AMERICAN ACADEMY of ACTUARIES
Lifetime Income Initiative
ISSUE BRIEF

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Risky Business: Living Longer Without Income for Life Legislative and Regulatory Issues

American workers retiring today face a more pronounced emphasis on individual responsibility and risk for their lifetime incomes than their parents experienced, primarily due to changes in the original benefit promises under defined benefit plans and their overall decline in availability. Often, new retirees take lump-sum distributions from their 401(k)s or other retirement funds they've amassed over decades with scant information about how to use those funds to create monthly income streams to pay for their basic needs in retirement. An increasing number of retirees are consequently facing difficult challenges to find the right lifetime income solutions. This is not just a personal financial issue but also a societal one, because public safety-net programs can be strained if they are expected to cover large numbers of individuals who have not addressed their lifetime income risk.

What can be done to address these obstacles and better prepare current and future retirees to secure and manage their lifetime income needs? Many approaches are needed to address the challenges faced by future retirees attempting to secure their lifetime incomes, including changes within retirement plans and broad-based education efforts, especially when participants are leaving a plan. Participation is needed from all stakeholder groups, including lawmakers, regulators, actuaries, employers, financial planning advisers, and financial-product and service providers to determine what, if any, changes to laws, regulations, or private-sector business practices should be pursued.

In June 2013, the American Academy of Actuaries issued a discussion paper called *Risky Business: Living Longer Without Income for Life* (http://www.actuary.org/files/Risky-Business_Discussion-Paper_June_2013.pdf). This paper examines the importance of a secure income that lasts an entire lifetime. It suggests a number of legislative and regulatory approaches that cover the following topics in order to address this issue:

- emphasize financial literacy and education for prospective retirees;
- refocus plan design on lifetime income needs; and
- refocus federal retirement policies to support lifetime income needs

These regulatory or legislative approaches fall within the purview of various bodies and are described in the appendices.

The American Academy of Actuaries is a 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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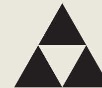

AMERICAN ACADEMY of ACTUARIES
Objective. Independent. Effective.™

1850 M Street NW, Suite 300, Washington, DC 20036
Tel 202 223 8196, Fax 202 872 1948
www.actuary.org

Mary Downs, Executive Director
David J. Nolan, Director of Communications
Craig Hanna, Director of Public Policy
Matthew Mulling, Policy Analyst, Pension

APPENDIX A

Department of Labor (DOL)

1. Issue: Provide education without risk of fiduciary liability

Except for Social Security benefits, retirement savings are concentrated in employer-sponsored retirement plans. As a result, the workplace can offer a significant forum to make retirement-planning education available to employees, not just at retirement but throughout their careers. Many employers that currently sponsor retirement plans already provide some guidance to employees through third-party-sponsored seminars on the topic of investment decisions.

Although employers are often optimally situated to provide retirement planning information and advice to their employees, few are willing and able to do so. One possible reason for this is a concern that the employer could incur fiduciary liability should advice received by an employee through such an effort later be claimed to have harmed an individual's financial position. A lesser concern is the cost; however, that should be small and manageable.

A similar situation exists at the time of benefit commencement in a defined benefit (DB) plan. Participants in a DB plan often opt to take their benefits in a lump sum at retirement in lieu of the guaranteed income.[1] Increased education at the time of distribution about the value of lifetime income could lead to a better-informed decision and a general change in behavior by employees at the time of retirement in favor of securing lifetime income.

Current Requirement: No requirement to provide education. Concerns about fiduciary liability are an impediment for some employers.

Possible Solution: Employer-based education will require some regulatory action to provide appropriate protection to employers from liability under Employee Retirement Income Security Act (ERISA) fiduciary requirements.[2]

Proposed regulations from the DOL on fiduciary conflict of interest address this issue, but there may be a need for further clarification.

Pros and Cons: Regulatory action to facilitate employer participation in education would improve education activities and can lead to a more efficient use of retirement plans. However, the value of any action could be diminished if employers do not want to expend the extra cost or take on the administrative burden. Small employers in particular would probably benefit from cost-saving, standardized approaches, perhaps supported and coordinated by the DOL.

