

May 3, 2012

By Electronic Delivery

CC:PA:LPD:PR (Reg-115809-11)
Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

Re: Comments Regarding Proposed Regulation on Longevity Annuity Contracts

Ladies and Gentlemen:

The Investment Company Institute¹ is pleased to submit comments on the Treasury Department's and Internal Revenue Service's proposed rulemaking on longevity annuity contracts.² The proposal would provide an exclusion from the Internal Revenue Code section 401(a)(9) required minimum distribution (RMD) requirements for the value of qualifying longevity annuity contracts (QLACs) purchased under certain defined contribution (DC) plans or individual retirement annuities and accounts (IRAs).³ We understand that this exclusion would be intended to encourage the use of longevity annuities, which begin at an advanced age (such as age 85), as part of a retirement income strategy.

The Institute shares the government's concern over the ability of retirees to manage their retirement assets to last a lifetime. We support the efforts of Treasury, the Service, and the Department

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.4 trillion and serve over 90 million shareholders.

² 77 Fed. Reg. 5443 (Feb. 3, 2012).

³ The value of a QLAC would be excluded from the account balance used to determine RMDs, prior to annuitization. After payments begin, distributions under the contract must satisfy the RMD rules applicable to annuities in Treas. Reg. §1.401(a)(9)-6 (other than the required beginning date).

of Labor to examine ways to encourage and facilitate the use of lifetime income strategies.⁴ This proposal aims to solve a technical obstacle to purchasing longevity annuities within tax-deferred retirement accounts. The underlying purpose is to avoid the problem of a retiree having to take RMDs from amounts allocated to longevity insurance within a retirement account, prior to the annuity starting date permitted under the contract. Although this proposal raises certain concerns described later in this letter, we agree with the overall approach taken in the proposal, in terms of its limited scope. Because the problem intended to be addressed involves a very specific situation, the exclusion itself should be similarly limited. For the reasons set forth below, we do not believe it would be appropriate to expand the exclusion beyond strict longevity insurance, within the parameters outlined in the proposal. In any event, our comments also include some general concerns relating to incentivizing the use of annuities.

QLAC Criteria

Product Features

As outlined in the proposed regulation, the exclusion from RMDs would not extend to variable or equity-indexed annuities, or to contracts offering commutation benefits, cash surrender value, or certain death benefits like period certain payments. The effect of these product feature restrictions is to limit the exclusion, as proposed, to true deferred annuities where the individual is locked in to the annuity decision and has no access to the premiums paid until the annuity starting date. We believe these are important restrictions.

Annuities have the potential to provide individuals with higher periodic payments than they could generate investing on their own. This extra income—referred to as the mortality premium—is attained through the pooling of risks, specifically the risk of long life. Through a life insurance company, individuals who purchase an annuity are effectively pooling their investments. Individuals who live beyond average life expectancy have their periodic payments subsidized by individuals who die prior to average life expectancy. Assets set aside to pay commutation benefits, cash surrender value, or certain death benefits like period certain payments are not pooled assets and thus do not protect against longevity. Further, the payment stream from an annuity contract with such provisions could be replicated by using a portion of the funds used to purchase the annuity to buy an annuity with no such provisions, and placing the remaining funds in an investment account. Some individuals may prefer to

⁴ See Institute letter to Employee Benefits Security Administration and Internal Revenue Service, Department of Treasury, Re: Request for Information on Lifetime Income Options, dated May 3, 2010, available at <http://www.ici.org/pdf/24278.pdf>.

have a single investment that combines an annuity with an investment account; others may prefer to have an investment account that is separate from their annuity contract. However, we believe tax rules should strive to treat economically equivalent investments equally and should not provide a preference to investment products that are bundled with an annuity contract.⁵ We therefore agree with the approach taken in the proposal to prohibit commutation or cash surrender value benefits, as well as death benefits such as period certain payments or refunds of premiums.

We also urge Treasury and the Service to clarify that any product whose payout feature is uncertain should not qualify as a QLAC. Such a limitation should be expanded beyond variable or equity-indexed annuities to any product that is designed so that the payout is dependent on investment performance or some other market index during the accumulation or payout phase of the product. In such a situation, the investor does not know the amount of the periodic payments that he or she will receive during the payout phase and therefore has a much more limited ability to protect against longevity risk—the concern identified by Treasury as the rationale behind granting favorable treatment under the RMD rules.⁶

The preamble to the proposed regulation specifically requests comments on insurance products that provide guaranteed withdrawal benefits (known as guaranteed minimum withdrawal benefits (GMWBs) or guaranteed lifetime withdrawal benefits (GLWBs)).⁷ We firmly believe these products should not be considered QLACs, for the same reasons discussed with respect to commutation or death benefits. Evidenced by the fact that investors have access to their own investment funds, these are not products that provide guaranteed income simply by pooling investments. Rather, these products are more akin to a long-term derivative contract that, in exchange for an annual fee, guarantees investment returns will not fall below a certain level (or floor). Some investors may find that GMWBs or GLWBs provide the appropriate balance of risk and return, and thus choose to invest in these products.

⁵ In this respect, the RMD rules are designed to ensure that individuals use tax-deferred retirement savings over their life expectancies (or joint life expectancies) in retirement, thereby limiting the ability to use these funds for purposes other than retirement income. It would be inconsistent with this policy goal to permit deferral beyond the universally-applicable required beginning date for a financial product that offers anything more than simple longevity protection.

⁶ This limitation is not intended to exclude products with inflation-protected payout streams from the definition of a QLAC. Such products are not subject to market risk that could negatively impact the amount of periodic payments that will be received during the payout phase.

⁷ 77 Fed. Reg. 5443, 5450.

However, none of these products should be permitted under any final regulation providing RMD relief for longevity insurance.

