**Title:**

**Improving Individual Annuity Choices:**

**From a New Choice to an Expanded PBGC Mission**

**Summary of the Proposal:**

In the defined contribution world, most plans avoid annuity forms of distribution. This is partly because most plan sponsors and fiduciaries lack the expertise and appetite to wrestle with implementing an annuity choice, and further because the addition of an annuity alternative would become a permanent (protected) plan benefit. It is particularly challenging for plan fiduciaries - as well as plan participants! - to make an intelligent choice for a cost-effective annuity provider.

Described below is a proposal that aims to simplify access to the annuity world for participants with account balances. This is possible without burdening plan sponsors. PBGC already operates an annuity program for missing participants with defined contribution balances. Section 4050(d) of ERISA authorizes that, and could be tracked in a new Section 4051 that allows participants in defined contribution plans (other than ESOPs) to transfer all or part of their account balances to the PBGC, and thereby receive annuity distributions without any need for employer involvement (or plan changes).

Simplification would come mainly for defined contribution plan participants. In particular, a minor change to ERISA would enable them to pursue the purchase of annuities under a protective umbrella that combines PBGC’s institutional knowledge with a legislative mandate to have PBGC offer such annuities under a “best interest” standard that protects program participants. Employers would merely need to provide a safe harbor annuity notice, akin to a 402(f) notice. Meanwhile, PBGC would become more relevant, and ideally be invigorated to act for the benefit of a new, broader class of retirees.

**Detailed Description of Proposal**

* **Description of Current Law**

By adding Section 4050(d) to ERISA, the Pension Protection Act of 2006 authorized PBGC to establish a missing participant program for plans not subject to Title IV of ERISA, including defined contribution retirement plans. Ten years later, the PBGC issued proposed regulations implementing ERISA Section 4050(d), with final regulations being issued on December 22, 2017. Those regulations made PBGC’s missing participant program available to defined contribution plans and small professional service plans terminating on or after January 1, 2018 (the “2018 Program”).

In its final 4050(d) regulations, PBGC explains how annuities will be provided under the 2018 Program: namely, a “distributee whose benefit transfer amount is non-de minimis will be paid an annuity (a 50 percent joint and survivor annuity if married), unless the distributee elects (with spousal consent if married) a lump sum (or another type of annuity) instead. PBGC will make available the same annuity forms that it does for participants in trusteed plans under § 4022.8.”[[1]](#footnote-1)

Ongoing defined contribution plans are outside the 2018 Program, with PBGC acknowledging that is an important issue. Meanwhile, PBGC has activated the 2018 Program, with summary information appearing within its webpage titled “*Missing Participants Program for Defined Contribution Plans*.”[[2]](#footnote-2)

* **Reasons for Change**

***(a) Retirees Want Retirement Income Security***

In a 2016 report about improving the retirement income alternatives for 401(k) plan participants, the Government Accountability Office begins with the observation that “Workers relying in large part on their 401(k) plan in retirement may not always have a feasible way to make their savings last throughout retirement.”[[3]](#footnote-3)

The financial challenge facing retirees receives even more recent and detailed attention in a pending law review article titled “*Defined Contribution Plans and the Challenge of Financial Illiteracy****.***”[[4]](#footnote-4) That article highlights two problems endemic within 401(k) and other defined contribution plans, namely the complexity of managing personal investments, and the challenge associated with deciding the rate of expenditure of retirement savings. In particular, that article provides research-based support for these propositions:

(1) *[Financial Complexity]. “*The challenge with this [defined contribution] system is that U.S. employees are poorly equipped to make decisions about how to invest for retirement. Retirement investing is complicated, the typical 401(k) plan offers participants products that many of them do not understand, and retirement saving is most effective when people begin saving early. In addition to the initial decisions, effective retirement investing requires plan participants to evaluate whether to make changes to their portfolios over the course of their career and, when they retire, to determine how to manage the balance in their accounts to provide income for the rest of their lives. … The complexity of appropriate retirement investing is compounded by the fact that financial literacy rates in the general population are low.”[[5]](#footnote-5)

(2) *[Post-retirement Spending]* “[T]o the extent that participants are successful in accumulating a large balance for retirement in their 401(k) plans, they then become responsible for deciding what to do with that money when retiring or changing jobs. Nothing in the existing regulatory structure creates a role for the employer in assisting its employees with decisions about how to use that account balance to fund their retirement, including deciding whether to roll over the account, determining how much to withdraw and figuring out how to invest what is, for most retirees, more money than they have ever been responsible before.”[[6]](#footnote-6)