2. Issue: Model financial education materials for DC plans

Except for some tax-related information provided upon distribution, the amount and type of information provided to participants in defined contribution (DC) plans, both on a periodic basis and at time of termination, varies greatly. This disparity can result in varying degrees of understanding among participants in different plans. A common set of information, perhaps contained in model language, would serve as a consistent basis for broad educational initiatives. Important issues include choosing lump sum vs. income, income equivalents to a lump sum, and selecting among income options.

Current Requirement: There is no current standard information requirement for DC plans.

Possible Solution: DOL could specify minimum standards of content that would be used in all plans. Items could include: (a) pros and cons on income vs. lump sums, (b) value of income equivalents for a lump sum, (c) differences among income options, both annuities and withdrawal programs, (d) importance of understanding fees, both in-plan and with rollovers, when given the option of staying or rolling over, and (e) considerations of whether or not to make a rollover. The DOL could provide generic material for this

1 Full lump sum distributions are allowed in 54 percent of large DB plans, and 65 percent of participants in those plans take the lump sum. Partial lump sum distributions are allowed in 25 percent of large DB plans, and 13 percent take a partial lump sum. *Retirement Income Practices Study,* MetLife, June 2012

2 See Academy comments to DOL for more background: http://www.dol.gov/ebsa/pdf/1210-AB33-RTT042.pdf and http://bit.ly/ZOC5lo

information and links could be provided to DOL website materials on these issues.

Pros and Cons: Standardized communication requirements, model disclosures, and educational materials would provide uniform information, simplify administration, reduce fiduciary risk for plan sponsors, and enhance participant understanding. Education should include general information upon enrollment in a plan plus reinforcement on a yearly basis. This effort should have minimal cost because the information is readily available. Although the information would not be equally useful to all participants, it would provide a start to better widespread understanding.

3. Issue: Income estimates on DC statements

ERISA section 105 requires DC plans to furnish each participant with an individual benefit statement, at least annually (quarterly where plan participants control investment choices), that includes the participant's "accrued benefits" or account balance. Discussion of how participants can translate account balances into income streams should be a recurring part of the needed education process. Doing this as part of the individual benefit statement will refresh and reinforce the education periodically.

Current Requirement: None.

Possible Solution: The Department of Labor[3] and members of Congress have made certain proposals to require that the standard periodic retirement benefit statement that individuals receive show the monthly amount of retirement income that could be generated by the accumulated balance. This illustration would focus the statements on income potential as well as total account balances. Several different lifetime income strategies could be illustrated, at several ages that profile the possible retirement date span, and at a range of investment returns that profile possible investment allocations and investment environments. In order to keep statements simple, the DOL could create a website that tracks exactly with the statement, so participants wanting comprehensive information could calculate it.

An additional illustration could be the amount of income that can be purchased immediately but payable at the normal retirement date. This could stimulate thinking about taking gradual action toward addressing longevity risk.

To aid participants' fuller understanding of their statements, the simplest and easiest method would be to make all plans' statements consistent with one another. This standardized statement could include mandated mortality, interest, expense, and annuitization assumptions, either fixed by regulation and updated as necessary, or tied to specified market rates. If the DC plan contains an annuitization option, that could be used. Current plan-specified factors should be used if the annuity is to be paid from a companion DB plan. Use of such common assumptions would narrow the plan sponsor's responsibilities and lower its costs. The common assumptions could be re-addressed periodically. All possible approaches should be explored with plan sponsors or record-keepers that could provide the service.

Pros and Cons: Participants may not fully understand the limited amount of monthly income that could be provided by an account balance that may look large but actually isn't when viewed in terms of its income potential. Creating an understanding of income potential can be foundational for prompting action to save more and plan for a payout strategy. The statement of income potential also can provide insight into choice of retirement date and the benefit of choosing various investment strategies. Because assumptions are averages and will be addressing events that may occur far into the future, the statement would need to include caveats about potential fluctuations. Preparing the income estimates will incur a moderate cost; however, they can provide

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3 Advance Notice of Proposed Rulemaking regarding the pension benefit statement requirements under section 105 of the Employee Retirement Income Security Act of 1974, 78 FR 26727 – 39 (May 8, 2013).

significant value. Costs can be controlled by standardization and use of certain mandated assumptions. The inclusion of three investment returns, three potential retirement dates, and possibly more than one income choice, including both annuity and other approaches, would be extremely valuable in stimulating retirement planning thinking. At the same time, too many figures may be intimidating to some participants; consequently, great care would need to be taken to design the presentation to be of value to a broad spectrum of users. This goal could be approached either through carefully designed printed material that accommodates both the participants who want limited information and those who want comprehensive information, or through a link to a more detailed discussion.

