Testimony on Longevity Annuity Guidance
Seth Safra on behalf of ERIC, 6/1/2012

I. Introduction

A. Good afternoon. My name is Seth Safra. I am a partner of the law firm Covington & Burling, and I am appearing today on behalf of The ERISA Industry Committee, commonly known as "ERIC." ERIC is an association of the country's largest employers. ERIC's members provide meaningful and secure retirement and other benefits to millions of employees.

B. ERIC appreciates the efforts that have been made to increase interest in lifetime income and to encourage innovation, by reducing regulatory barriers. And we appreciate the opportunity to submit comments.

C. ERIC submitted three sets of comments on the lifetime income guidance:

1. Our comments on longevity annuities--which are the topic of this hearing;

2. Our comments on partial annuity distribution options--which we discussed this morning; and

3. Our comments on Revenue Ruling 2012-4, which addresses rollovers from defined contribution plans to defined benefit plans. We wish ***that*** guidance had also been issued in the form of proposed regulations so that we and others would have a chance to comment on important elements of that guidance. In any event, we would like to work with you to address those concerns.

D. As noted in our written comments, ERIC supports regulatory changes to accommodate deferred annuities.

E. Except to the extent that you have questions, I will not address everything that was included in our written comments. Rather, I would like to focus on two topics:

1. The penalty for not satisfying one of the QLAC requirements; and

2. Making QLACs available for defined benefit plans.

II. The first topic is the penalty for not satisfying a QLAC requirement.

A. Under the proposed regulations, if one requirement is not satisfied, the entire deferred annuity is disqualified and must be taken into account for purposes of minimum required distribution calculations.

1. For example, if an employee invests $101,000 in a deferred annuity, no part of the annuity will qualify for QLAC treatment.

B. We think this result is draconian and will be difficult to administer. No matter how hard we try, mistakes will inevitably occur. A more sensible rule is to allow QLAC treatment ***to the extent*** that the requirements are satisfied. So in my example, the first $100,000 would qualify for QLAC treatment and the last dollar would have to be taken into account for purposes of minimum required distribution calculations.

C. To calculate the part of an annuity that is a QLAC, we propose a simple ratio of the maximum amount that can be invested in the contract, divided by the amount invested. The QLAC would be equal to the value of the annuity times that ratio.

III. The second topic is QLACs for defined benefit plans.

A. The Preamble states that the proposed rule does not apply to defined benefit plans because defined benefit plans already offer annuities.

B. This is true. But ***deferred*** annuities generally are not available.

C. The same behavioral concern that affects defined contribution plans also affects defined benefit plans. It is well-documented that, given the existing choice between an annuity and a lump sum, participants overwhelmingly choose the lump sum. Yes, these people are giving up the protection of a lifetime income stream, but there are many rational reasons to make that choice. Here are 4:

1. If the participant elects an annuity and dies at a young age, he or she can forfeit significant savings;

2. Inflation. An annuity that is not indexed for inflation will lose value over time. Many participants believe--quite rationally--that they can hedge against inflation by taking a lump sum and investing wisely;

3. Annuities are not flexible enough to deal with life’s surprises--for example, an unexpected medical emergency; and

4. The favorable actuarial assumptions used to calculate lump sums make them attractive--often more valuable actuarially than an annuity.

D. Given these and other factors, it is clear that simply making an annuity available is not enough to encourage participants to elect the annuity. Allowing participants to combine a lump sum with an annuity would make the annuity more attractive.

E. The proposed regulations on partial annuity options are a step in the right direction. But a partial annuity is not as efficient as a deferred annuity.

1. The real value of an annuity is being able to hedge against longevity risk.

2. But during the first 10-20 years of retirement, longevity risk is not very significant. So there is not much value to having an annuity during those earlier years--especially when the value comes at the cost of giving up flexibility.

3. If participants can defer the start of the annuity, the annuity will cost less--leaving more value for a lump sum. So participants can retain flexibility for a fixed period to deal with unexpected surprises, and they will have the security of an annuity when they really need it.

F. The proposal to allow QLACs only in defined contribution plans and IRAs will lead to a result that we think is unintended and will harm retirees.

1. First, we expect the trend of choosing lump sums over annuities to continue.

2. Some participants will find the deferred annuity option attractive. Under the proposed rules, they will have to take a lump sum and roll it over to an IRA or another employer's plan and then buy a QLAC from an insurance company.

3. So, in effect, the regulation will force participants in defined benefit plans to buy annuities outside the plan instead of getting them directly through the plan.

4. We don't see any reason to force this inefficiency.

IV. Conclusion

A. Thank you again for allowing us to share our views on the proposed regulations.

A. I welcome any questions.