Amount Limitations

Under the proposal, the value of (or premium paid for) a QLAC would be limited generally to the lesser of 25 percent of the account balance or \$100,000. These limitations on deferral make sense in view of the overall purpose of the proposed exclusion for longevity insurance. As noted in the preamble,⁸ the percentage limit is consistent with the nature of the RMD rules which require the entire interest of the participant to be distributed over the life or life expectancy of the participant (and a designated beneficiary if applicable). Limiting the amount allocable to a QLAC to 25 percent of the account balance should result in an overall pattern of payments that is similar to the pattern of payments otherwise required under the RMD rules. The \$100,000 limit is also important in minimizing disproportionate deferral of distribution, considering that the rule would not require individuals to accelerate RMDs from the portion of the account balance not allocated to a QLAC, or otherwise exhaust those funds by the starting date of payments under the QLAC. We strongly urge Treasury and the Service to retain these limits in any final regulation.

General Concerns

It is important to keep in mind potential unintended consequences resulting from the special treatment afforded to longevity insurance products under this proposal. Providing favorable regulatory treatment to a specific product could be misunderstood by some consumers as a general stamp of approval by the Federal government. Individual consumers, whether participating in an employer-sponsored DC plan or owning an IRA, need to fully understand the risks associated with buying an annuity and how to evaluate different issuers based on solvency and other quality characteristics.⁹ Not all longevity annuities that meet the objective criteria for a QLAC will be equal and we hope that the Obama Administration, in its efforts to promote greater annuitization, will recognize this fact. In particular, we note that the Administration frequently uses the term “guaranteed” to describe payments

⁸ 77 Fed. Reg. 5443, 5445.

⁹ Consumers also should consider the effects of future inflation on the payment stream promised under a deeply-deferred annuity contract.

from annuities or other insurance products.¹⁰ There is, however, no absolute guarantee that payments promised by any insurance company will be fulfilled. While state guaranty funds are meant to protect annuity purchasers from insurer default or insolvency, they may not in all cases cover the full amount promised. Use of the term “guaranteed” without clarifying language contributes to the potential for misunderstanding by individual consumers and we therefore urge caution in this regard.

We are also concerned that annuities with a fixed nominal payout—either immediate or deferred—provide less protection against longevity risk than is implied in both the Treasury’s notice of its proposal and the Administration’s statement issued in conjunction with the proposals. While we agree that outliving one’s accumulated savings is a source of financial insecurity facing retirees, the source of uncertainty is multi-faceted. In addition to the risks of outliving one’s assets, retirees face inflation risk and the risk that even where a lifetime income stream is available, that income stream could become inadequate to cover basic living expenses. The erosive impact on purchasing power caused by inflation is a serious long-term threat to retirees. Assuming a relatively conservative 3 percent inflation rate (well below the actual 4.1 percent average of the last 60 years), the real value of a fixed payment stream will be cut in half in just 23 years. Thus, an income stream from a lifetime income product of \$30,000 per year must grow to \$60,000 per year over this period to provide the same purchasing power.¹¹ The failure to recognize the limits of deferred annuities with nominal payment streams to protect against inflation risk in the context of touting the product’s ability to protect against longevity risk is an example of the potential for the creation of consumer confusion that favorable regulatory treatment and the promotion of that treatment can generate.

Finally, while this proposal addresses one specific problem related to the RMD rules, there are other aspects of the RMD rules that deserve consideration. For example, with increased life expectancies and longer working careers, it would benefit today’s retirees to raise the age at which RMDs are required to begin. According to the Social Security Administration, the average life expectancy at age 65 is about four years longer for men, and three years longer for women, today than it was in 1962, when the age 70½ rule was first added to the retirement plan rules as part of the creation of

¹⁰ See, e.g., Report of the Council of Economic Advisers, *Supporting Retirement for American Families*, Feb. 2, 2012; Treasury Department press release, *U.S. Treasury, Labor Departments Act to Enhance Retirement Security for an America Built to Last*, Feb. 2, 2012, at <http://www.treasury.gov/press-center/press-releases/Pages/tg1407.aspx>.

¹¹ Almost one-fifth of 65-year-old men and nearly one-third of 65-year-old women will live to age 90 or beyond. See Annuity 2000 Table, Society of Actuaries.

Longevity Annuity Contracts

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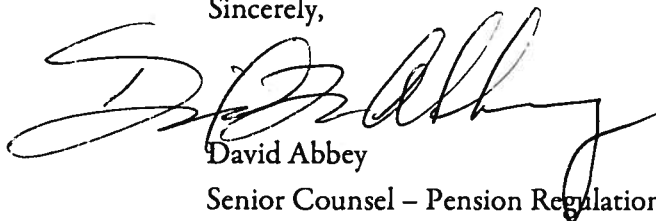
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Keogh plans.¹² Meanwhile, the Social Security normal retirement age has increased, from 65 to 67.¹³ We realize that such a change would require legislative action, but it bears mentioning in any discussion of modifying the RMD rules.

* * *

The proposed RMD exclusion for longevity annuity contracts is appropriately limited in size and scope. We urge Treasury and the Service to retain the restrictions set forth in the proposal in any final regulation. We also believe the Federal government should consider all possible implications of providing favorable regulatory treatment to annuity products, to avoid consumer misunderstanding and overall capacity issues. The Institute appreciates the opportunity to provide comments on this proposal.

Sincerely,

A handwritten signature in black ink, appearing to read 'D. Abbey', is written over the typed name and title.

David Abbey

Senior Counsel – Pension Regulation

¹² See <http://www.ssa.gov/OACT/TR/TR08/lr5a3.html>.

¹³ For a chart indicating the time frame for the change in normal retirement age, see <http://www.ssa.gov/retire2/retirechart.htm>.