4. Issue: Information on lifetime income guarantees

The significance of lifetime income risk is not well understood by many pre-retirees and retirees. The meaning of life expectancy and the financial consequences of living longer or shorter is not sufficiently appreciated. A good understanding of these concepts is needed for effective planning.

Current Requirement: No required information provided to participants through either DC plans or DB plans

Possible Solution: While customized material about specific options within a plan should be encouraged, the DOL could provide a notice to participants that would provide generic information on the importance of income guarantees extending for life – similar to the tax notice currently required by the Internal Revenue Service (IRS) on distributions. This information should include illustrations of the probability of survival of the individual and of one member of a married couple to various ages beyond average life expectancy at retirement, using one of a set of standard mortality tables. This information could be included in the proposed income estimation that would be provided to participants annually with their account statement. A link to a broader discussion could also be provided. Plan sponsors could also provide this information on their company intranet site or during company human resources meetings. Issuance of regulatory guidance could help address fiduciary responsibility concerns.

Pros and Cons: An understanding of lifetime income risk provides an essential basis for a retiree to determine the actions to take that will address the risk. Such a notice would be a small, low-cost administrative step for a plan.

APPENDIX B

Consumer Financial Protection Bureau (CFPB)

Issue: Information on lifetime income guarantees

Lifetime income risk and the issues associated with achieving income for life are not well understood by many pre-retirees and retirees. The meaning of life expectancy and the financial consequences of living longer or shorter are not sufficiently appreciated. A good understanding of these concepts is needed for effective planning.

Current Requirement: No required information provided to participants through either DC plans or DB plans.

Possible Solution: While customized material about specific options within an employer defined contribution plan should be encouraged, the CFPB could also provide access to generic information on the importance of income guarantees extending for life. Such information should be relevant not only to employer-sponsored plans but also to any funds set aside by an individual to provide retirement income. This information should include illustrations of the probability of survival of the individual and of one member of a married couple to

various ages beyond average life expectancy at retirement, using one of a set of standard mortality tables. A link to a broader discussion covering the various risks faced by retirees that impact effective lifetime income planning could also be provided. Plan sponsors could also provide access to this information on their company intranet site or during company human resources meetings.

Pros and Cons: An understanding of lifetime income risk provides an essential basis for a retiree to determine the actions to take that will address the risk.

APPENDIX C

National Association of Insurance Commissioners (NAIC)

Issue: Confidence in ability of payer to deliver lifetime income

Lifetime income is a long-term commitment, and some retirees may be concerned that the insurer or the pension plan will not be able to deliver the guaranteed benefits. Currently, individual state laws preclude the mention of state-based Life and Health Guaranty Associations (LHGA) protection in sales material, although this information is readily available on the Internet.

Current Requirement: LHGA protections cannot be mentioned in sales material in almost all states under the laws governing State Guaranty Associations.

Possible Solution: We encourage the NAIC to consider two solutions that could alleviate retirees' concerns about the security and future value of their guaranteed benefits:

- Provide annuity purchasers with a better understanding of the value of state Life and Health Guaranty Associations by providing an explanation at the time of annuity purchase.
- Consider increases in guarantee limits to keep coverage levels consistent with policy amounts.

Pros and Cons: A notice at time of purchase could increase consumer confidence, encouraging more consumers to choose lifetime income solutions. Higher coverage amounts will maintain the value of LHGA protections. On the other hand, a brighter spotlight on LHGAs may increase the risk of moral hazard among insurance companies that could take advantage of the external guarantee. The cost of higher coverage amounts would ultimately be borne by surviving insurance companies. Greater reliance on LHGA assurances could erode the value of insurers carrying higher ratings; however, a similar reliance on Federal Deposit Insurance Corporation (FDIC) guarantees on bank deposits has not reduced banks' interest in achieving high ratings.

