United States Government Accountability Office

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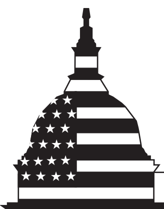
Report to the Chairman, Special Committee on Aging, U.S. Senate

June 2011

RETIREMENT INCOME

Ensuring Income throughout Retirement Requires Difficult Choices



GAO-11-400

June 2011

RETIREMENT INCOME

Ensuring Income throughout Retirement Requires Difficult Choices

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Highlights

Highlights of GAO-11-400, a report to the Chairman, Special Committee on Aging, U.S. Senate

Why GAO Did This Study

As life expectancy increases, the risk that retirees will outlive their assets is a growing challenge. The shift from defined benefit (DB) pension plans to defined contribution (DC) plans also increases the responsibility for workers and retirees to make difficult decisions and manage their pension and other financial assets so that they have income throughout retirement. GAO was asked to review (1) strategies that experts recommend retirees employ to ensure income throughout retirement, (2) choices retirees have made for managing their pension and financial assets for generating income, and (3) policy options available to ensure income throughout retirement and their advantages and disadvantages. GAO interviewed experts about strategies retirees should take, including strategies for five households from different quintiles of net wealth (assets less debt); analyzed nationally representative data and studies about retirees' decisions; and interviewed experts and reviewed documents about related policy options.

GAO received comments on a draft of this report from the Department of the Treasury and technical comments from the Department of Labor, Internal Revenue Service, Securities and Exchange Commission, Social Security Administration, and the National Association of Insurance Commissioners, and incorporated them, as appropriate.

View GAO-11-400 or key components.
For more information, contact Charles Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

What GAO Found

Financial experts GAO interviewed typically recommended that retirees systematically draw down their savings and convert a portion of their savings into an income annuity to cover necessary expenses, or opt for the annuity provided by an employer-sponsored DB pension instead of a lump sum withdrawal. Experts also recommended that individuals delay receipt of Social Security benefits until reaching at least full retirement age and, in some cases, continue to work and save, if possible. For example, for the two middle net-wealth households GAO profiled with about $350,000 to $375,000 in net wealth, experts recommended purchase of annuities with a portion of savings, drawdown of savings at an annual rate, such as 4 percent of the initial balance, use of lifetime income from the DB plan, if applicable, and delay of Social Security. To navigate the difficult choices on income throughout retirement, they noted strategies depend on an individual's circumstances, such as anticipated expenses, income level, health, and each household's tolerance for risks, such as investment and longevity risk.

Regarding the choices retirees have made, GAO found that most retirees rely primarily on Social Security and pass up opportunities for additional lifetime retirement income. Taking Social Security benefits when they turned 62, many retirees born in 1943, for example, passed up increases of at least 33 percent in their monthly inflation-adjusted Social Security benefit levels available at full retirement age of 66. Most retirees who left jobs with a DB pension received or deferred lifetime benefits, but only 6 percent of those with a DC plan chose or purchased an annuity at retirement. Those in the middle income group who had savings typically drew down those savings gradually. Nonetheless, an estimated 3.4 million people (9 percent) aged 65 or older in 2009 had incomes (excluding any noncash assistance) below the poverty level. Among people of all ages the poverty rate was 14.3 percent.

To help people make these often difficult choices, policy options proposed by various groups concerning income throughout retirement include encouraging the availability of annuities in DC plans and promoting financial literacy. Certain proposed policies seek to increase access to annuities in DC plans, which may be able to provide them at lower cost for some individuals. However, some pension plan sponsors are reluctant to offer annuities for fear that their choice of annuity provider could make them vulnerable to litigation should problems occur. Other proposed options aim to improve individuals' financial literacy, especially to better understand risks and available choices for managing income throughout retirement in addition to the current emphasis on saving for retirement. Proposed options include additional federal publications and interactive tools, sponsor notices to plan participants on financial risks and choices they face during retirement, and estimates on lifetime annuity income on participants' benefit statements.

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Abbreviations

BLS	Bureau of Labor Statistics
CPI-U	Consumer Price Index for all urban consumers
CPS	Current Population Survey
CRS	Congressional Research Service
DB	defined benefit
DC	defined contribution
ERISA	Employee Retirement Income Security Act of 1974
EBRI	Employee Benefit Research Institute
HRS	Health and Retirement Study
IRA	individual retirement arrangement
IRS	Internal Revenue Service
Labor	Department of Labor
NAIC	National Association of Insurance Commissioners
PBGC	Pension Benefit Guaranty Corporation
QDIA	qualified default investment alternative
QJSA	qualified joint and survivor annuity
RFI	request for information
SEC	Securities and Exchange Commission
SSA	Social Security Administration
Treasury	Department of the Treasury

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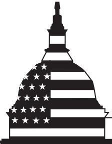


United States Government Accountability Office
Washington, DC 20548

June 7, 2011

The Honorable Herb Kohl
Chairman
Special Committee on Aging
United States Senate

Dear Mr. Chairman:

As the life expectancy of U.S. residents continues to increase, the risk that retirees will outlive their assets is a growing challenge.[1] Today, a husband and wife both aged 65 have approximately a 47 percent chance that at least one of them will live to his or her 90th birthday and a 20 percent chance of living to his or her 95th birthday.[2] In addition to the risk of outliving one's assets, the sharp declines in financial markets and home equity during the last few years and the continued increase in health care costs have intensified workers' concerns about having enough savings and how to best manage those savings in retirement.[3]

In addition, the shift among employer-sponsored pension plans from defined benefit (DB) to defined contribution (DC) plans heightens the responsibility for workers and retirees to manage their pension and other financial assets so that their assets last throughout retirement. In "traditional" DB plans, a retiree is entitled to receive a specified, periodic

[1]Since 1970, life expectancies at age 65 have risen by about 2 years for women and nearly 4 years for men.

[2]These life expectancies are based on Social Security cohort life tables, using a weighted average for people born in 1950 (i.e., turning 65 in 2015) and for people born in 1940 (i.e., turning 65 in 2005) to approximate expectancies for people turning 65 in 2011. See Felicitie C. Bell and Michael L. Miller, *Life Tables for the United States Social Security Area 1900-2100*, Actuarial Study No. 120, SSA Pub. No. 11-11536 (Washington, D.C., Social Security Administration, Office of the Chief Actuary, August 2005).

[3]GAO has highlighted such concern in earlier reports. See, for example, GAO, *Retirement Income: Challenges for Ensuring Income throughout Retirement*, GAO-10-632R (Washington, D.C.: Apr. 28, 2010); *Private Pensions: Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs*, GAO-09-642 (Washington, D.C.: July 24, 2009); *Private Pensions: Low Defined Contribution Plan Savings May Pose Challenges to Retirement Security, Especially for Many Low-Income Workers*, GAO-08-8 (Washington, D.C.: Nov. 29, 2007); and *Baby Boom Generation: Retirement of Baby Boomers is Unlikely to Precipitate Dramatic Decline in Market Returns, but Broader Risks Threaten Retirement Security*, GAO-06-718 (Washington, D.C.: July 28, 2006).

annuity benefit for life, usually based on years of service and other factors, whereas workers in DC plans accumulate balances in individual accounts with employer or employee contributions (or frequently both) plus accrued earnings. In DC plans, participants are typically responsible for investing and assuming investment risk.

The Department of Labor (Labor) and the Department of the Treasury (Treasury) regulate employer-sponsored pension plans in the private sector. In light of the shift from DB to DC plans, which moves responsibility to retirees for ensuring that assets provide income throughout retirement, Labor and Treasury issued a public request for information (RFI) in 2010 on options for facilitating access to and the use of lifetime retirement income sources, including lifetime annuities, in employer-sponsored plans and individual retirement arrangements (IRA).[4]

Given your interest in these retirement income options, we examined the following:

1. What strategies do experts recommend retirees employ to ensure income throughout retirement?
2. What choices have retirees made for managing their pensions and financial assets for generating income?
3. What policy options are available to ensure income throughout retirement and what are their advantages and disadvantages for retirees?

To identify the strategies that experts recommend retirees employ to ensure income throughout retirement, we interviewed a judgmental sample of a range of financial planners and other financial experts from different academic and industry organizations and a retiree interest group,

[4]U.S. Department of the Treasury and U.S. Department of Labor, *Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans*. 75 Fed. Reg. 5,253 (Feb. 2, 2010). Labor is currently reviewing the rules under the Employee Retirement Income Security Act (ERISA) and the Treasury is currently reviewing the plan qualification rules under the Internal Revenue Code to determine whether, and, if so, how the departments could or should enhance, by regulation or otherwise, the retirement security of participants in employer-sponsored retirement plans and in IRAs by facilitating access to, and the use of, lifetime income or other arrangements designed to provide a lifetime stream of income after retirement. IRAs can be individual retirement accounts or individual retirement annuities.

which were from different geographic areas of the country. (See app. I.) We focused our discussion on five households that we randomly selected from the Health and Retirement Study (HRS) in the lowest, middle, and highest net wealth quintiles with different combinations of pension plans in the middle and highest quintiles.[5] See financial and nonfinancial characteristics by quintile in appendix II, and the selected households' summary financial data in appendix III. We also reviewed company specific financial product documentation and studies of retirement income strategies such as those describing systematic withdrawals from retirement savings. To review the choices retirees have made for managing their pension and financial assets for generating income, we analyzed data from the HRS, reviewed others' research, and analyzed data from the Social Security Administration (SSA). We reviewed additional data from the Employee Benefit Research Institute (EBRI), the Census Bureau and the Bureau of Labor Statistics (BLS). To identify policy options that are available to ensure income throughout retirement, as well as their advantages and disadvantages, we reviewed information from a variety of academic, consumer, industry, and government sources. This included selected submissions in response to the Labor and Treasury RFI, other publications, and interviews with academic, consumer, industry, and government officials. We conducted this performance audit from January 2010 through June 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. For more information on our scope and methodology, see appendix I.

