at ii. By employer size, forty-five percent had 10,000 or more employees, twenty percent had 5,000 to 10,000, twenty-eight percent had 1000 to 5000, and seven percent had under 1000 employees. Fifty-five percent of the employers responding have publicly traded stock. Consulting firm surveys provide information representative of what their clients are saying and doing, and may be influenced by the messages they have received from the consulting firm. *Id.*

101. *Id.*

### Appendix VI

Appendix VI summarizes key features of sources of retirement resources for consumers:

#### *Retirement Resources and Sources of Paycheck Replacement*

SOURCE OF INCOME	STRUCTURE	CHOICES MADE	CHARACTERISTIC
<i>Social Security</i>	Benefit automatically paid as lifetime real income with survivor benefits	When to retire, couples can choose whether to retire at same time	Income provided directly from system; no market purchase
<i>Employer sponsored Defined benefit(DB) plans</i>	Default option is lifetime income with joint and survivor benefit	May have choices of form of income or lump sum Decision timing: at retirement <sup>102</sup>	Income provided by plan; no market purchase by individual Private sector benefits generally not inflation indexed
<i>Employer sponsored Defined contribution (DC) plans</i>	Provides account balance	How to withdraw funds from plan in accordance with structure available	Income generally purchased from market – plan sponsor defines options available

---

102. See also JAMES M. POTERBA, *Individual Decision Making and Risk in Defined Contribution Plans*, 13 ELDER L.J. 285 (2005) (discussing how retirees can “allocate assets within the plan, and when to draw down from the plan.”) *Id.*

<i>Key touch points: at time of retirement when discussing distributions *</i>	May have income support from employer – can be in-plan or out-of-plan In few cases, employer allows transfer to DB for income purchase	How to invest funds Whether to use income options provided; income options include both guaranteed income and fund payout without guarantees	Options can include guaranteed lifetime income and also gradual payout; whether guarantees are included and features may be confusing to buyer
<i>Additional touch points: when discussing post-retirement strategy</i>	Funds subject to Federally required minimum distribution requirements (RMD) <sup>103</sup>	Defaults are very important, but income based defaults are seldom provided RMD rules sometimes viewed as default; provide for gradual withdrawal of funds	Annuity purchase timing: at or after retirement (gradually during working life in some plans)

---

103. See *Retirement Plans FAQs regarding Required Minimum Distributions* IRS (Feb. 6, 2013), <http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Required-Minimum-Distributions> (explaining that required minimum distribution rules define payments required from pre-tax funds).

<i>Individual retirement accounts and other personal savings</i> <i>Key touch points: interaction with sources of advice* (formal or informal)</i>	Asset accumulation Pre-tax IRA funds subject to RMD requirements	Individual decides how to use resources Income options generally retail priced products and features can be confusing RMD rules sometimes viewed as default; provide for gradual withdrawal of funds	Annuities purchased in marketplace Timing up to individual Market choices include real guaranteed lifetime income and other payouts, likely to be confusing
---	---	--	---

\*Sources of advice and or guidance include advisors, insurance agents and brokers, representatives of employer and plan administrator, friends, and family.

#### *Appendix VII: Tradeoffs*

There are various options for the utilization of financial assets during retirement, and major differences and trade-offs between options, as shown in the Exhibit below.

#### *Trade-offs between Post-Retirement Options: Perspective of the Individual*

<i>Features</i>	<i>Lifetime Income Annuity</i>	<i>Other Products with Guarantees</i>	<i>Withdrawals</i>
Guaranteed income for life (protects against mortality risk)	Yes	Yes, but at lower level than income annuity	No
Mortality leveraging*	Yes	Some	No
Investment risk	With insurance company	With individual	With individual

Investment decisions	With insurance company	With insurance company, but may be able to choose from fund options	With individual unless delegated
Liquidity/access to funds	Not in most products	Yes, within limits	Yes
Remaining account value goes to heirs if early death	No, unless refund option elected	Yes, after fees for guarantees	Yes
Individual has control that resources will not be exhausted before death	Yes	Yes, but at lower level than income annuity	No
Owner can control funds in the account while income is being paid out	No	Yes, within limits	Yes, but they can be spent down and they will be gone. They can be diminished by bad performance
Impact on portfolio	Guaranteed income to cover living expenses allows more freedom in considering use of other resources	Guaranteed income to cover living expenses allows more freedom in considering use of other resources	

\*Mortality leveraging means that early deaths among people receiving payouts from the pooled annuity funds subsidize the payouts for those who live longer. This pooling effect enables higher payouts than if taking systematic withdrawals.

The authors believe that most members of the public do not understand the range of options and the trade-offs between them. Comparison between annuity products with similar features is straightforward, but comparisons between solutions that involve different approaches are much more complex and not

straightforward. Dealing with these issues involves choices by the various parties involved in annuitization.

It is important to recognize that when withdrawals are used, the risks go beyond those discussed earlier. Funds can be exhausted before death for a variety of reasons, such as poor investment performance (particularly in early years), withdrawing too much, giving unplanned gifts to family members, spending too fast, divorce, health or long term care shock, or loss of cognitive functioning. In the risk management framework, the lifetime income discussion is likely to focus on products with embedded guarantees, both lifetime income annuities, and investment products with floor income guarantees. The alternatives can be used in combination and often this is a good approach.

---

\*1 Kelli Hueler is CEO and founder of Hueler Companies, an independent data and research firm providing reporting and systems designed for the annuity and stable value marketplace. Ms. Hueler is nationally recognized as a key contributor on the topic of lifetime income creation. Hueler Companies was founded in 1987 and today the firm's data, market research, and analytical reporting are considered the industry standard. In 2004, Hueler Companies launched Income Solutions®, a ground breaking automated annuity purchase program adopted widely by large plan administrators, plan sponsors, and key industry associations.

\*2 Paula H. Hogan, CFP®, CFA is the Founder and CEO of her eponymous fee-only financial advisory firm in Milwaukee, Wisconsin. Ms. Hogan is a nationally recognized leader in the financial advisory field. She has served on the national boards for the Financial Planning Association and for NAPFA, the National Association of Personal Financial Advisors. She is also the author of multiple articles for both the Journal of Financial Planning and for the AII Journal.

\*3 Anna M. Rappaport, FSA, MAAA is the founder of Anna Rappaport Consulting. She chairs the Society of Actuaries Committee on Post-Retirement Needs and Risks, and is a past President of the Society of Actuaries. She is an internationally recognized actuary and writes and speaks frequently. She recently served on the ERISA Advisory Council and serves on the GAO Retirement Security Advisory Panel. She will complete 50 years as a Fellow of the Society of Actuaries in 2013.