APPENDIX D

Treasury and DOL

Issue: Safe harbor guidelines on retirement income program design and implementation

Employers and defined contribution (DC) retirement plan sponsors have safe harbor guidelines under ERISA 404(c) and for Qualified Default Investment Alternatives (QDIAs) that apply to the investment menu in the accumulation phase. If analogous safe harbor guidance for the design, administration, and implementation of a program of retirement income were applied during the decumulation or retirement phase, employers and plan sponsors might be encouraged to implement such programs.

Current Requirement: DC plans are not required to implement a program of retirement income in the plan. As a result, the vast majority of plan sponsors pay a lump sum equal to the account balance to participants when they

terminate employment or retire. Participants must then make their own decisions to generate retirement income from their savings throughout their retirement, or engage a retail financial institution or financial adviser to help them with this task.

Plan sponsors that wish to implement a program of retirement income must rely on the general prudent man rule for deciding the "right" course of action. This situation has created confusion and uncertainty among plan sponsors, with the result that programs of retirement income are not common in DC retirement plans.

When Treasury released Notice 2014-66 concerning inclusion of deferred annuities in target date funds, the DOL released a statement concerning safe harbor requirements that do not require selection of the "safest annuity." The principal change seemed to be that the annuity selection responsibility would switch from the plan sponsor to the investment manager, while the process-based requirements would be unchanged. This change may be helpful because investment managers should be more willing to perform the process as well as being more comfortable with it.

Possible Solution: The DOL could issue safe harbor guidelines that a DC plan sponsor could follow to implement a program of retirement income. If a plan sponsor complies with such safe harbor guidance in the design, implementation, and disclosure of a program of retirement income, it would be protected in the event that a retiree experiences unfavorable outcomes—including outliving assets, reduction in the amount of retirement income after it has commenced, and/or retirement income that does not keep pace with inflation. The plan sponsor would also be protected against liability that an inappropriate form of retirement income solution was offered to a participant by the plan or that the plan selected the wrong specific product to implement the retirement income strategy. Note that such safe harbor guidance would not require a plan sponsor to implement a program of retirement income; such an action would be voluntary by a plan sponsor.

Pros and cons: Because the implementation of a program of retirement income and the use of a safe harbor would be voluntary, it would not incur additional cost for plan sponsors that do not wish to implement such a program. Guidelines could be adopted that minimize additional administrative complexity and consider common capabilities of current DC plan administrators.

APPENDIX E

Treasury

1. Issue: Cost of subsidies and supplemental benefits excluded in lump sum calculations

The current method of calculating lump sum benefits from DB plans does not require the inclusion of subsidies and supplemental benefits, such as enhanced early retirement benefits; consequently, lump sum values can have a lower relative value compared to their annuity equivalents. This methodology potentially creates understated value for a participant who elects a lump sum and reduces the cost of providing lump sum options and offers.

Current Requirement: Only basic retirement benefits are required to be included in a lump sum calculation.

Possible Solution: Treasury could interpret the requirements for calculation of lump sum calculations to include subsidies and supplements, such as subsidies for early retirement benefits that are more valuable than actuarially reduced normal retirement benefits.

Pros and Cons: Inclusion of all benefits in a lump sum calculation would provide more equivalent values for the retiree. Although increased value could encourage greater use of

lump sum distributions, it would provide more assets for retirement lifetime income.

2. Issue: Delays in updating mortality for lump sum calculations

Lump sum payouts from DB plans can be understated due to the use of outdated mortality tables. Older tables generally provide for higher expected mortality rates, which leads to the undervaluing of a participant's benefit. As a result, a participant's minimum allowed lump sum payment is lower than if based on a more current table. The mortality change could go in the opposite direction, in which case the lump sum value could be decreased.