Background

While income in retirement varies widely by source, Social Security benefits are the foundation of income for nearly all retiree households. In aggregate, Social Security is the largest source of retirement income for households with someone aged 65 or older, but other financial assets such as pension income from DB and DC plans, private savings, and assets such

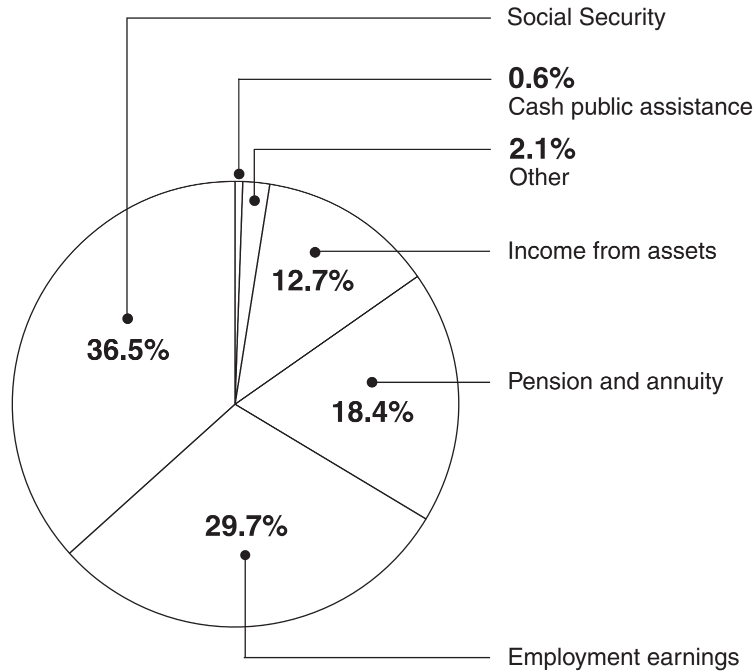
[5]The HRS is a national, longitudinal survey of older people produced by the University of Michigan sponsored by the National Institute of Aging. We used HRS data to identify quintiles based on net wealth—IRA assets, present value of DB and DC pension assets, and other financial and nonfinancial assets net of debt, but excluded the present value of Social Security assets. Nonfinancial assets include home equity, business ownership, and the net value of vehicles.

as home equity are important sources of retirement income for many.[6] (See fig. 1.) In 2008, the most recent year for which data were available, among households with someone aged 55 to 60, the median net wealth for the middle quintile of net wealth was $339,000. The median household income for the middle net wealth quintile was about $70,000 in the preceding year, according to the Health and Retirement Study. (See app. II.) Earnings from work can be an important source of income for some households with a member aged 65 or older because, for example, a spouse younger than 65 may be working. Yet many people aged 65 or older also work. In 2010, 29.1 percent of people aged 65 to 69 worked at least part-time and 6.9 percent of people aged 75 or older were employed.[7]

[6] A DB plan promises to provide a benefit that is generally based on an employee's years of service and, frequently, salary. Typically, DB annuity payments are received on a monthly basis by the retired participant and continue as long as the recipient lives (and also for the lifetime of the surviving spouse if the participant is married and this form of benefit is taken). DC plan benefits, primarily those from 401(k) plans, are based on the contributions and investment returns in individual accounts. For each participant, typically both the plan sponsor and the participant may periodically contribute a specific dollar amount or percentage of pay into each participant's account. Private savings include bank account balances and IRA funds. IRAs are retirement savings arrangements which allow workers to make tax-deductible and nondeductible contributions to an individual account. For workers who meet certain conditions regarding their income or who are not otherwise eligible to participate in an employer-sponsored pension plan, contributions to a regular (traditional) IRA receive favorable tax treatment; workers may be eligible to take an income tax deduction on some or all of the contributions they make to their traditional IRA. Amounts withdrawn from a traditional IRA are fully or partially taxable in the year withdrawals are made. If the taxpayer made only deductible contributions, withdrawals are fully taxable. Investment income on funds in the account is tax deferred until funds are withdrawn. Workers below certain income limits may also contribute to Roth IRAs, which do not provide an income tax deduction on contributions, but permit tax free withdrawals. Individuals may also transfer funds to a Roth IRA, but must pay taxes on the pretax amounts transferred.

[7] These estimates are from the BLS analysis of Current Population Survey (CPS) data. The 95 percent confidence intervals for these estimates are 28.2 to 30.0 percent and 6.3 to 7.5 percent, respectively, for adults aged 65 to 69 and adults aged 75 or older.

Figure 1: Sources of Aggregate Income for Households with Someone Aged 65 or Older, 2008



Source: SSA, Office of Retirement and Disability Policy, *Income of the Population 55 or Older, 2008.*

Notes: "Household" here refers to what SSA identifies as aged units—either a married couple living together or a nonmarried person. The age of a married couple is the age of the husband if he is 55 or older; if the husband is younger than 55, the age of the married couple is the age of the wife. Thus a married couple is considered to be 65 or older if the husband is 65 or older or if the husband is younger than 55 and his wife is 65 or older. Data reported by the Social Security Administration for pension income includes regular payments from IRA, Keogh, or 401(k) plans. Nonregular (nonannuitized or lump sum) withdrawals from IRA, Keogh, and 401(k) plans are not included. Social Security income includes retirement, auxiliary (such as spousal), survivors, and disability benefits. Data reported for income from assets includes interest income, income from dividends, rents or royalties, and estates or trusts. Other income includes noncash benefits, veteran's benefits, unemployment compensation, workers' compensation, and personal contributions. Income from others is excluded. The 95 percent confidence intervals for the share of aggregate income are 35.9 to 37.1 percent for Social Security, 29.1 to 30.3 for employment earnings, 17.9 to 18.9 for pension and annuity income, 12.3 to 13.1 for income from assets, 1.9 to 2.3 for other, and 0.5 to 0.7 for cash public assistance.

Social Security benefits provide annually inflation-adjusted income for life—and in 2008 were on average the source of 64.8 percent of total

income for recipient households with someone aged 65 or older.[8] Under changes legislated in 1983, the retirement age for an unreduced benefit (the full retirement age) is gradually increasing from age 65, beginning with retirees born in 1938, and will reach age 67 for those born in 1960 or later.[9]

Despite these changes, the cost of Social Security benefits is projected to exceed sources of funding, and the program is projected to be unable to pay a portion of scheduled benefits by 2036.[10] In 2010, for the first time since 1983, the Social Security trust funds began paying out more in benefits than they received through payroll tax revenue, although trust fund interest income more than covers the difference, according to the 2011 report of the Social Security trust funds' Board of Trustees.[11] However, changes to Social Security could eliminate or reduce the size of this projected long-term shortfall.

At retirement, DB plan participants are eligible for a specified payment for life (either immediately or deferred, and with or without benefits for a surviving spouse), but some DB plans also give participants a choice, sometimes a difficult choice, to forego a lifetime annuity and instead take

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[8]Data for 2008 were the most recent available. This estimate is the mean proportion of income from Social Security for households in which one or more member is a Social Security recipient aged 65 or older. For 34.2 percent of such households, Social Security benefits were the source of 90 percent or more of income. See Social Security Administration, *Income of the Population 55 or Older, 2008* (Washington, D.C., April 2010), 300 (table 9.A1). The 95 percent confidence intervals for these estimates are 64.1 to 65.5 percent and 33.5 to 34.9 percent respectively.

[9]Those born in 1938 were the first to be affected when they turned 62 in 2000 and faced a greater reduction for retiring at that age.

[10]These estimates are based on results using intermediate assumptions in the 2011 report of the Social Security trust funds' Board of Trustees. The Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, *The 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, (Washington, D.C., May 13, 2011).

[11]The Social Security Administration estimates that over the next several years, and over the long term, trust fund income, excluding trust fund interest, is projected to be less than trust fund expenses, absent any changes. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 temporarily reduced employees' share of the Federal Insurance Contributions Act (FICA) tax from 6.2 to 4.2 percent of covered wages for calendar year 2011. To avoid harming Social Security's solvency, however, the act directs the Treasury to transfer from the general fund to the Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds an amount equal to 2.0 percent of covered wages. Pub. L. No. 111-312 § 601, 124 Stat. 3296, 3309-10.

a lump sum cash settlement (distribution) or roll over funds to an IRA. DC participants face a number of difficult choices regarding their account balances, such as leaving money in the plan, purchasing an annuity,[12] or transferring or rolling over their balance into an IRA. Employers who sponsor qualified plans and enable departing participants to receive lump sum distributions must also give participants the option to have these amounts directly rolled over into an IRA or another employer's tax-qualified plan.[13]

Workers entering retirement today typically face greater responsibilities for managing their retirement savings than those who retired in the past. Social Security continues to provide a foundation of inflation-adjusted income for life, but fewer retirees today have defined benefit plans providing lifetime income. DC plans have become much more common and they generally do not offer annuities, so retirees are left with increasingly important decisions about managing their retirement savings.[14] Participants in DB plans also face similar decisions when the plan offers a lump sum option, including not only whether to take the annuity or lump sum, but decisions about managing these savings if a lump sum is elected.

For households with someone aged 65 or older with income from assets, such as interest and dividends, the estimated median amount of asset income for households in the third (middle) income quintile was $1,022 in 2008. For those in the highest income quintile the median was $8,050.[15] Financial assets provide income, but can also provide flexibility to draw down funds as needed during retirement. For workers with a self-directed lump sum or other retirement savings, the money can be taken in periodic distributions for which there are strategies to help reduce the chance that

[12]An annuity is an insurance agreement or contract that comes in a number of different forms and can (1) help individuals accumulate money for retirement through tax-deferred savings, (2) provide them with monthly income that can be guaranteed to last for as long as they live, or (3) do both.

[13]Not all plans, however, accept rollovers from other plans.

[14]From 1990 to 2008, the number of active participants in private sector DB plans fell by 27.6 percent from about 26 million to about 19 million. From 1990 to 2008, the number of active participants in DC plans increased by 90.3 percent from about 35 million to about 67 million.

[15]The 95 percent confidence intervals for these estimates are $983 to $1,061 and $7,796 to $8,304, respectively, according to SSA.

a retiree does not outlive his or her money. For example, retirees could draw down a portion of their balance as a form of regular income to supplement Social Security and possibly DB pension income, investing the balance of savings in a diversified portfolio of mutual funds containing equities and fixed income securities.

An alternative to self-managing periodic distributions from savings is to use one's savings to purchase an immediate annuity from an insurance company that guarantees income for life. An immediate annuity can help to protect a retiree against the risk of underperforming investments, the risk of outliving one's assets (longevity risk) and, when an inflation-adjusted annuity is purchased, the risk of inflation diminishing one's purchasing power.[16] Researchers have concluded that annuities have important benefits. For example, according to one association of actuaries, it is more efficient to pool the risk of outliving one's assets than to self-insure by accumulating enough assets to provide enough income in case one lives to a very old age.[17] Annuities provide income at a rate that can help retirees avoid overspending their assets and provide a floor of guaranteed income to prevent unnecessarily spending too little for fear of outliving assets, according to one association. Annuities can also relieve retirees of some of the burden of managing their investments at older ages when their capacity to do so may diminish, which may also make them susceptible to fraudulent sales. On the other hand, annuities may be inappropriate or expensive for people who have predictably shorter-than-normal life expectancies. Likewise, funds used to purchase immediate annuities are no longer available to cover large unplanned expenses. Also, immediate annuities that provide for bequests have higher costs.[18]

There is little consensus about how much income constitutes "enough" retirement income. Retirement income adequacy may be defined relative to a standard of minimum needs, such as the poverty rate, or to the level of spending households experienced during working years. Some economists and financial advisors consider retirement income adequate if the ratio of

[16]According to the Insured Retirement Institute, very few life insurance companies offer true inflation-protected annuities for sale in the United States.

[17]According to the American Academy of Actuaries, without pooling longevity risk, through an immediate annuity for example, a retiree would need to accumulate substantially more in savings to ensure not outliving his or her assets.

[18]Annuity providers may offer term-certain options or death benefit options for an additional cost.

retirement income to preretirement income—called the replacement rate—is from 65 to 85 percent, although some retirees may need considerably less or more than this. Typically, however, retirees do not need to replace 100 percent of preretirement income to maintain living standards for several reasons. For example, retirees will no longer need to save for retirement and their payroll and income tax liability will likely fall. However, some researchers cite uncertainties about health and long-term care costs as reasons a higher replacement rate may be necessary.[19] Table 1 shows replacement rates from Social Security benefits for low and high earners retiring in 2011, as well as the remaining amount of preretirement income from other sources necessary to achieve a 75 percent replacement rate.[20]

Table 1: Preretirement Earnings Replacement Rates for Workers Retiring in 2011 at Age 65, Percentage of Career-Average Earnings

Source of replacement rate income	Low earners' replacement rate	High earners' replacement rate
Social Security	55.2	33.9
Replacement rate needed from other sources to achieve 75 percent replacement rate	19.8	41.1

Sources: GAO analysis and the 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, Table VI.F10.

