AMERICAN ACADEMY of ACTUARIES

November 18, 2009

The Honorable Earl Pomeroy
1501 Longworth House Office Building
Washington, DC 20515
Phone: (202) 225-2611
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VIA FACSIMILE

Dear Congressman Pomeroy:

On behalf of the American Academy of Actuaries'[1] Pension Committee, I would like to thank you for your leadership and commitment to enhancing retirement security for all Americans. The *Retirement Security Needs Lifetime Pay Act of 2009*, H.R. 2748, is an important step toward ensuring adequate retirement security by providing incentives for annuities and we are very supportive of such an initiative. Neglecting to set aside adequate resources is a common problem in retirement planning – particularly for those who survive beyond their life expectancies. By encouraging annuitization and removing the barriers to longevity insurance, H.R. 2748 will help to address this problem.

The tax incentive for annuities in H.R. 2748 currently excludes qualified defined benefit (DB) plans. We strongly urge you to treat qualified defined benefit plans no less favorably than other sources of retirement income. With so many people reaching retirement age but having to postpone retirement due to declining account balances, our public policies should encourage the expansion of the defined benefit system, rather than create another reason for employers to end their defined benefit plans in favor of defined contribution plans. As lump sums are currently available in many DB plans, an incentive to select the annuity option in all defined benefit plans is good public policy – whether it encourages expansion of defined benefit plans, discourages further cutbacks in DB benefits, or gives participants more of a reason to elect the annuity option over the lump sum option. We believe this incentive should be available to all annuities provided from defined benefit plans, whether or not they are backed by the PBGC or an annuity contract from a private insurance company.

H.R. 2748 currently provides for both a percentage cap and a dollar cap on the exclusion from income. Lower caps would apply more to annuities purchased from a defined contribution plan or IRA ("fully taxable annuities") rather than to annuities purchased with after-tax money, where a portion of each payment is excluded from taxation due to the basis recovery rules in Internal Revenue Code (IRC) Section 72 ("partially taxable annuities"). While we are comfortable with having a lower *percentage* cap for fully taxable annuities, we believe that the *dollar* cap should be the same for both types of annuity, as discussed below.

[1] The American Academy of Actuaries is a professional association with over 16,000 members, whose mission is to assist public policymakers 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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Having a lower percentage cap for fully taxable annuities makes sense because the net exclusion for the fully taxable annuity (25 percent of the full amount) will generally be comparable to, if not larger than, the net exclusion (50 percent of the taxable portion) of the partially taxable annuity. However, we believe that the maximum dollar exclusion should be the same for both types of annuity. While the 25 percent / 50 percent differential discussed above achieves some rough comparability between the two types of annuities at lower payment levels, the higher dollar exclusion limit for partially taxable annuities winds up being far more valuable for these annuities than for comparable fully taxable annuities when the payments are large.

The attached example illustrates this point by comparing the effect of this proposal on annuities purchased though a tax-qualified plan with the effect on annuities purchased with after-tax dollars. We have made this comparison based on initial investments of $200,000, $400,000 and $600,000. For the $200,000 investment, the increase in the after-tax annual payment is roughly comparable. For the $600,000 investment, the increase in the after-tax annual payment is much more significant for the partially taxable annuity than for the fully taxable annuity.

We strongly support the longevity insurance provisions of H.R. 2748. We have long believed that the effective prohibition against longevity insurance in qualified plans pursuant to IRC Section 401(a)(9) is in direct conflict with the important goal of ensuring retirement security for those who outlive their savings. Permitting qualified plans to provide this type of benefit will make it much easier for retirees to manage their assets by providing a definite timeframe for spending down retirement savings. It will also help to safeguard against older citizens being forced into poverty because they have outlived their savings.

Members of the Pension Committee, as well as Academy staff, would be happy to meet with you to discuss these concerns, as well as other issues related to H.R. 2748, such as the treatment of annuities that would already be in pay status at the time that this bill is enacted and the effect of this legislation on Roth IRAs and Roth 401(k)s. If you have any questions or concerns, please contact Jessica Thomas, the American Academy of Actuaries' pension policy analyst, at 202-785-7868 or Thomas@actuary.org. Thank you for your consideration of this matter.

Sincerely,

John H. Moore, FSA, MAAA, EA, FCA
Chair, Pension Committee
American Academy of Actuaries

HR 2748 Example

Assumptions

a.	Tax rate		35%		35%		35%
b.	Age		65		65		65
c.	Annuity premium per $1 of annual payment	$	12.00	$	12.00	$	12.00

Annuity purchased in 401(k) / IRA

d.	Lump sum in 401(k)	$	200,000	$	400,000	$	600,000
e.	Annuity (fully taxable) = d. / c.		16,667		33,333		50,000
f.	After-tax (current) = e. x (1 - a.)		10,833		21,667		32,500
g.	Exclusion from tax (proposed) = lesser of 25% of e. or $5,000		4,167		5,000		5,000
h.	After-tax proposed = g. + (e. - g.) x (1 - a.)		12,292		23,417		34,250
i.	Increase in after-tax annuity = h. - f.		1,458		1,750		1,750
j.	Increase as a percentage of gross annuity = i. / e.		8.8%		5.3%		3.5%

Annuity purchased with after-tax dollars

k.	After-tax Lump Sum	$	200,000	$	400,000	$	600,000
l.	Annuity (partially taxable) = k. / c.		16,667		33,333		50,000
m.	IRS life expectancy		20.0		20.0		20.0
n.	Exclusion ratio = k. / (l. x m.)		60.00%		60.00%		60.00%
o.	Exclusion (current) = l. x n.		10,000		20,000		30,000
p.	After-tax (current) = o. + (l. - o.) x (1 - a.)		14,333		28,667		43,000
q.	Additional exclusion (proposed) = lesser of 50% of (l. - o.) or $10,000		3,333		6,667		10,000
r.	After-tax (proposed) = o. + q. + (l. - o. - q.) x (1 - a.)		15,500		31,000		46,500
s.	Increase in after-tax annuity = r. - p.		1,167		2,333		3,500
t.	Increase as a percentage of gross annuity = s. / l.		7.0%		7.0%		7.0%