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## Approaches for Promoting Voluntary Annuitization

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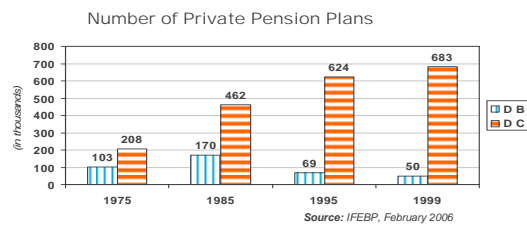
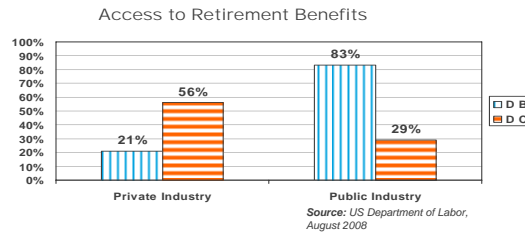
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### Agenda

- Why do We Need to Promote Voluntary Annuitization?
- Incentives for Promoting Voluntary Annuitization
- Default Approaches for Promoting Voluntary Annuitization
- Create Purchasing Coalitions to Improve Annuity Pricing and De-concentrate Risk
- Providing Tax Credits to Insurers to Improve Annuity Pricing
- Conclusion

## Why do we need to promote voluntary annuitization?

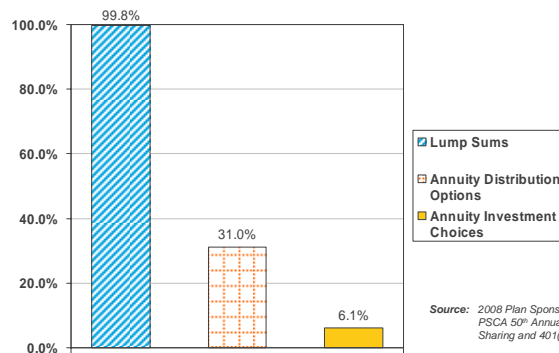
- Shift from DB to DC plans increases individual longevity risk



## Why do we need to promote voluntary annuitization?

- Lump sums are predominant form of distribution from DC plans

Percentage of DC plans offering:



## Why do we need to promote voluntary annuitization?

- Problems caused by shift of longevity risk to individuals
  - Risk is difficult for individuals to understand
  - Risk is hard for individuals to quantify
  - Risk is difficult for individuals to mitigate
- Longevity risk is very predictable and manageable when pooled, but difficult to predict at the individual level
  - Overestimate means reducing consumption to conserve assets and results in possible windfall to heirs
  - Underestimate results in running out of assets too early

## Why do we need to promote voluntary annuitization?

- Individuals are reluctant to choose life annuities
  - Fear of losing control of assets
  - Lack of knowledge
  - Fear of dying before receiving “money’s worth”
- Yet 47% of American adults worry that they will outlive their money (*Gallup Poll, February 2008*)
- Mandatory annuitization probably not feasible
  - Individuals prize choice
  - Public resents government intrusion
- Insurers view annuity sales as unprofitable
  - Market is small
  - Sales are time consuming
  - Adverse selection affects prices and public perception of “value”

## Incentives for Promoting Voluntary Annuitization

### *Government Incentives*

- Reasons for government to expend funds
  - Individuals who out-live their assets will need government assistance
  - Social Security in its current form likely will not support promised benefits to baby boomers
- Possible incentives
  - Tax exclusions or reductions on annuity income
  - Government matching funds on annuity purchases
  - Government subsidies on annuity purchases

## Incentives for Promoting Voluntary Annuitization

### *Employer Incentives*

- As employers continue shifting longevity risk to employees, they should consider shouldering responsibility for helping employees mitigate the risk
- Possible incentives
  - Match on allocations to annuity investment option
  - Match on annuity distributions
  - Employer subsidized annuity conversion factors

## Incentives for Promoting Voluntary Annuitization

### *Portability Approaches*

- Currently employees who have a deferred annuity investment option in a DC plan likely cannot transfer that option to another employer's plan
- Also a challenge for plan sponsors who want to change recordkeepers
- Possible approaches to facilitate portability:
  - Develop insurer cooperatives
  - Introduce standardized annuities