Notes: Replacement rates represent the sum of annual scheduled benefit amounts and other retirement income as a percent of career-average annual earnings. A "low earner" is someone whose career average earnings are about 45 percent of the national average wage index, while a "high earner" has career average earnings of about 160 percent of the average wage index. The national average wage index for 2009 was $40,711.61.

Social Security benefits for retired workers at full retirement age (age 66 for workers born 1943 to 1954) in 2011 provide 90 percent of the first $680 of average indexed monthly earnings, 32 percent of additional earnings up to $4,100, and 15 percent of earnings above $4,100.

[19]See, for example, Jonathan Skinner, "Are You Sure You're Saving Enough for Retirement," *Journal of Economic Perspectives*, 21(3) (Summer 2007): 59-80; Congressional Budget Office, *Baby Boomers' Retirement Prospects: An Overview* (November 2003).

[20]Due to the long-term fiscal challenges facing Social Security, options for reform may result in lower benefits and reduced replacement rates from Social Security. As a result, reforms to the Social Security system may increase the need for retirement income from other sources such as private pensions. See GAO, *Social Security Reform: Answers to Key Questions*, GAO-05-193SP (Washington, D.C.: May 2005).

The Employee Retirement Income Security Act of 1974 (ERISA) is the primary statute governing private pension plans, including DB and DC plans.[21] It seeks to protect the interests of employee benefit plan participants and their beneficiaries. Title I of ERISA, enforced by Labor, sets standards of conduct and requires accountability for the people who run or provide investment advice to plans, known as plan fiduciaries,[22] and requires administrators to provide participants with certain disclosures, including periodic benefit statements as well as a summary plan description. Title IV of ERISA created the Pension Benefit Guaranty Corporation (PBGC) as a U.S. government corporation to provide plan termination insurance for certain DB pension plans that are unable to pay promised benefits. The Internal Revenue Service (IRS), under Title II of ERISA, and subsequent amendments to the Internal Revenue Code (the Code), generally is responsible for ensuring that plans meet certain requirements for tax qualification and for interpreting rules in Title I of ERISA regarding participation, vesting, benefit accrual, and minimum funding. Tax qualification enables employers to make tax-deductible contributions and the plan to earn interest on a tax-deferred basis. The tax advantages are intended to encourage employers to establish and maintain pension plans for their employees and advance other public policy objectives. For example, certain provisions of the Code set required minimum distributions from tax-deferred accounts, such as traditional IRAs and qualified plans, generally by April 1 in the year following the year in which the account holder reaches age 70 ½. These required minimum distributions help to ensure that account holders withdraw tax-deferred savings in retirement rather than accumulate savings for their estate.

Once an individual withdraws his or her funds from either a DB or DC plan, a myriad of laws and regulations typically applies, depending on the investment decisions that the individual makes with those funds. In this instance, the individual is no longer a plan participant governed by ERISA, but is now essentially a retail investor governed by the laws and regulations that are pertinent to the particular product or asset in which

[21] 29 U.S.C. § 1001 note.

[22] Under ERISA, a fiduciary is anyone, such as a sponsor, trustee, investment adviser, or other service provider, to the extent they exercise any discretionary authority or control over plan management or any authority or control over the management or disposition of plan assets, or who renders investment advice respecting plan money or property for a fee or other compensation, or has discretionary authority or responsibility for plan administration. 29 U.S.C. § 1002(21)(A).

he or she chooses to invest, and whether or not the funds are in an IRA.[23] The different laws, regulations, and agencies that may come into play vary depending on the type of assets held.[24]

Various other federal and state agencies may regulate the investment or insurance products offered in pension plans or outside of plans on the retail market. For example, the Securities and Exchange Commission (SEC) regulates mutual funds, which are pooled investments in a portfolio of securities. In addition, certain types of annuities may be regulated by states, while other types may also be subject to federal securities laws and thus regulation by the SEC. For example, the SEC, among others, regulates variable annuities, including regulation of disclosure and sales practices. (See app. V on selected retirement income arrangements and products.) Insurance company annuities are generally regulated by state insurance departments, which set reserve requirements for the insurance companies offering annuities. More recently, states are also regulating sales and marketing practices and policy terms and conditions to ensure that consumers are treated fairly when they purchase insurance products and file claims. Although each state has its own insurance regulator and laws, the National Association of Insurance Commissioners (NAIC) provides a national forum for addressing and resolving major insurance issues and for allowing regulators to develop consistent policies on the regulation of insurance when consistency is deemed appropriate.

[23]IRAs are subject to an exclusive benefit requirement and the prohibited transaction rules in Code section 4975 (as interpreted by Labor). Under the exclusive benefit requirement contributions made to pension plans must be maintained for the exclusive benefit of participants and their beneficiaries. Further, some IRAs, including those in Savings Incentive Match Plans for Employees of Small Employers (SIMPLE), are DC plans subject to various ERISA rules for plan sponsors. Thus, IRS and, to a limited extent, Labor have oversight responsibilities for certain types of IRAs. IRS has responsibility for tax rules governing how to establish and maintain IRAs, while Labor has sole responsibility for oversight of fiduciary standards for employer-sponsored IRAs, and has issued guidance to employers related to payroll-deduction IRAs regarding when such an arrangement would be a pension plan subject to Labor's jurisdiction. 29 C.F.R. § 2510.3-2(d) and 29 C.F.R. § 2509.99-1. Except for rulemaking authority regarding the tax code's prohibited transaction provisions, which apply to IRAs, Labor does not have jurisdiction to oversee payroll-deduction IRA programs that are operated within the conditions of their guidance. Also, more households own traditional IRAs than employer-sponsored IRAs. Labor and IRS also work together to oversee IRA prohibited transactions; generally, Labor has interpretive jurisdiction and IRS has certain enforcement authority. See GAO, *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*, GAO-08-590 (Washington, D.C.: June 4, 2008).

[24]See GAO-10-632R, 14-15 for details.

State guaranty associations protect individuals with annuities up to specified limits in the event of insurer insolvency. If an insurance company becomes insolvent, guaranty associations assess solvent insurers to pay covered claims to affected policyholders. However, the associations are not state agencies, and their specified limits and the extent of coverage vary across states.

Experts Recommend Retirees Balance Draw Down of Savings and Use of Lifetime Retirement Income Options

Experts we interviewed tended to recommend that retirees draw down their savings strategically and systematically and that they convert a portion of their savings into an income annuity to cover necessary expenses or opt for the annuity provided by an employer-sponsored DB pension, rather than take a lump sum.[25] The experts also frequently recommended that retirees delay receipt of Social Security benefits until they reach at least full retirement age.[26] However, according to the experts, the combination of these strategies depends on an individual's household circumstances, such as the standard of living the household seeks, its financial resources, and its tolerance for risks such as investment, inflation, and longevity risk.

To learn what these experts recommend, we presented them with the financial profiles of five actual near-retirement households whose data we drew from the HRS as of 2008.[27] We randomly selected households from the lowest, middle, and highest net wealth quintiles and households with varying types of pensions. See table 2 for a summary of their recommendations for each of these households and appendix III for a more detailed description of each household's financial characteristics.

[25]However, our selection of experts did not provide a statistically representative sample of all financial experts.

[26]Under Social Security, retiree benefits are reduced for retirees who start drawing benefits before their full retirement age and increased for those who delay the start of benefits up to age 70.

[27]We did not have access to any personal identification information for selected households; they remain anonymous.

Table 2: Recommended Savings Strategies, by Income Level, for Near-Retirement Households

Net wealth quintile and sample household	Total net wealth[a]	Gross financial wealth[b]	Marital status	Pension type	Experts we spoke to tended to recommend
Lowest quintile (household 1)	$2,000	$0	Single	None	Continue working and accumulating assets, if possible. Delay Social Security.
Middle quintile (household 2)	$349,000	$191,000	Married	DC	Purchase annuity and systematically draw down balance of financial assets. Delay Social Security. Continue working and accumulating assets, if possible.
Middle quintile (household 3)	$373,000	$170,000	Married	DB	Take DB annuity income,[c] purchase annuity, and systematically draw down balance of financial assets. Delay Social Security. Continue working and accumulating assets, if possible.
Highest quintile (household 4)	$1,597,000	$1,262,000	Married	DB	Take DB annuity income and systematically draw down financial assets. Delay Social Security.
Highest quintile (household 5)	$1,518,000	$579,000	Married	DB and DC	Liquidate some real estate, take DB annuity income,[c] and systematically draw down financial assets. Spouse in poor health take Social Security early and spouse in good health delay.[d]

Source: GAO analysis of HRS data.

Notes: These estimates have sampling errors associated with them. For 95 percent confidence intervals and additional household financial characteristics, see appendix II.

[a]Total net wealth is the sum of gross financial wealth, the market value of homes and other real estate, housing debt, nonhousing debt, and the value of vehicles, rounded to the nearest thousand.

[b]Gross financial wealth is the sum of the present value of a DB plan, DC plan, IRA assets, business assets, and other financial assets, rounded to the nearest thousand. The value of homes and other real estate, housing debt, vehicles, and nonhousing debt are excluded.

[c]The present value of these DB plans was about $30,000.

[d]One of the members of this household may not be able to continue working to delay taking Social Security as their self-reported health status was "poor," compared with "good" and "very good" for most of the other respondents and spouses in these households.

Draw Down a Portion of Savings Systematically for Income, Liquidity, and Inflation Protection

Experts we interviewed recommend that when retirees use their savings or other assets to supplement other sources of retirement income, they draw down a portion of these reserves at a systematic rate. The drawdown rate should preserve some liquidity—immediately available funds—in case of unexpected events such as high medical costs. Such a drawdown should be part of a larger strategy that includes a certain amount of lifetime retirement income (such as Social Security, defined benefit, and

annuity income). Drawdowns should be taken from assets invested in a broadly diversified portfolio comprised of medium exposure to stocks and the balance in bonds and cash. However, drawing down assets invested in stocks and bonds was recommended with the caveat that holding stocks and bonds leaves households exposed to the uncertainty in financial markets over an unknown number of retirement years.[28]

Hypothetical "Smooth" Systematic Drawdown Plan

Starting balance of $100,000. Four percent annual drawdown in year 1 and increase by 3 percent inflation each year.

Income draw

Year 1, $4,000
Year 2, $4,120
Year 3, $4,244
Year 4, $4,371
Year 5, $4,502
…
Year 20, $7,014
…

Ending balance either grows or declines depending on investment performance.

The systematic drawdown of financial assets can be based on a "smooth" and sustainable level of income throughout retirement or on a retiree's remaining life expectancy. The smooth drawdown approach takes annual withdrawals based on assumptions about one's life expectancy and future investment return.[29] According to the Congressional Research Service (CRS), an approach based on a retiree's remaining life expectancy could involve withdrawing amounts in light of the retiree's remaining life expectancy in the year that a withdrawal occurs. One example, under the Code, would be required minimum distributions, which help to ensure that account holders withdraw tax-deferred retirement savings in retirement rather than for estate planning. The minimum distributions are calculated based partly on life expectancy.