Current Requirement: Through its regulations, Treasury and the IRS provide the applicable mortality table that must be used when determining the minimum lump sum payment a participant may receive for his or her DB plan annuity. The current table applicable for distributions with annuity starting dates during 2014 and 2015 was determined in IRS Notice 2013-49 and is a blend of mortality tables issued by the Society of Actuaries (SOA) in 2000, adjusted to reflect the impact of expected mortality improvement. The Treasury and IRS are required to revise the applicable mortality table at least every 10 years to reflect the actual mortality experience of pension plans and projected trends in that experience.

Possible Solution: Monitor the table more closely and update as soon as possible whenever a specified source, such as the SOA, issues updated mortality and projected mortality improvement tables. The requirement that the table be updated every 10 years can be maintained, but would likely not be necessary.

Pros and Cons: The proposed approach would better equate the value a participant receives as a lump sum and the corresponding amount of monthly income. Moving from the RP-2000 with various projection scales to the RP-2014 and MP-2014 generally increases lump sum amounts by 2 to 8 percent. This change will not directly encourage lifetime income but could provide larger lump sums that could enhance retirement income potential. The plan sponsor may be less likely to offer a lump sum option and more likely to purchase an annuity if the artificial lump sum cost advantage created by using an outdated mortality table is eliminated. The approach would be limited by the frequency that new tables and projection scales are issued. It would also make it more difficult for plan sponsors and participants to project future lump sum values.

APPENDIX F

Senate Finance Committee and House Ways and Means Committee

1. Issue: Incentives to generate lifetime income

Lifetime income annuities provide a good solution to longevity risk. Unfortunately they are underused in part because of perceived concerns such as loss of liquidity and investment control and reduced investment yields. The features that mitigate these concerns may be underappreciated or not understood by many consumers. At the same time, our current tax and social services systems effectively subsidize those who elect lump sums because a safety net is provided for those who are not successful in managing the lump sum. As such, financial incentives are needed for the purchase of annuities that will benefit retirees and society alike.

Current Requirement: Taxation on tax-qualified annuities is deferred until the income is received. Non-qualified savings have a deferral of taxation on interest through the use of exclusion ratios and exclusion amounts, but this benefit is quite limited.

Possible Solution: Lifetime income guarantees could be encouraged by providing additional well-targeted tax-favored treatment. For example, interest earned after lifetime income has been purchased irrevocably could be afforded tax-free treatment. This incentive can be designed in various ways: It could apply to pension payments from DB plans, single premium immediate annuities, deferred income annuities, guaranteed minimum income benefits, and guaranteed lifetime withdrawal benefits on variable annuities and mutual funds (in the last case dependent upon some type of irrevocable withdrawal utilization guarantee). This treatment could apply both to tax-qualified and individual retirement savings. A variant of this solution was proposed in the Retirement Security Needs Lifetime Pay Act (H.R. 2748 in 111th Congress).

Pros and Cons: Other actions to encourage use of lifetime income solutions include various types of education and availability of appropriate products. The addition of a financial incentive completes the full set of programs to lead retirees to take action. This proposal would result in permanently reduced tax revenues, but this reduction could be offset to some extent—and perhaps more than fully—by a reduction in costs of social safety net programs. Other advantages are a societal benefit of improved retirement lifestyle and an economic benefit of more stable consumer spending patterns.

2. Issue: ERISA definition of full retirement age constrains flexibility in plan design and management

Current Requirement: Full retirement age in DB retirement plans is limited to the later of age 65 and the fifth anniversary of plan participation by IRS rules; however, this age has become outdated because of improving longevity and changes in the Social Security program.

Possible Solution: The rules setting the full retirement age for private-sector DB plans could be changed to permit employers to raise the full retirement age to match the full retirement age of Social Security, currently age 66 and scheduled to rise to age 67.

Pros and Cons: This retirement timing behavioral signal would be better aligned with the behavioral signal inherent in the Social Security normal retirement age and would possibly encourage workers to remain in the workforce and retire later. Delaying retirement could lead to higher standards of living in retirement[4] as a result of more benefits accumulating in a worker's pension plan, allowing individuals more time to accumulate other retirement savings, and shortening the retirement period to be covered. Delaying

4 http://www.actuary.org/files/Normal-Retirement-Age_Issue-Brief_March-2013.pdf.

retirement can be physically difficult in some industries, and may result in fewer employment opportunities for younger workers.