## Incentives for Promoting Voluntary Annuitization

### *Expanded Catch-up Opportunities*

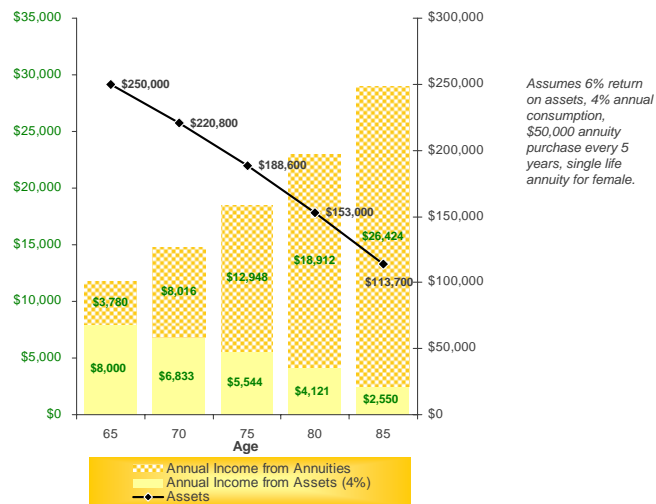
- Currently many public sector employers allow conversion of accumulated leave to a DC plan contribution at retirement or to purchase of service credits in a DB plan
- Concept is limited by IRC limits on elective deferrals and by lack of significant leave banks in private sector
- Expand concept to allow unlimited DC plan contributions in final year before retirement if applied to distribution annuity

## Incentives for Promoting Voluntary Annuitization Employee Education Enhancements

- Investment education programs and tools are now considered standard features in DC plans
- Advice on account spend-down should be strengthened
  - Offer advice on account spend-down risks, tools, and techniques
  - Use professional “distribution” advice specialists
  - Require written notice for retirees who elect lump sums
  - Require language on participant statements about longevity risk and value of annuitization

## Incentives for Promoting Voluntary Annuitization Annuitization in Stages

- Annuitizing assets in stages spreads interest rate risk over various interest rate environments
- Also leaves larger portion un-annuitized in early years while guaranteeing more lifetime income in later years
- Employer plans could facilitate by allowing reassessment and increasing annuitized portion every 5 years after retirement



## Default Approaches for Promoting Voluntary Annuitization

### *Government Mandates*

- Now QJSA is default distribution form for DB and money purchase pension plans
- Encourage annuitization by:
  - Extending QJSA default to all types of plans
  - Applying default to a percentage of benefit or below an indexed dollar limit
  - Facilitating split distribution forms

## Default Approaches for Promoting Voluntary Annuitization

### *Employer Mandates*

- Employees view default as the “recommended” option
- Employers could make QJSA or SLA the default distribution form in their DC Plans
- Employers could also consider period certain annuity combined with longevity insurance

## Default Approaches for Promoting Voluntary Annuitization

### *Automatic Rollover Changes*

- Change automatic IRA rollover rules for default cashouts between \$1,000 and \$5,000
  - Increase automatic rollover limit from \$5,000 to \$20,000 and eliminate \$1,000 floor
  - Make SSA (or alternate pre-approved annuity provider) the recipient of automatic rollovers for distributees who fail to elect a distribution option

## Create Purchasing Coalitions to Improve Annuity Pricing and De-concentrate Risk

- Currently longevity risk insurance in the US is concentrated in DB plans (public and private) and a few large insurance companies
- Recent events demonstrate how risk concentration can unravel the financial markets
- De-concentrate risk by adding governments to spread risk over a larger base
- One approach:
  - Allow rollovers to SSA for purchase of supplemental annuity
  - May include subsidized premium rates
  - Consider pros and cons of offering both variable and fixed annuities



## Create Purchasing Coalitions to Improve Annuity Pricing and De-concentrate Risk

- Other possible approaches to make annuities more affordable:
  - Develop purchasing coalitions sponsored by states or non-profit organizations for small employers and individuals
  - Develop model legislation through NAIC
  - Allow annuity purchases through state retirement systems
  - Securitize annuities through a government agency to free up insurance company assets and allow earlier realization of profits

## Providing Tax Credits to Insurers to Improve Annuity Pricing

- Government supported approaches might also be explored:
  - Provide tax credits or deductions to insurers
  - Base credits on rewarding increased sales levels
  - Combine credits with government-funded education program

## Conclusion

- Reluctance to annuitize must be overcome
  - Increase public's knowledge of longevity risk
  - Make annuitization process easier
  - Improve annuity pricing and perception
- A variety of strategies are needed to encourage voluntary annuitization
  - Some involve government expenditures or employer costs
  - Some primarily make annuity purchases automatic or more convenient
- A multi-faceted approach would prove most successful
- Future research should explore:
  - How much annuitization is optimum?
  - What types of organizations are best suited for pooling longevity risk?
  - How much of a role should government have in promoting annuitization?

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