The experts we spoke to recommended a smooth systematic drawdown from retiree investments, but their recommendations varied on the rate of drawdown, depending on retirees' acceptance of the risk of running out of money and the experts' own assumptions about future investment returns. For example, those we spoke to recommended annual withdrawals of 3 to 6 percent of the value of the investments in the first year of retirement, with adjustments for inflation in subsequent years. These rates generally comport with CRS estimates for assuring a lifelong source of income.[30]

[28]Life expectancy has risen over time. A male who reached age 65 in 1960 could expect to live another 13 years, while a man who reached age 65 in 2010 could expect to live another 19 years, according to the Social Security Board of Trustees. Females have experienced similar gains. A female who reached age 65 in 1960 could expect to live another 17 years, while a female who reached age 65 in 2010 could expect to live another 21 years. *Trustees Report* (2011), cohort life table p. 91.

[29]While the traditionally recommended drawdown strategy is to draw only the income from investments, experts we spoke to recommended that retirees draw from both income and principal and seek a return on their investments irrespective of the income yield.

[30]These drawdown probabilities depend upon the assumptions underlying the CRS simulation model. Janemarie Mulvey and Patrick Purcell, *Converting Retirement Savings into Income: Annuities and Periodic Withdrawals*, (Congressional Research Service: 2009).

We're seeing annuity Guaranteed Income Riders offering a 5/6/7% drawdown rates (depending on age) guaranteed for life!*

Using historical rates of investment return on a limited selection of stocks and bonds, CRS estimated that a drawdown rate of 4 percent on an investment portfolio with 35 percent U.S. stocks and 65 percent in corporate bonds would be 89.4 percent likely to last 35 years or more.[31] (See additional probabilities from the CRS estimates in table 3.) Importantly, drawdown rates identified by CRS are based on historical rates of return, and there is no assurance that future investment returns will match historical returns.

Table 3: Estimated Probability by CRS That a Retirement Account Will Last for at Least a Specific Number of Years

	Initial annual drawdown rate		
	4%	**5%**	**6%**
Probabilities that money will last a given number of years, excluding the impact of investment fees and taxes			
25 years or more	97.7%	87.8%	65.2%
30 years or more	94.0	77.0	49.5
35 years or more	89.4	66.9	38.8

Source: CRS Monte Carlo simulation of a portfolio consisting of 35 percent S&P 500 index and 65 percent AAA-rated corporate bonds.

Note: There is no assurance that future investment returns will match historical rates of return. In addition, CRS estimates are based on investment returns from 1926 to 2007, while the S&P 500 declined 38.5 percent in 2008 (providing a total return of -37.0 percent). The probabilities of drawdown shown in the table depend upon the validity of the assumptions used to create the Monte Carlo simulation model.

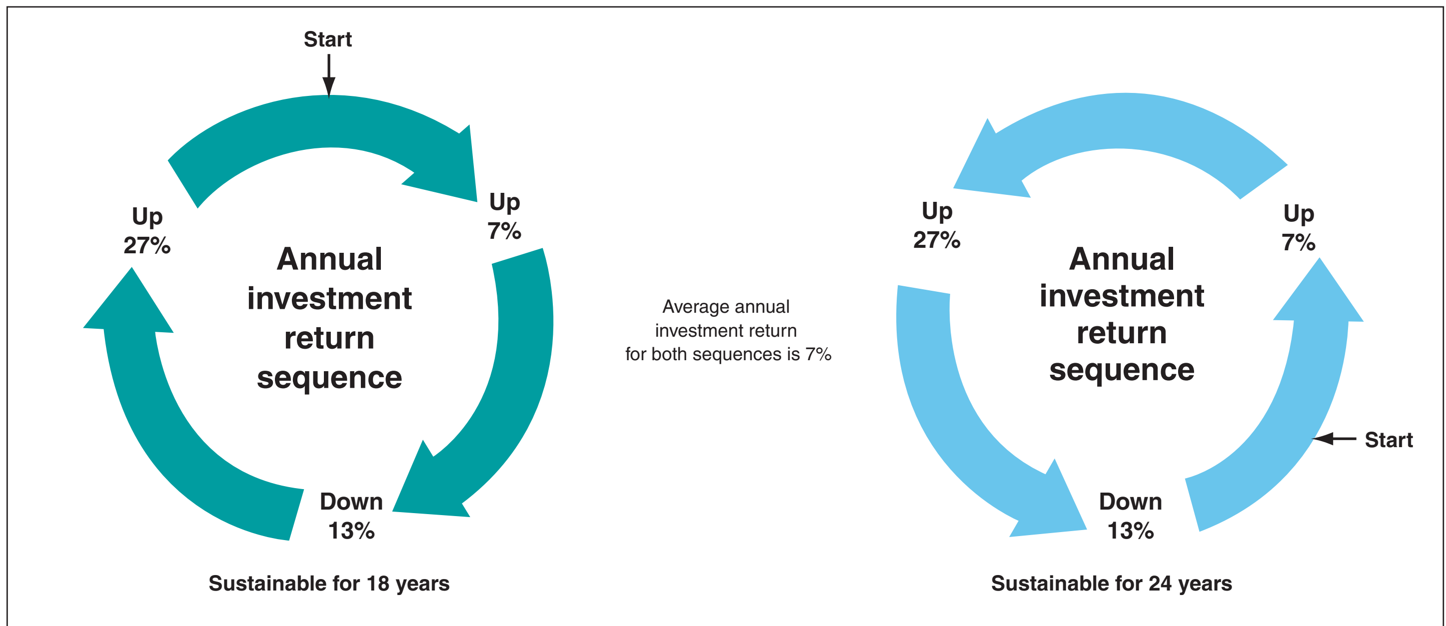
According to the experts we spoke to and literature we reviewed, another factor that can affect the success of drawdown strategies is the sequence of investment returns: if the drawdowns begin after the value of the investments has declined, the income drawn would deplete a greater proportion of the investments than if growth had occurred before the

[31]The experts we spoke to recommended that retirees hold more than the two asset classes used in the CRS retirement model. In addition, CRS excluded the effect of investment fees and taxes in its analysis. According to the Investment Company Institute and the investment research firm, Lipper, mutual fund fees incurred by investors averaged about 1.0 percent for stock mutual funds and 0.7 percent for bond funds in 2009. See *Investment Company Fact Book: A Review of Trends and Activity in the Investment Company Industry*, 51st ed., Investment Company Institute (2011). As we have previously reported, fees are one of many factors to consider when choosing among investment options, such as in DC plans and IRAs, because fees can significantly decrease retirement assets. Even a small fee deducted from one's assets annually could represent a large amount of money years later had it remained in the account to be reinvested. See, for example, GAO, *Retirement Savings: Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants*, GAO-09-641 (Washington, D.C.: Sept. 4, 2009).

*There's all kinds of different products, and rates change over time. Check with you personal advisor.

income were drawn. If, for example, annual investment returns on retirement savings are up 7 percent in the first year, then down 13 percent in the following year, and then up 27 percent, with subsequent returns throughout retirement a repetition of the first 3 years, the average return would be 7 percent. If the sequence of returns in the second and third year were reversed, holding all else constant, the average annual return would be the same; yet if withdrawals are made each year, savings would be depleted sooner with the first sequence of returns (see fig. 2).[32]

Figure 2: Sequence of Investment Returns Can Affect the Sustainability of a Drawdown Strategy



Source: GAO analysis; Moshe A. Milevsky and Alexandra C. Macqueen.

Notes: We assumed a $100,000 initial investment at age 65, an annual drawdown rate of 9 percent, and withdrawals taken monthly. We used an unusually high initial drawdown rate to illustrate both return sequences resulting in the retiree running out of money before age 90. The time-weighted arithmetic average return for both sequences is 7 percent, and the time-weighted geometric average for both is 5.74 percent. The scenario is based on GAO analysis and Moshe A. Milevsky and Alexandra C. Macqueen, *Pensionize Your Nest Egg: How to Use Product Allocation to Create a Guaranteed Income For Life*, (Ontario, Calif.: John Wiley & Sons Canada, Ltd., 2010).

[32]The scenario is based on GAO analysis and Moshe A. Milevsky and Alexandra C. Macqueen, *Pensionize Your Nest Egg: How to Use Product Allocation to Create a Guaranteed Income For Life* (Ontario, Calif.: John Wiley & Sons Canada, Ltd., 2010), 34-47.

Lifetime Retirement Income Sources and Increased Social Security Benefits Can Provide Additional Income Security

Experts we spoke to generally recommended lifetime retirement income from DB plans, when DB plans are available to workers, and income annuities, in conjunction with systematic drawdown of other savings, to provide a greater level of retirement income security. Furthermore, they frequently recommend retirees delay Social Security to boost inflation-adjusted lifetime retirement income.[33]

Lifetime Retirement Income from DB Plans

When the choice of taking a lump sum in exchange for lifetime retirement income from a DB plan is available,[34] the experts we spoke with generally recommended that retirees take lifetime retirement income because it would reduce their exposure to investment and longevity risks. However, private sector DB plans do not typically provide inflation protection. Without inflation protection, the value of the income may be greatly diminished over a long retirement. For example, income of $1,000 per month in 1980 would have purchasing power closer to $385 a month 30 years later in 2009.[35] When a DB income stream does not adjust with inflation, many experts recommended investing other savings in stocks and bonds, which have on average returned above the rate of inflation. Nevertheless, for retirees who want guaranteed income, experts we spoke to considered lifetime retirement income from DB plans preferable over purchasing an annuity with a lump sum distribution, since DB plans may be able to provide payments at a higher rate than is available through an insurance annuity outside of the plan.

Lifetime Retirement Income from Annuities

The experts we spoke with also recommended that retirees enhance their guaranteed income by purchasing an annuity with some limited portion of their savings. The income needed from an annuity depends, in part, on the

[33]SSA officials noted that beneficiaries who are eligible for more than one type of benefit may have other ways to boost inflation-adjusted lifetime retirement income. For example, under certain circumstances a beneficiary could claim a spousal benefit at their full retirement age on their lower-earning spouse's earnings record and defer receipt of his or her own retirement benefit past full retirement age in order to earn an increased benefit up to age 70.

[34]An estimated 49 percent of state and local government workers with a DB had a lump sum option available in 2007. See U.S. Department of Labor, *National Compensation Survey: Retirement Benefits in State and Local Governments in the United States, 2007*, Summary 08-03 (May 2008). The 95 percent confidence interval for this estimate is 44.7 to 53.3 percent.

[35]Based on BLS Consumer Price Index data for all urban consumers (CPI-U).

amount of living expenses not covered by other sources of guaranteed income such as Social Security or a DB pension. For those that want a higher level of predictable income, an annuity can reduce the uncertainty that comes with managing a portfolio of investments and systematically drawing down income. The experts noted that retirees may have more difficulty managing a portfolio of investments as they age.

With regard to our sample of near-retirement households, the experts we spoke to recommended that the middle quintile households purchase annuities with a portion of their savings, but that the lowest quintile household accumulate some precautionary cash savings before purchasing an annuity or investing in securities. Furthermore, they suggested that the two households in the highest quintile had sufficient resources to go without annuities, unless the individuals were very risk averse and felt the need for additional protection for longevity. With regard to the middle quintile household without a DB plan, experts specified that they should consider using a portion, such as half, of their $191,000 in financial assets to purchase an inflation-adjusted annuity. Based on current annuity rates, a premium valued at half of $191,000 would provide an additional $355 per month ($4,262 in the first year) until the death of the last surviving spouse, and include annual increases tied to the Consumer Price Index.[36] A monthly payment in the first year at this rate would provide slightly more than the annual income provided by a 4 percent drawdown.[37] By purchasing an annuity, this household would reduce its exposure to the risks inherent in a drawdown strategy—namely, the risks of longevity, inflation, and market volatility. This household would also have some liquidity by having kept half of its initial savings available to cover unexpected expenses or to leave for a bequest.