3. Issue: Maximum Social Security deferral age

Social Security recognizes the value of delayed retirement by increasing available benefits 8 percent[5] annually from the attainment of normal, or full, retirement age through the earlier of actual retirement age or age 70, when the benefit amount stops increasing. This structure provides some flexibility for retirees and offers equivalent value for deferring income commencement. Longevity risk, by its definition, relates to the consequences of not having enough money at older ages and can be partially addressed by increasing income guarantees available at those ages.

Current Requirement: Social Security benefit commencement can be economically deferred no later than to age 70. (Any further deferral creates a loss of value due to a decreasing life expectancy and a lack of benefit increase.)

Possible Solution: Allow deferral with increasing benefit to a higher age, such as five years beyond the normal retirement date. Currently this would be age 71 and would be age 72 for retirees born after 1959. It would dynamically adjust if normal retirement ages are further increased.

Pros and Cons: Increasing the delayed retirement age beyond age 70 would present the possibility of increasing the amount of Social Security income available to a retiree during the later years of life. Doing so would also provide additional benefits for widow(er)s of deceased beneficiaries. The delayed commencement of Social Security always carries the risk that a retiree might forgo receiving benefits and die before the deferred retirement date, but this is a risk that many retirees find has an attractive trade-off for better longevity protection.

4. Issue: Required Minimum Distribution (RMD) age

The current RMD age of 70½ was set 50 years ago. Since the establishment of Social Security, life expectancy at age 65 has increased six years. RMDs can encourage premature drawdown of retirement assets in the current environment of increased life expectancy.

Current Requirement: RMDs in retirement plans, other than Roth IRA plans, must begin at the later of termination of employment and attainment of age 70½, except that 5 percent owners of a company sponsoring a plan must begin withdrawals at age 70½ regardless of employment. RMDs must begin at age 70½ in other tax-qualified plans, including IRAs and Simplified Employee Pensions (SEPs).

Possible Solution: The RMD age on tax-qualified accumulations could be increased from 70½ to a higher age in order to recognize the past increases in life expectancy. The increased age could be a set age, such as age 75, or could be set as a constant date after normal retirement age, such as five or six years later.

Pros and Cons: The objective of this approach is to create a practical solution for individuals who have changed employers (and, thus, have tax-qualified savings other than in a retirement plan with their current employer) and wish to defer retirement income until true retirement. This approach would make IRA treatment more consistent with 401(k) treatment. It would facilitate income planning for individuals who may have to work longer. Raising the RMD age would also increase the annual amount available to individuals over their retirement years.

5. Issue: Requirement of lifetime income options in DC plans

Having both in-plan and outside-of-plan income solutions is essential so that participants in all situations can have access to lifetime income arrangements. Many options already exist outside

5 For those born 1943 and after.

of plans, but having more lifetime income options available within plans would also help.

Current Requirement: DC plans may provide in-plan annuity options; however, many plan sponsors are reluctant to provide them either for fear of fiduciary risk or to simplify administration. The current safe harbor describes a process that should be followed in selecting products, but many plan sponsors have difficulty with satisfying the process requirements with confidence.

In Notice 2014-66, the Treasury removed some ambiguity with the indication that inclusion of deferred annuities with age-based income in target date funds would not be discriminatory; however, further progress in achieving greater use of lifetime income solutions would require legislation.

Possible Solution: A requirement that some form of guaranteed lifetime income and/or structured withdrawals be one of the investment or distribution options offered in individual account plans would be helpful to plan participants, provided that the requirement is accompanied by a clear set of regulations that allow for effective implementation at reasonable cost and without subjecting plan sponsors to undue fiduciary risk. The current safe harbor, which specifies a process for selecting annuity providers, could be modified to recognize specific acceptable provider characteristics, so it will be relied upon by more plan sponsors.

Individual plan sponsors should also be encouraged or required to make a form of lifetime income a default option. Such a change would require some level of fiduciary protection, such as clarification of a safe harbor.