It is one thing to identify a weakness within the defined contribution system. It is quite another to suggest a viable solution. For instance, while converting an individual’s account balance into a lifetime income could provide retirees with a more predictable, less risky financial future, there is wide recognition of the following:

The problem with annuities is that people pay far too much in fees to buy them. The commissioned salesperson, for one, gets a fat chunk of your cash for getting you to sign the contract — often as much as 8% or more of your lifetime savings.[[7]](#footnote-7)

***(b) 401(k) and other Defined Contribution Plans Generally Avoid Annuities***

Through various surveys, retirees have expressed a strong desire for a stable retirement income.[[8]](#footnote-8) Unfortunately, plan sponsors are themselves wary of offering annuity choices to employees. As noted in a 2019 article titled “*DC Plan Sponsors Still Shunning Annuities*”:

The top reason cited for not offering an annuity-type product in defined contribution plans is being uncomfortable or unclear about the fiduciary implications.[[9]](#footnote-9)

From the plan sponsor perspective, annuities involve complex financial judgements for which most plan fiduciaries lack the competence (due to inexperience with annuities) or appetite (due to the time needed to learn about them, and the attendant fiduciary responsibility). Further, because of the protected benefit rules set forth under Code Section 401(d)(6), employers understandably fear that, once they open the door for annuity distributions, they cannot close it (except prospectively, which does not eradicate the fiduciary or administrative burden). As a result, most defined contribution plans perceive annuities as an undesirable alternative to offer to participants. Instead they tend to limit their distribution menu to lump sums and installments.[[10]](#footnote-10)

The ERISA Industry Council (aka ERIC) recently recognized the above in the following proposal published in “*Modernizing the DC/401(k) Plan System*”:[[11]](#footnote-11)

#14. Provide Lifetime Income/Annuity Provider Selection Fiduciary Safe Harbor

Many employers and fiduciaries are reluctant to offer defined contribution plan participants annuity and similar lifetime income distribution options because of the risks associated with selecting the provider of annuities and similar lifetime income options and with entering into contract terms and fee arrangements with such providers.

Congress has noticed and taken recent action. In the SECURE Act, Section 204 provides some relief for plan fiduciaries with respect to their selection and review of annuity providers and annuities. In theory, this will encourage plan fiduciaries to add annuity alternatives within 401(k) and other defined contribution plans. Reasonable minds differ on whether this will prompt an annuity boom within plans, with red flags being raised for plan sponsors and participants.[[12]](#footnote-12) Consider the following, which seems to reflect a fair assessment of the plan sponsor perspective:

“I like the notion that there will be more annuities in retirement plans,” Hopkins [director of research for Carson Wealth] said, “but considering the lack of financial literacy and understanding of annuities coupled with the lack of investment advice 401(k) participants receive, I worry about a lot of unsuitable investments into annuities occurring.”[[13]](#footnote-13)

**Description of Proposal**

Set forth below is a provision, modeled after Section 4050 of ERISA, that would allow participants in defined contribution plans (other than ESOPs) and individual retirement accounts to roll over (or transfer) all or part of their account balances into PBGC’s annuity program. A conforming change to Section 402(f) of the Code would relieve plan sponsors and fiduciaries from amending plans or otherwise being responsible for this distribution alternative. Plan sponsors would merely need to provide participants with a safe harbor notice from PBGC, and then distribute account balances in accordance with participant elections.

**Detailed Analysis of Proposal**

* **Simplification Resulting from Proposal**

There is an old saying that those who study theology are like sailors who take a boat out into a storm: they may survive, but odds are they will perish. The same risk seems inherent for those who consider purchasing annuities. Employers fear the fiduciary risk. Individuals should be even more intimidated because they generally have less buying power and financial literacy.

The proposal submitted in this paper seeks to simplify individual choice - by providing access to annuities under a PBGC-operated program that is run in the best interests of those who elect to transfer their defined contribution accounts to the PBGC. Currently, these individuals face the impossible challenge of budgeting lump sum distributions and individual accounts into a lifetime income. The availability of cost-effective annuities from the PBGC would simplify their ability to secure a stable financial future, thereby protecting them and society.

* **Implications for Employee/Participant Rights**

This proposal would expand participant rights by providing participants with a government-sponsored (and sanctioned) annuity alternative that will automatically be available to them whenever they become entitled to receive a distribution from defined contribution plans, other than ESOPs (or from IRAs).