[36]Annuity quote was obtained on April 1, 2011, from Income Solutions, Hueler Investment Services, Inc., and Vanguard. The insurance company offering the annuity is American General Life Companies. The premium for this annuity would be $95,500 of qualified retirement funds and the transaction fee is 2 percent of the premium. The rate also assumes that both the male and female spouse turned 66 on March 31, 2011, the annuity commencement date was June 1, 2011, the purchasers were residents of Florida, upon death of one spouse the surviving spouse continues to collect 100 percent of the income, and the surviving spouse is the sole beneficiary of the income. The inflation adjustment is based on the BLS Consumer Price Index for all urban consumers (CPI-U).

[37]The annuity would provide $4,262 in the first year, and a 4 percent annual drawdown strategy would provide $3,820. The annual amount provided by the annuity does not equal the product of 12 monthly payments due to rounding.

For all the advantages of annuities, however, some of the experts we spoke to noted that there is commonly a psychological hurdle involved in the difficult decision to exchange a large principal payment for an unknown number of small monthly payments. In addition, some planners tempered their recommendations for annuities, given what they viewed as the credit risk of annuity insurance companies or the risk of defaulting on their obligation to make annuity payments. On the other hand, an economist and an actuary we spoke to—who do not work for insurance companies—maintain that the credit risk is small relative to the risks inherent in holding stocks and bonds.[38]

Annuities also carry some disadvantages with regard to estate and tax planning. Regarding a retiree's estate, annuities are typically not refundable upon death, whereas any funds that remain with the deceased's systematic drawdown strategy could be left to beneficiaries. With regard to taxes, the income from annuities purchased with nonqualified funds is taxed as ordinary income, whereas part of the investment return from a systematic drawdown strategy of nonqualified savings is often taxed at lower capital gains or dividend tax rates.

Delay Social Security

Financial experts we spoke to recommended that retirees delay their receipt of Social Security benefits in order to increase the amount they receive from this guaranteed inflation-adjusted retirement income, particularly since Social Security benefits are the foundation of income for nearly all retiree households. Although, the experts cited factors to consider before choosing to delay Social Security benefits, such as one's health and personal life expectancy and the availability of other sources of income.

Under market conditions at the time of the drafting of this report, we found that by delaying Social Security benefits an individual can gain additional retirement income at a lower cost than from an immediate annuity. While individuals may choose reduced Social Security benefits at the early eligibility age of 62, the payments they will receive at full retirement age (age 66 for those born from 1943 to 1954) will be higher,

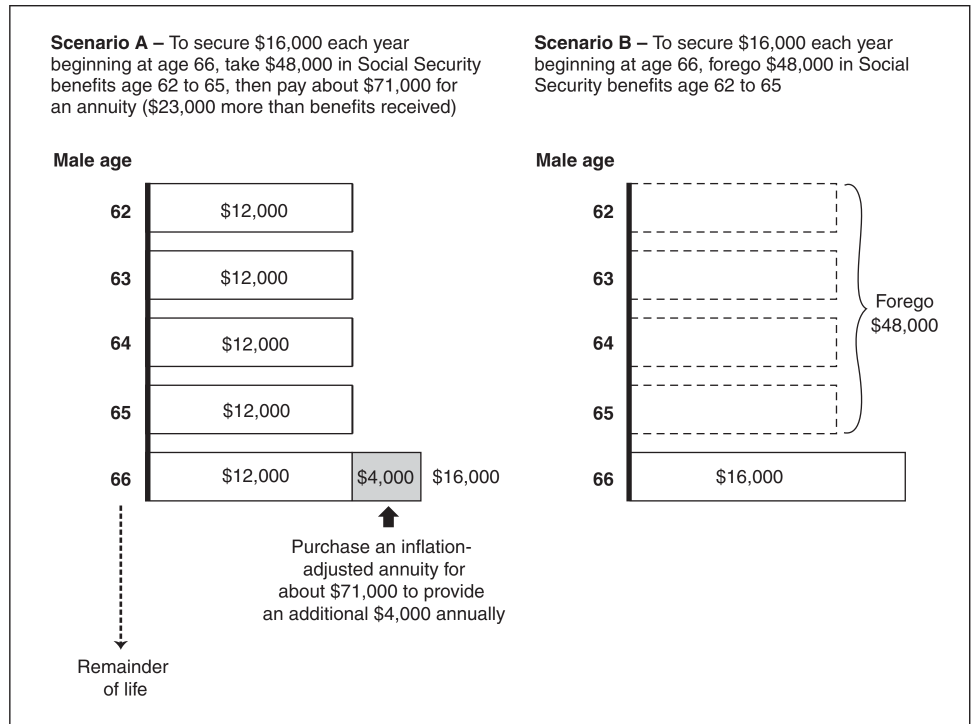
[38]The value of income annuities is backed by state guaranty associations, as defined by state laws. The value of annuities is generally protected for at least $100,000 in each state. For a description of the regulation of annuities, see GAO, *Retirement Income: Challenges for Ensuring Income throughout Retirement*, GAO-10-632R (Washington, D.C.: Apr. 28, 2010), 15-16.

and continue to increase incrementally the longer they wait, up to age 70.[39] The total estimated amount of benefits collected by electing to delay receipt of benefits from age 62 up to age 70 is intended to be approximately actuarially equivalent, but determinations of actuarial equivalence at any particular time depend on assumptions as to current and projected interest and mortality rates. The amount of money that a retiree would forego by waiting to start benefits until age 66 is less than the amount needed to purchase an annuity that would provide the additional monthly income available by waiting until full retirement age. If, for example, a person collects $12,000 per year at age 62 and every year thereafter (with yearly adjustments for inflation), they could wait until age 66 and collect $16,000 per year (33 percent more with additional adjustments for inflation from age 62 to 66) and every year thereafter.[40] By beginning to collect benefits at age 62 they would have collected a total of $48,000 by age 66, and could then purchase an inflation-adjusted annuity to provide income to make up the difference. However, the cost of the annuity for a single male would be 47.4 percent more than the $48,000 they could collect from age 62 through 65. (See fig. 3.)

[39]Benefits received at age 62 are reduced by 25 percent of the amount that would be provided at a full retirement age of 66 and benefits received at age 70 are increased by 32 percent from the same full retirement age. For example, if starting to receive benefits at age 62 would provide $1,000 per month, then receiving benefits at a full retirement age of 66 would provide $1,333 per month and age 70 would provide $1,760 per month with additional increases for inflation. Additional months of work may also result in still higher benefits.

[40]Additional work and cost-of-living adjustments may also contribute to higher benefits, but for purposes of this example we assume that neither applies.

Figure 3: Delaying Social Security Is More Cost Effective than Purchasing an Annuity to Enhance Retirement Income



Source: GAO analysis based on formulas from SSA and an annuity quote from Income Solutions.

Notes: This is a quote for a single-life immediate annuity for a male resident in the State of Washington, currently aged 66, with no beneficiary. If the annuity were based on a female's life, the cost of the annuity would be more.

Many Retirees Forego Options to Secure Additional Lifetime Retirement Income

Most of today's retirees have taken early (and therefore, reduced) Social Security benefits, though increasing numbers of people of retirement age are also working. While most with DB pensions are receiving lifetime retirement income, few have purchased annuities with DC or other assets. Retirement age investors generally have limited allocations in stocks. Though most retirees tap their financial assets gradually, some exhaust their resources and many, particularly those in the oldest age group, live in poverty.

Most Retirees Have Chosen Reduced Social Security Benefits, though Increasing Numbers of Retirement Age Individuals Work

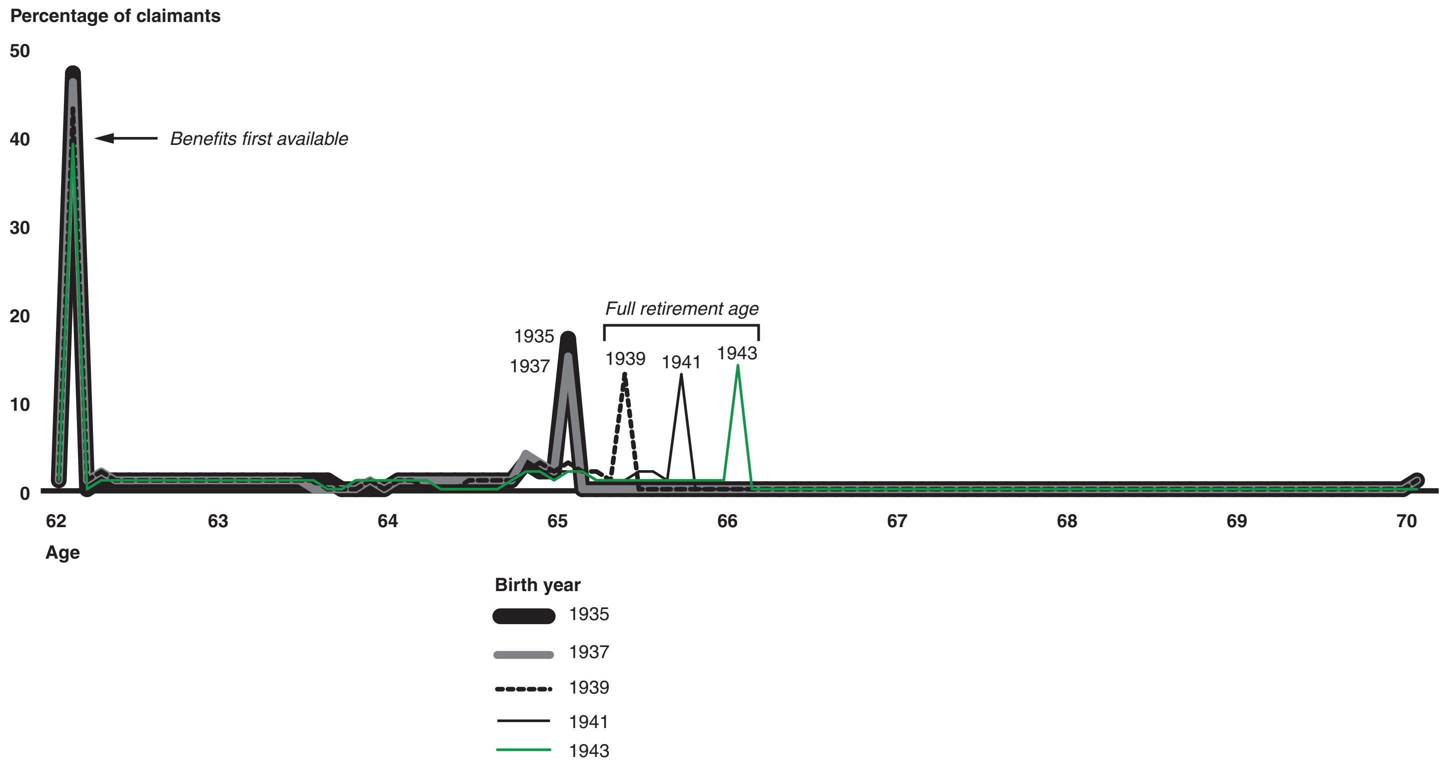
The experts we talked with frequently recommend that retirees delay taking Social Security to increase their lifetime retirement income, but most of today's retirees took Social Security before their full retirement age, which has committed many to substantially lower monthly benefits than if they had waited. Among those who were eligible to take benefits within 1 month after their 62nd birthday from 1997 through 2005, 43.1 percent did so, according to Social Security administrative data compiled by the Office of the Chief Actuary.[41] An estimated 72.8 percent took benefits before age 65, and only 14.1 percent took benefits the month they reached their full retirement age, which varied from age 65 to age 66 depending on birth year.[42] In addition, only about 2.8 percent took benefits after their 66th birthday. By taking the benefits on or before their 63rd birthday, 49.5 percent of beneficiaries born in 1943 passed up increases of at least 25 to 33 percent in monthly inflation-adjusted benefits that would have been available, had they waited until their full retirement age.[43] (See fig. 4.)