Pros and Cons: The probability of a participant taking action on lifetime income is heavily dependent upon the availability of products to meet the need. Having lifetime income products available will provide a reason for discussing lifetime income solutions and then will facilitate taking action. This availability would add another dimension to many plans and, thus, would create additional cost in both a due diligence process and administering the additional option.

6. Issue: Ability to eliminate lump sum option for accrued benefits

Current regulations preclude removing any benefit, including optional forms of payments, from a plan once it has been accrued. If a DB plan makes lump sums available but the cost of lump sums increases, the plan can incur payouts that can weaken plan funding.

Current Requirement: Any optional form of payment on accrued benefits provided in a DB plan cannot subsequently be removed.

Possible Solution: Allow plan sponsors to cease offering lump sum options on accrued benefits.

Pros and Cons: Elimination of lump sum payouts would increase the utilization of lifetime income. Additionally, it would help strengthen plan funding. On the other hand, it would reduce flexibility for plan participants.

7. Issue: Social Security funding needs a sound footing

The adequacy of Social Security funding has been widely discussed as part of the public policy process; consequently, it is not discussed here at length. However, because it plays a very significant role in providing lifetime income, it is appropriate to highlight some dimensions of the issue.

A critical piece of most Americans' retiree lifetime income is the benefit that they will receive from the Social Security program. The longer-term financial issues that the program faces will result in reduced benefits starting in approximately 20 years unless action is taken. Though 20 years might appear to be a distant point in the future, waiting has serious negative consequences. Each year that action is delayed is one less year that future retirees have to plan for possible changes to their benefits. In addition, delaying will require more drastic action when it is taken, with the likely consequence of not spreading the impact of changes over multiple generations.

The American Academy of Actuaries advocates that one of the changes that should be incorporated in any Social Security reform is a gradual increase in retirement age to reflect the reality that retirees are living longer. Other possible approaches to address Social Security's financial condition are discussed in an Academy monograph on Social Security Reform Options.[6] Other commenters have suggested other changes either to benefits or revenues. Finally, any reform should keep in mind the value of Social Security as a program that provides a government guaranteed lifetime income for most Americans. A reduction in Social Security benefits will place greater reliance on other lifetime income solutions.

8. Issue: Soundness of PBGC financing

Other than Social Security, the primary provider of lifetime income in the United States is the defined benefit pension plan system. Keeping the plans healthy (and in existence) is a key to the maintaining what current levels of lifetime income we now have. One key to the success of the DB system is the guarantees provided by the Pension Benefit Guaranty Corporation (PBGC). According to the PBGC 2014 Projection Report, if PBGC's finances are not reformed, the PBGC multiemployer insurance programs, even with the premium increases under the Multiemployer Pension Reform Act of 2014 (MPRA), are likely to eventually run out of money to pay benefits, while the single employer programs have an uneven premium structure.

Guaranteeing the pension benefits of millions of Americans is an expensive task. Policymakers and the public need to understand the challenges of financing this valuable insurance. The cost should reflect the benefit guarantees that the PBGC provides in excess of a plan's assets and the likelihood of the PBGC incurring that obligation.

However, greater or inequitable premiums could encourage sponsors to exit defined benefit plans and may be an impediment to the creation of new defined benefit plans. A fair and equitable premium structure, therefore, would not only help fund the insurance coverage, but also contribute to stabilizing the retirement system. Concerns and evaluation of the PBGC premium structure were detailed in an Academy issue brief: *Examining the PBGC Premium Structure*,[7] April 2012, but are summarized here for convenience.

Current Requirement: Since the agency was founded, its premiums have been set by Congress. Unfortunately, neither the level nor the form of premiums has been consistent with the risk exposure. For some financially challenged sponsors and plans, PBGC's premiums would appear to be inadequate. As a result, financially sound companies are asked to make up the difference. And when Congress increases those premiums to cover the previous actions of other companies or to "pay for" legislation unrelated to pensions, it diminishes companies' willingness to maintain their pension plans.