* **Likelihood of Enactment or Implementation**

Given that the SECURE Act recently passed with one provision being intended to promote the use of annuities as a distribution alternative, this proposal seems to be a logical extension of a recognized Congressional direction, and consequently should have a reasonable likelihood of enactment. Further, it should receive support from some key constituencies, namely:

1. Employers - “Retirement readiness” is a common employer aim in order to enable older employees to feel financial secure when they near or reach normal retirement age. As shown from the articles noted above, a high percentage of older workers have expressed the desire to convert their defined contribution accounts into a lifetime income stream, which is possible through annuities.
2. PBGC - In the wake of the declining number of defined benefit plans, PBGC would likely appreciate an expansion of its purpose in order to be more impactful on retirement security. PBGC has expertise relevant to annuity pricing, and already has experience (through the 2018 Program) with converting defined contribution accounts into annuities.
3. Participants and their Advocates - This proposal should appeal to those participants who are fearful of being fleeced in the annuity market, but who desire an annuity form of distribution with respect to their 401(k) and other accounts.

* **Originality**

On information and belief, the proposal described in this submission is totally original and has never been the subject of prior advocacy before Congress, or any federal, state, or other legislative or regulatory body.

**Required Statutory or Regulatory Changes**

As indicated above, existing Section 4050(d) of ERISA served as the framework for the proposal for a new Section 4051 of ERISA.

See the next page for the proposed legislation.

**PROPOSAL:**

**AMEND ERISA TO ADD THE FOLLOWING SECTION**

**29 U.S. Code § 1351. Participant-elected Transfers of Certain Individual Accounts**

**(a) General rule**

**(1) Transfer to corporation**

An eligible participant in a plan or arrangement described in subsection (f) may elect to transfer all or part of his or her account balance to the corporation, but only in money and only to the extent the participant has the authority to direct that such account be distributed or transferred based on the terms and conditions of the plan or arrangement to which the eligible participant’s account balance relates.

**(2) Information to the corporation**

To the extent provided in regulations, an eligible participant in a plan or arrangement described in subsection (f) shall provide the corporation with such information as the corporation may require with respect to the eligible participant’s account balance that is being transferred to the corporation.

**(3) Payment by the corporation**

If the account balance of an eligible participant is transferred to the corporation under subsection (a)(1), the corporation shall pay to the participant or beneficiary the amount transferred (or the appropriate survivor benefit) in such form as is based on the designated account and the assumptions prescribed by the corporation at the time that the corporation received the designated account. Such assumptions shall be actuarially sound taking into account the corporation’s costs hereunder. The corporation shall make payments under this subsection available in the same forms and at the same times as a guaranteed annuity benefit under section 1322 of this title would be available to be paid.

**(b) Treatment of transferred assets**

A transfer to the corporation under this section shall be held in a separate trust, provided that the corporation may consolidate the assets of such trust with the assets of terminated plans for which the corporation is trustee under section 1342 of this title, subject to the rules set forth in that section.

**(c) Safe Harbor for Plan Administrators.**

A plan administrator is deemed to satisfy section 404(e) of ERISA and section 401(a)(31) of title 26 in the case of an eligible participant if the plan administrator —

**(A)** transfers all or part of an eligible participant’s designated account balance directly from the plan’s trust to the corporation both pursuant to such participant’s election and in accordance with the terms and conditions of this section (in, and

**(B)** provides the corporation such information and certifications with respect to such designated account balance as the corporation shall specify.

**(d) Definitions.**

For purposes of this section—

**(1) Eligible participant.** The term “eligible participant” means a participant or beneficiary under a plan described in subsection (f) hereof, and shall include alternate payees under domestic relations orders that meet the requirements of section 206(d)(3) of Title 1.

**(2) Designated account.** The term “designated account” means the portion of an eligible participant’s individual account that is transferred to the corporation pursuant to subsection (a).

**(e) Multiemployer plans.**

The corporation shall prescribe rules similar to the rules in subsection (a) for participants in multiemployer defined contribution plans.

**(f) Plans and arrangements covered by this section**

A plan or other arrangement is described in this section if either —

**(1)** the plan is a pension plan (within the meaning of section 1002(2) of this title)—

**(A)** to which the provisions of this section do not apply (without regard to this subsection),

**(B)** which is not a plan described in paragraph (2), (3), (4), (6), (7), (8), (9), (10), or (11) of section 1321(b) of this title,

**(C)** which is a plan described in section 401(a) of title 26 which includes a trust exempt from tax under section 501(a) of such title, and

**(D)** which is not a plan described in either section 4975(e)(7) of the Code or section 407(d)(6) of Title 1; or

**(2)** an individual retirement account described in section 408(a) of title 26, or an eligible deferred compensation plan described in section 457(b) of title 26 which is maintained by an eligible employer described in section 457(e)(1)(A) thereof.