[41]Reduced Social Security retired worker benefits are typically first available the month after an eligible worker's 62nd birthday. Relatively few people born early in a month qualify as having been at 62 throughout the first month of their Social Security retirement.

[42]An estimated 19.5 percent of beneficiaries began receiving benefits on or after reaching their full retirement age.

[43]Delaying the start of benefits results in receiving benefits for fewer months, but provides an increased level of monthly benefits no matter how long the recipient lives. Recipients had an opportunity to repay the benefits they had received without interest and receive a higher benefit recalculated based on a later start date, but the SSA closed this option as the application withdrawal must occur within 12 months of the first month of entitlement. See Social Security Administration, *Amendments to Regulations Regarding Withdrawal of Applications and Voluntary Suspension of Benefits*, 75 Fed. Reg. 76,256 (Dec. 8, 2010).

Figure 4: Awards of Social Security Retired Worker Benefits by Age and Birth Year, 1997-2009



Source: GAO analysis of data from the SSA, Office of the Chief Actuary.

Note: This graph is based on actual awards of retired worker benefits plus projections of the number of workers who had not taken benefits by the end of 2009. Disability benefit recipients are excluded.

This early retirement pattern changed little over the 1997 to 2009 period, while under law enacted in 1983, the Social Security full retirement age shifted by birth year from age 65 to 66 for those born 1938 to 1943.[44] The proportion of those who took benefits the first month they were eligible declined from 47.2 percent to 39.4 percent, but the percentage of those

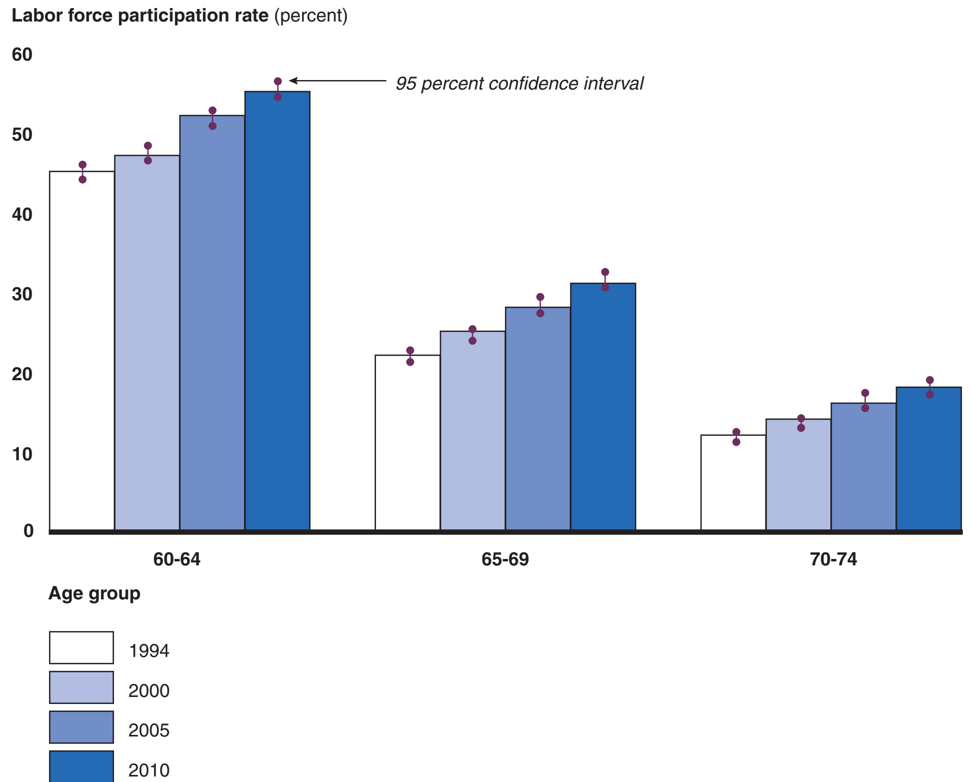
[44] Pub. L. No. 98-21 § 201(a), 202(w)(6), 97 Stat. 65 (1983).

who waited until the month they reached their respective full retirement age also decreased—from 17.4 to 13.9 percent.[45]

While most people who are collecting Social Security retirement benefits do not work, many do continue working at an older age. As shown in figure 5, the proportion of older adults in the workforce has increased over the last several years.

[45]Data from SSA's Office of the Chief Actuary indicate that the percentage of those who waited until full retirement age or later varied from 22.8 percent for those born in 1935 to 18.1 percent for those born in 1939, and 19.5 percent for those born in 1943. According to the experts we consulted, if recipients have poor health and a less than average life expectancy, taking benefits earlier nonetheless may be warranted. In addition, a few experts noted that delaying benefits may not be appropriate if recipients place a high value on having money now, rather than later. If delaying benefits requires increased borrowing to make ends meet, it may be better to take benefits early.

Figure 5: More People 60 and Older Are in the Labor Force, 1994-2010



Source: Bureau of Labor Statistics - Current Population Survey.

Notes: BLS identifies the labor force as employed residents aged 16 or older as well as those unemployed and seeking work. From 2005 to 2010 the unemployment rate rose from 3.2 percent to 7.3 percent for those aged 60 to 64 and from 3.5 percent to 6.7 percent for those aged 65 or older. Active duty members of the military and institutionalized residents are excluded from these data.

These increases in labor force participation may, in part, have arisen in response to changes in the Social Security law effective in 2000 that eliminated penalties for earning wages while collecting Social Security

benefits after their full retirement age.[46] With these changes, more people who are eligible or receiving benefits are working.

Most Workers Leaving Employment with a DB Pension and Retiring Received Lifetime Annuities

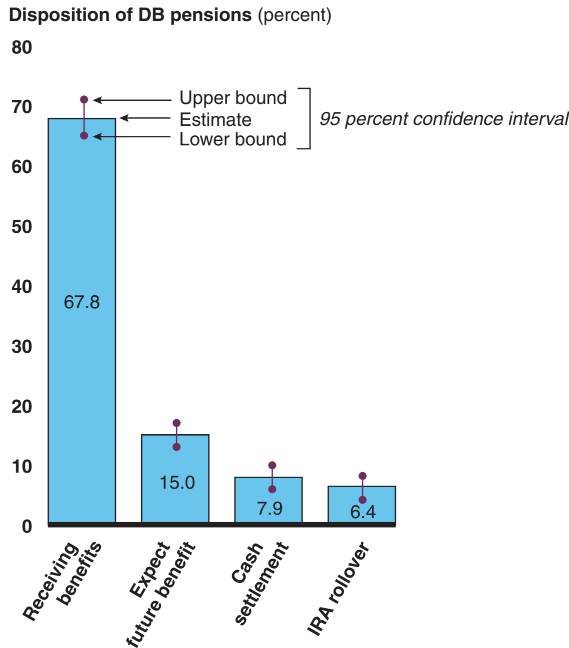
Experts we spoke to generally recommend taking lifetime retirement income, and most workers leaving employment with a DB pension and retiring received lifetime retirement income from their DB annuity. An estimated 67.8 percent of workers who left employment and retired with a DB pension from 2000 through 2006 commenced the DB annuity; fewer deferred benefits.[47] (See fig. 6.) Limited data suggest that among retiring workers who indicated they had an option to take a cash settlement, IRA rollover, or an annuity, an estimated 8.6 percent took a cash settlement, and 10.3 percent rolled over funds to an IRA.[48] (See app. IV, table 14.)

[46]Pub. L. No. 106-182 (codified at 42 U.S.C. § 1305 note). Up to a specified amount—the retirement earnings test—Social Security retired worker beneficiaries can earn wages and salary without a reduction in benefits before full retirement age. The earnings test rose to $14,160 for recipients age 62 through the year before full retirement age in 2009 and remained at that level in 2010. Every $2 of earnings over this limit results in a $1 reduction in Social Security benefits; however, early beneficiaries generally recoup the amounts withheld because of the earnings test in the form of higher recalculated benefits after they reach full retirement age. A higher earnings limit—$37,680—applies in the year full retirement age is attained, but only for the months before reaching full retirement age. Beginning at full retirement age, earnings tests no longer apply. For additional information, see GAO, *Retirement Decisions: Federal Policies Offer Mixed Signals about When to Retire*, GAO-07-753 (Washington, D.C.: July 11, 2007), 17, 30.

[47]Or they may not yet have been eligible to commence benefits.

[48]GAO conducted a similar analysis for the 1992 to 2000 period. See GAO, *Private Pensions: Participants Need Information on Risks They Face in Managing Pension Assets at and during Retirement*, GAO-03-810 (Washington, D.C.: July 29, 2003), 16. Other studies we located on the disposition of pensions were anecdotal or focused on workers who left one job to go to another or were based on data from few plans. Figure 6 estimates are based on 1,336 observations. We identified 208 respondents who indicated they had a full or partial lump sum option and 247 who indicated they did not have such an option. These results were based in part on data compiled for Alan L. Gustman, Thomas L. Steinmeier, and Nahid Tabatabai, *Pensions in the Health and Retirement Study* (Cambridge, Mass.: Harvard University Press, 2010). Lump sum payments may become somewhat less attractive as provisions in the Pension Protection Act of 2006 require that the minimum lump sum payments be calculated based on corporate bond rates as opposed to U.S. Treasury security interest rates. As corporate bond rates are typically higher than Treasury interest rates for similar maturities, a smaller lump sum is needed to cover the expected future benefits. The lump sum present value of an annuity benefit is lower if interest rates are high. Pub. L. No. 109-280 (codified at 26 U.S.C. § 430(h)(2)(D)).

Figure 6: Most Workers Received Lifetime Benefits from Their DB Pension Rather than a Cash Settlement or IRA Rollover, 2000-2006



Source: GAO analysis of HRS data, including pension data compiled by Alan Gustman, et al.

Note: Some respondents chose a combination of options, so the sum of percentages exceeds 100.0 percent. This analysis is limited to respondents in the HRS, 2000-2006. See appendix IV for details and confidence intervals for these estimates. ERISA requires DB plan sponsors to offer participants an annuity benefit, but they may also provide a lump sum benefit option.

The Code permits a plan sponsor to provide a participant an involuntary cash settlement if the vested value of their pension is $5,000 or less. Among retirees who received a DB lump sum (cash settlement or IRA rollover) some received a lump sum of $5,000 or less.