Possible Solution: A new premium structure should be transparent and spell out how it will address ongoing costs and legacy costs. Ongoing viable plan sponsors should pay ongoing costs. Applying basic insurance principles, premiums for ongoing costs should be adequate and appropriately risk-related. Adequacy in this context refers to the overall level of the premiums relative to the true cost of the insurance provided and risk-related refers to the degree to which the premiums charged to the insured reflect the range of risks the insured presents to the PBGC.

Determining who should pay for the legacy costs is not an actuarial issue; rather it is a policy decision that needs congressional attention. Some options for allocating this legacy cost include:

- Assign the full legacy costs to existing DB plan sponsors, spread over future years to reduce the immediate burden.

6 http://www.actuary.org/files/Soc-Sec-Reform-Options_Monograph_03-03-2014.pdf
7 http://www.actuary.org/files/publications/IB_on_PBGCPremium_120426.pdf

- Assign only a portion of the legacy costs in the premium structure so that it does not create a significant impediment to sponsors continuing or establishing DB pension plans.

Pros and Cons: Reforming PBGC premiums is important to the financial soundness of the PBGC and important to encourage the preservation of responsible pension plans. Deferring action now will necessitate more drastic actions in the future. Without the tools to set its financial house in order and to encourage responsible companies to keep their plans, PBGC may face, for the first time, the need for taxpayer funds or a reduction in benefits provided.

Solutions to the legacy costs are controversial because of their impact on those who would assume the burden of being designated to pay. Nevertheless, a premium structure that transparently separates ongoing and legacy costs and enables the PBGC to fulfill its mission will be supportive to a viable retirement income system.

9. Issue: Attractiveness of maintaining and creating DB plans

The continuation of and formation of DB plans and possible introduction of plans that include risk sharing as a way to increase availability of lifetime income have been discussed as part of the public policy process; consequently, it is not discussed here at length. However, because DB plans play a very significant role in providing lifetime income, it is appropriate to highlight some actions that could increase the attractiveness of sponsoring DB plans.

No single action is sufficient to significantly increase the attractiveness of sponsoring DB plans, but a number of initiatives could in combination produce positive results. Using a principles-based approach to this objective, some legislative or regulatory steps to keep the DB plans healthy might:

- Permit better risk sharing between employers and employees. One example would be the type of mortality and investment risk-sharing among the participants described in Sen. Harkin's USA Retirement Fund, which was proposed in January 2014.
- Encourage greater cost sharing between employers and employees. While cost-sharing is currently possible, very few plan sponsors take this approach because of the administrative difficulties and negative tax implications for employees. Cost sharing would become more acceptable if the employee contributions were on a pre-tax basis, similar to 401(k) treatment.
- Permit employers to more easily pool or transfer fiduciary, administrative, and reporting responsibilities to experts outside the company. This might be accomplished by allowing outside financial entities to sponsor pension plans of multiple unrelated employers.
- Make funding less volatile and more predictable. For example, a collar could be placed on required contributions in order to limit the annual increase or decrease in contributions.
- Permit plans to eliminate or modify non-lifetime income payout options. This option was discussed in item F.6.
- Encourage plans to periodically illustrate to participants the value of their accrued benefit. Just as expressing DC balances in monthly benefits provides useful information to participants, expressing the value of the monthly benefit in a DB plan as a present value would also be helpful to participants.

Members of the Academy's Lifetime Income Risk Joint Task Force who participated in drafting this issue brief include: Noel Abkemeier, MAAA, FSA – co-chairperson; Nancy Bennett, MAAA, FSA, CERA; Bruno Caron, MAAA, FSA; John Esch, MAAA, FSA; Andy Ferris, MAAA, FSA, FCA; Andrew Forgrave, MAAA, EA, FCA, MSPA; C. David Gustafson, MAAA, EA, FCA; Novian Junus, MAAA, FSA; Barbara Lautzenheiser, MAAA, FSA, FCA; Cynthia Levering, MAAA, ASA; Tonya Manning, MAAA, EA, FSA, FCA – co-chairperson; Mark Shemtob, MAAA, EA, ASA, MSPA; Kenneth Steiner, MAAA, FSA; Steven Vernon, MAAA, FSA; Zorast Wadia, MAAA, EA, FSA, FCA; Benjamin Yahr, MAAA, FSA