**(g) Regulatory authority**

The corporation shall prescribe such regulations as are necessary to carry out the purposes of this section in a manner that is in the best interests of eligible participants, including rules relating to the amounts to be paid by the corporation. The corporation shall have the discretion —

(1) to offer private sector annuity alternatives in addition to, or in lieu of, the corporation’s annuity alternatives; and

(2) to determine the extent to which its regulations and decisions under 29 U.S. Code § 1350 shall be followed or disregarded for purposes of this section.

**(h) Effective Date**

The amendments made by this section shall take effect 180 days after enactment.

1. 82 FR 60800 (12/22/2017), <https://www.federalregister.gov/documents/2017/12/22/2017-27515/missing-participants#print>. [↑](#footnote-ref-1)
2. <https://www.pbgc.gov/prac/missing-p-defined-contribution>. [↑](#footnote-ref-2)
3. U.S. Government Accountability Office, 401(k) PLANS: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants, GAO 16-433 (August 2016), <https://www.gao.gov/assets/680/678924.pdf>. [↑](#footnote-ref-3)
4. Fisch, Jill E. and Lusardi, Annamaria and Hasler, Andrea, Defined Contribution Plans and the Challenge of Financial Illiteracy (February 13, 2019). Cornell Law Review, 2019, Forthcoming; U of Penn, Inst for Law & Econ Research Paper No. 19-22; European Corporate Governance Institute - Law Working Paper No. 478/2019. Available at SSRN: <https://ssrn.com/abstract=3384778> or [http://dx.doi.org/10.2139/ssrn.3384778](https://dx.doi.org/10.2139/ssrn.3384778). [↑](#footnote-ref-4)
5. Id. at page 2 (2nd paragraph of Introduction). [↑](#footnote-ref-5)
6. Id., at page 24 (main text ending with footnote 86). [↑](#footnote-ref-6)
7. Tuchman, Why getting an annuity from your 401(k) is a terrible idea, Marketwatch, published: Oct 2, 2019 12:33 p.m. ET; see also, See Joseph H. Aughtman, The Annuity Conundrum: Responding to the Abuse of Elderly Investors, 38 The Brief 38, 39 (2008) (“with a frequency that is disturbing, annuities are being used as instruments to defraud investors”). [↑](#footnote-ref-7)
8. See, for example, Employees Want Retirement Income Certainty, Plan Sponsor magazine, October 30, 2018 (“94% said they would keep all or at least some of their money in a target-date fund (TDF) that guaranteed an income stream for life") (article found <https://www.plansponsor.com/employees-want-retirement-income-certainty/>). [↑](#footnote-ref-8)
9. Rebecca Moore, Plan Sponsor Magazine, January 18, 2019, <https://www.plansponsor.com/dc-plan-sponsors-still-shunning-annuities/>). [↑](#footnote-ref-9)
10. Stephen Miller, SECURE Act Alters 401(k) Compliance Landscape, SHRM, January 20, 2020, <https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/secure-act-alters-401k-compliance-landscape.aspx> (“SHRM’s 2019 Employee Benefits survey of 2,763 HR specialists found that only 7 percent of respondents said their organizations offered lifetime income solutions, such as in-plan annuities or help for retirees to purchase an out-of-plan annuity with in-plan assets. ”); see also, Edward Zelinksy, The Defined Contribution Paradigm, 114 Yale L.J. 451, 456-457 (2004) (“Typically the distribution from a defined contribution plan today takes the form of a single lump sum payout of the employee's account balance rather than an annuity or other periodic distribution spread over time.”). [↑](#footnote-ref-10)
11. See page 15 at <https://www.eric.org/wp-content/uploads/2019/11/Modernizing-the-401k-Plan-System.pdf>. [↑](#footnote-ref-11)
12. Id. (“Some are critical of using annuities in defined-contribution plans, pointing to their complexity and high fees. ‘There will come a time where we will point back to this as the start of a trend toward high-cost annuities being offered in 401(k) plans to the detriment of retirement savers,’ Barbara Roper, director of investor protection at the Consumer Federation of America, told the *New York Times* earlier this year.”). [↑](#footnote-ref-12)
13. Elizabeth Festa, SECURE To Ignite ‘Huge Boom’ In Annuities, But Not Immediately, Annuity News, January 28, 2020, <https://insurancenewsnet.com/innarticle/secure-to-ignite-huge-boom-in-annuities-but-not-immediately#.XjNDAetOlN0>. [↑](#footnote-ref-13)