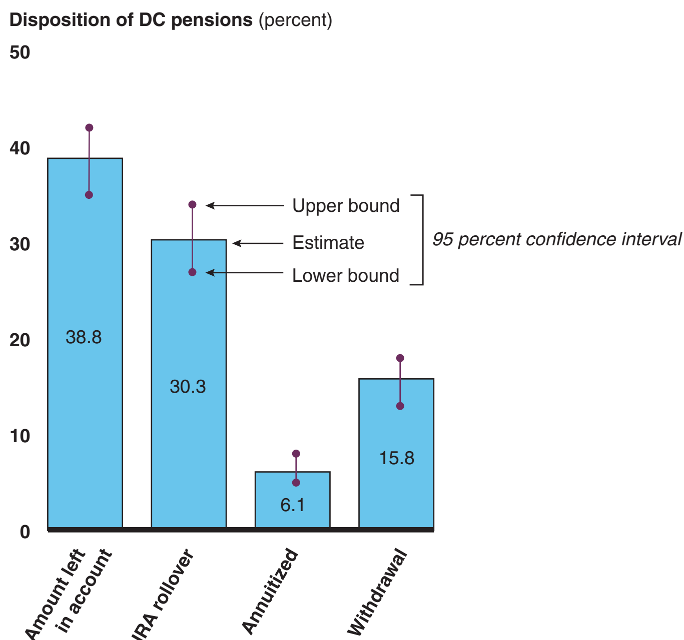
As most retirees leaving employment with a DB pension and retiring receive an annuity benefit, many households with retirees have some pension or annuity income (apart from Social Security). In 2008, an estimated 40.7 percent of households with a member aged 65 or older received pension or other annuity income.[49]

[49]This is based on SSA analysis of Census Bureau CPS March Supplement survey data for 2008. The 95 percent confidence interval for this estimate is from 40.1 percent to 41.3 percent. This estimate does not include all withdrawals from a pension, such as lump sum distributions.

Few with DC Plans Choose or Purchase an Annuity

The experts we spoke with recommended that retirees enhance their guaranteed income by purchasing an annuity with some limited portion of their savings, yet few workers leaving employment with DC pensions and retiring (6.1 percent) converted their funds or a portion of the money to an annuity. (See fig. 7.) An estimated 38.8 percent that reported leaving employment with a DC pension and retiring during the 2000 to 2006 period left funds in the account, and 30.3 percent rolled them over to an IRA. Fewer chose to take a withdrawal (15.8 percent). This analysis, however, only reveals the decisions that retirees made immediately or soon after leaving employment. In some cases some of the retirees may have purchased annuities at a later time.[50]

Figure 7: Dispositions of DC Pensions by Retiring Workers, 2000-2006



Source: GAO analysis of HRS data, including pension data compiled by Alan Gustman, et al.

Notes: Some respondents chose a combination of options. The figures shown indicate the percentage of respondents who selected one or more options. Analysis is limited to respondents in the HRS, 2000-2006. See appendix IV for details and confidence intervals for these estimates.

[50]Some researchers recommend gradually annuitizing during retirement rather than at retirement. See for example, Wolfram J. Horneff, Raimond H. Maurer, Olivia S. Mitchell, and Michael Z. Stamos, “Variable payout annuities and dynamic portfolio choice in retirement,” *Journal of Pension Economics and Finance*, vol. 9 (2010): 163-183.

Although traditional insured life annuities provide predictable lifetime retirement income, the amounts of income they provided retirees has been modest. The vast majority of annuity sales are sales of deferred annuities—annuities that provide purchasers investment opportunities to increase savings while deferring federal income taxes with an option to draw a guaranteed lifetime retirement income stream at a later time. However, purchasers of these annuities typically do not convert them to an income stream.[51] In 2009, 94.4 percent of annuity sales were deferred annuities ($225 billion of the $239 billion). In contrast, sales of traditional fixed immediate annuities purchased to provide lifetime retirement income totaled about $7.5 billion (3.1 percent of total sales).[52] This represents a small portion of retirees' assets (an estimated 1.5 percent of the IRA and nonpension financial assets held by those aged 66 in 2008, for example). If this amount had been used to purchase 100 percent joint and survivor immediate annuities for all those aged 66, these annuities would provide only an estimated 0.26 percent of this group's aggregate total household income.[53] Annuities can be purchased with either pension assets on which income taxes have been deferred (tax qualified) or with other assets. In 2009, more than half (57.9 percent) of the amount of annuities purchased came from tax-qualified sources.

In Order to Reduce Market Risks, Investors Approaching Retirement Generally Have Chosen to Reduce Allocations to Stocks

Although experts we spoke to recommended a moderate exposure to stocks to support a retirement income drawdown strategy, households near retirement had a wide range of allocations to stocks (equities),

[51]According to the Insured Retirement Institute, in 2008, less than 1 percent of the amount of deferred annuities sold was converted to lifetime retirement income.

[52]Another $5.6 billion of fixed immediate annuities were structured settlements—contracts to provide a stream of income in lieu of a lump sum settlement, in civil court settlements, for example.

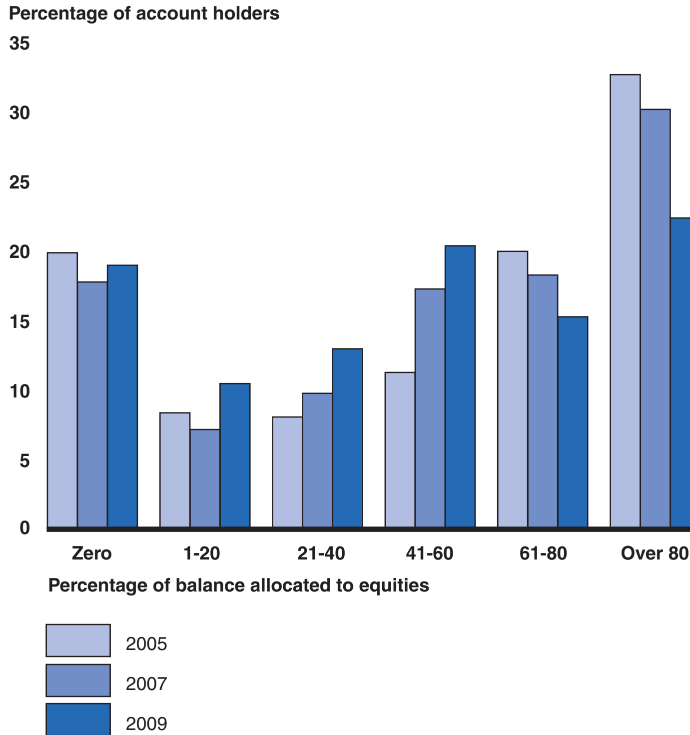
[53]This estimate is based on an annuity quote from Income Solutions through Vanguard's portal March 3, 2011. Such annuities would provide no adjustment for inflation and no term certain feature.

according to analysis by EBRI.[54] In the volatile stock market from 2005 to 2009, allocations to equities declined among older 401(k) investors (those in their 60s). While some of the decrease in allocations to equities may have resulted from the decline in stock prices relative to bond prices, some reflects investors' decisions to reduce allocations to stocks. During 2008, for example, investors withdrew a net total of $234 billion from stock funds and added a net $28 billion to their bond fund holdings, according to the Investment Company Institute.[55] The proportion of 401(k) investors with no allocations to equities changed little, but the proportion with allocations of 80 percent or more of their assets to equities fell from 32.6 percent to 22.3 percent. (See fig. 8.)

[54] Jack VanDerhei, Sarah Holden, and Luis Alonso, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009*, Issue Brief No. 350, EBRI (November 2010). These data come from 401(k) recordkeeping organizations for 20.7 million 401(k) participants compiled jointly by EBRI and the Investment Company Institute. These data may not definitively indicate the trends for all 401(k) account holders, as the universe of data providers varies from year to year and may not be statistically representative of all 401(k) account holders. HRS data compiled by Gustman, et al. provide evidence of household equity allocations including those in IRAs, DC plans, and assets outside retirement accounts. Gustman, et al. found that an estimated 34.6 percent of households with a member approaching retirement (turning age 53 to 58 in 2006) held no assets in stocks. On average, the middle 10 percent of households (from the 45th to the 55th percentile by wealth) held an estimated $49,363 in stocks, representing 58.7 percent of their financial assets. Alan L. Gustman, Thomas L. Steinmeier, and Nahid Tabatabai, "What the Stock Market Decline Means for the Financial Security and Retirement Choices of the Near-Retirement Population," *Journal of Economic Perspectives*, 24(1) (2010): 161-182.

[55] Depending on when during the year they made withdrawals from stock funds, these transactions may have been fortuitous or detrimental to their returns. These figures reflect net flows of funds into and out of mutual funds, and do not reflect the change in valuation due to changes in market prices. From the end of fiscal year 2007 to the end of fiscal year 2008 the total net assets of retail money market funds, excluding government accounts, increased by $39 billion.

Figure 8: Allocations to Equities Declined for 401(k) Account Holders in Their 60s, Year-End 2005-2009

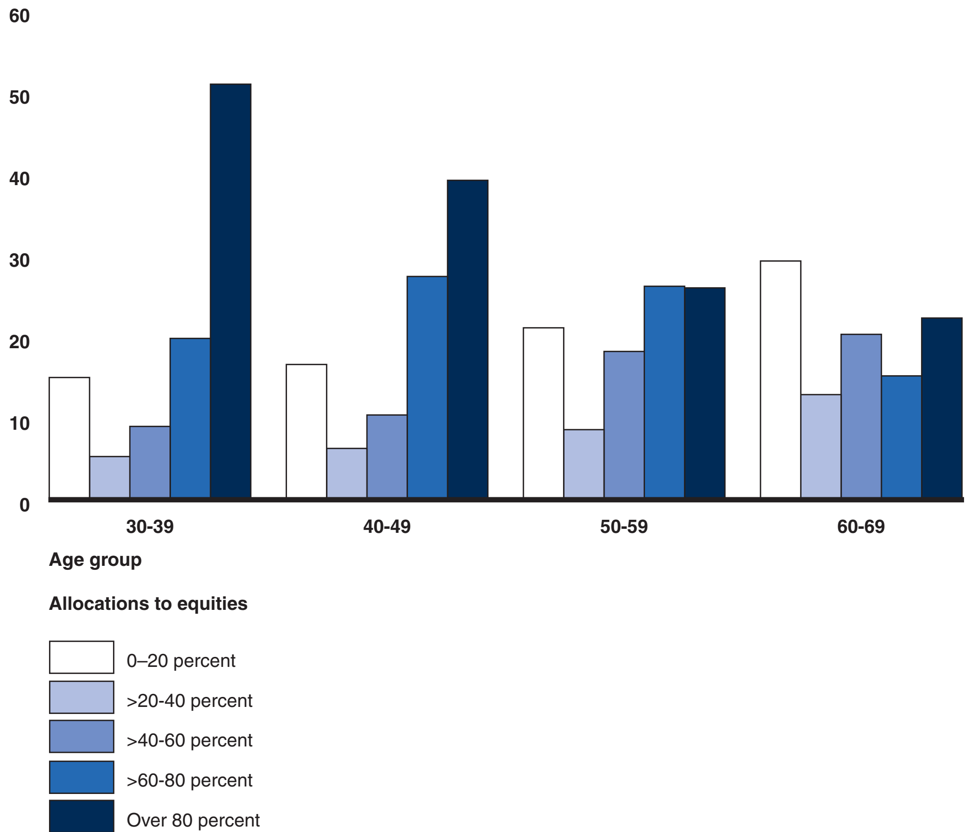


Source: Employee Benefits Research Institute.

Note: These results are based on the Investment Company Institute/EBRI 401(k) database, which included information concerning 20.7 million plan participants with $1.2 trillion in 401(k) assets at the end of 2009. This represents an estimated 44 percent of all 401(k) assets. While some of the decrease in allocations to equities may have resulted from the decline in stock prices relative to bond prices, some reflects investors' decisions to reduce allocations to stocks. From the end of 2005 to the end of 2009 the total cumulative return for the Standard and Poor's 500 stock market index was a 2.7 percent loss. Over this same period the Barclays Capital U.S. Aggregate Bond Index returned 24.4 percent.

By the end of 2009, smaller proportions of 401(k) investors in their 60s held high proportions of their balances in equities than younger investors. Although certain experts we spoke with recommended that some retirees hold between 40 and 60 percent of financial assets in stocks, about one-fifth (20.3 percent) of 401(k) investors aged 60 to 69 had such allocations, according to EBRI's analysis. (See fig. 9.)

Figure 9: Older 401(k) Investors Held Smaller Allocations in Equities than Younger Investors, Year-End 2009



Source: Employee Benefits Research Institute.

Most Retirees with Financial Assets Have Tapped Them Gradually, but Others Have Few Assets and Outlive Them

Although many retirees lack substantial savings, most have some savings and have typically drawn on those savings gradually, as the experts we spoke to recommend. According to Urban Institute researchers' analysis of associations between household assets, age and income data from HRS survey responses gathered over the 1998 to 2006 period, individuals in the highest income quintile typically accumulated wealth, at least until their

eighties.[56] Those in the middle income quintile typically started to spend down wealth at somewhat earlier ages, but, as the experts we spoke to recommended, gradually enough to likely have assets when they die. Those in the lowest income quintile typically have few nonannuitized assets and spend them fairly quickly.

Economists' analysis of U.S. Census survey data from 1997, 1998, 2001, 2002, 2004, and 2005 indicate a comparatively modest rate of withdrawals prior to the age at which the Code required minimum distribution requirements apply.[57] Also, as a household gradually draws down and consumes the principal of their savings, their living expenses, rising with inflation, will be an ever bigger portion of their declining principal.

Although many retirees draw on resources gradually, some older people are at risk of outliving their financial assets, particularly if a significant adverse health event occurs. Our analysis of HRS data indicates that among individuals born in 1930 or earlier that had net household financial assets of $15,000 or more in 1998, an estimated 7.3 percent of those alive in 2008 had net financial assets of $2,000 or less.[58]

Entering a nursing home is associated with substantial declines in household wealth for households with a person aged 70 or older.[59] Although several experts we spoke to recommended it, few retirees purchase long-term care insurance to protect themselves from some of the

[56]Karen E. Smith, Mauricio Soto, and Rudolph G. Penner, "How Seniors Change their Asset Holdings During Retirement," Retirement Policy Discussion Paper 09-06, The Urban Institute (October 2009). This study focused on HRS data for the 1998 through 2006 period for people age 60 and older in 2006.

[57]James M. Poterba, Steven F. Venti, and David A. Wise, "The Drawdown of Personal Retirement Assets," National Bureau of Economic Research Working Paper Series #16675 (January 2011), http://www.nber.org/papers/w16675 (accessed Feb. 1, 2011).

[58]The 95 percent confidence interval for this estimate is 6.2 percent to 8.5 percent. Adjusting for inflation using the CPI-U, $15,000 in 1998 represents $19,807 in 2008 dollars. Net financial assets here include the value of IRAs, but exclude the value of pensions, expected Social Security benefits, and nonfinancial wealth such as home equity.

[59]See Richard W. Johnson, Gordon B.T. Mermim, and Cori E. Uccello, "When the Nest Egg Cracks: Financial Consequences of Health Problems, Marital Status Changes, and Job Layoffs at Older Ages," The Urban Institute (Washington D.C., January 2006). In 2009 an estimated 44.3 percent of long-term care expenditures were borne by the Medicaid program, according to the National Health Expenditure data from the Centers for Medicare and Medicaid Services, Office of the Actuary. Confidence intervals for this estimate were not available.

risk that they will be impoverished by having to pay for nursing home services and certain assisted living services, as premiums can be expensive.[60]

Apart from whether individuals outlive their assets, millions of retirees live in poverty late in life. Even with the widespread availability of Social Security, Medicare, and Medicaid benefits, in 2009 an estimated 3.4 million people aged 65 or older lived in poverty. The poverty rate for this age group (8.9 percent), however, was lower than for all U.S. residents (14.3 percent).[61] On the other hand, poverty among women aged 75 and older is much greater than for men. During the 2005 to 2009 period, the Census Bureau estimated that 13.5 percent of women in this age group had incomes below the poverty line in the previous year compared with 7.7 percent of men.[62]

In the future, it is unclear to what extent similar patterns will hold for retirees. For example, investment returns may differ from historical rates of return. Also, DB plans and the lifetime retirement income that retirees frequently received were more common for current retirees. The shift away from DB plans toward DC plans may mean that increased retirement savings and other options for generating retirement income from savings, such as annuities, might become more important for retirees in the future.

[60]EBRI estimates that a large proportion of the workers' retirement savings deficit is attributable to the need to fund nursing home and home health care expenses. These costs increase the present value of needed additional retirement savings by $25,317 for married couples, $32,433 for single males, and $46,425 for single females in 2010 dollars. See EBRI, *Retirement Savings Shortfalls for Today's Workers*, Notes, 31(10) (October 2010), 2. The coverage of long-term care insurance policies varies widely, but on average policyholders aged 70 and over paid an average of $3,026 in premiums in 2007.

[61]This measure of poverty is based on money income including cash public assistance, but does not take into account noncash benefits received. The 90 percent confidence intervals for these estimates are 3.3 million to 3.6 million, 8.7 percent to 9.1 percent, and 14.0 percent to 14.6 percent, respectively. Other age groups had higher poverty rates. For example, an estimated 20.7 percent of those under age 25 and 9.4 percent of those approaching retirement age (age 60 to 64) had incomes below the poverty level. The 90 percent confidence intervals for these estimates are 20.2 to 21.2 percent for those under 18, 20.1 to 21.3 percent for those age 18 to 24, and 8.9 percent to 9.9 percent for those age 60 to 64.

[62]These estimates are based on U.S. Census Bureau's American Community Survey reports of income for the previous year during the 2005–2009 period.

Various Proposed Policies Would Seek to Promote Access to Annuities through Defined Contribution Plans and Improve Financial Literacy about Retirement Income

Proposed Options for Promoting Access to Annuities through Employer DC Plans Take Many Forms

Multiple experts told us about increasing lifetime retirement income by purchasing an annuity, but DC plans typically do not offer access to annuities and their participants infrequently use annuities when leaving employment and retiring. The February 2010 Labor/Treasury RFI asked about ways to facilitate access to lifetime retirement income products such as annuities in DC plans, and a number of policy options were proposed by respondents.[63] (See table 4.) These policy options in responses to the RFI came from industry, consumer, academic, and other groups.

Table 4: Selected Policy Options Proposed by RFI Respondents to Promote Access to Annuities in DC Plans

Policy option	Basic description
Revise the Safe Harbor Provision for Selecting Annuity Providers	Labor would revise its 2008 regulation that establishes a safe harbor for the selection of an annuity provider.[a] Although the current regulation provides a general process sponsors may use to meet their fiduciary responsibilities when they select an annuity provider, certain industry groups suggested that it lacks sufficient detail. Some proposed revising a key condition of the current safe harbor that requires sponsors, specifically, to assess the ability of an insurance company to make all future payments under an annuity contract.
Require sponsors to offer an annuity as a choice	Legislation could require that sponsors of DC plans offer annuities as a choice to plan participants.

[63] 75 Fed. Reg. 5,253 (Feb. 2, 2010). Additional measures were proposed to increase the use of annuities. For example, a few respondents proposed that plan participants be required to annuitize a portion of their DC plan assets under certain circumstances; others recommended that federal income taxes on income from annuities be reduced.

Policy option	Basic description
Encourage sponsors to offer a default annuity	Sponsors would be encouraged to offer an annuity as the participant's election by default in DC plans. For example, some industry groups suggested that Labor clarify its regulation on qualified default investment alternatives (QDIA) regarding the conditions under which sponsors could include annuities as QDIAs.[b] Another option for DC plans would require an annuity as the default way to take pension benefits, as with DB plans.
Modify tax law on minimum distributions for deeply deferred annuities	A legislative exemption from required minimum distributions for deeply deferred annuities could make it easier for sponsors to offer a deeply deferred annuity, or "longevity insurance." A deeply deferred annuity is a type of income annuity that can be purchased near or at retirement, and regular annuity payments start after reaching an advanced age, such as 80 or 85. (See app. V on selected types of retirement arrangements and products.) Individuals can presently purchase these newer annuities on the retail market.
Modify spousal protection provisions	Proposed changes to the Code or regulations regarding spousal protections include exempting DC plans, allowing spousal consent procedures to occur electronically,[c] or clarifying the requirements for newer products such as annuities with guaranteed living benefits.[d] For spousal protections in most DC plans such as 401(k) plans, an individual can elect a lump sum payment without spousal consent, but needs to obtain the consent of his/her spouse to elect any life annuity that is not a qualified joint and survivor annuity.[e]

Source: GAO analysis based on RFI responses.

[a]73 Fed. Reg. 58,447 (Oct. 7, 2008). 29 C.F.R. § 2550.404a-4. The safe harbor is an optional way for sponsors or other fiduciaries of defined contribution plans to satisfy their responsibilities under ERISA. It includes general conditions for fiduciaries to satisfy when selecting a provider of annuities for benefit distributions from defined contribution plans.

[b]The QDIA regulation limits liability for sponsors of DC participant-directed plans that automatically invest contributions in specific types of investments. The types of investments which may be QDIAs generally include lifecycle (i.e., target-date) funds, balanced funds, and managed accounts. 29 C.F.R. § 2550.404c-5. For more information, see GAO, *Defined Contribution Plans: Key Information on Target Date Funds as Default Investments Should Be Provided to Plan Sponsors and Participants*, GAO-11-118 (Washington, D.C.: Jan. 31, 2011). According to one industry group, the existing regulation already permits sponsors to include annuities as QDIAs.

[c]For example, regulations on electronic disclosures do not allow solely an electronic waiver for these decisions, such as with a Personal Identification Number, since Treasury/IRS found that such procedures would not sufficiently protect the integrity of the spouse's consent. 71 Fed. Reg. 61,877 (Oct. 20, 2006). 26 C.F.R. § 1.401(a)-21(d)(6).

[d]Newer annuity products with guaranteed living benefits, such as guaranteed lifetime withdrawal benefits, include variable annuities that have riders to provide various protections or additional features, subject to certain restrictions. (See app. V.) These newer products also raise other questions, including their cost, complexity, vesting rules, and protections of state guaranty associations.

[e]According to IRS publications, requirements on spousal protections do not apply to DC plans (other than money purchase plans) that meet all of the following criteria: (a) the plan provides that the participant's nonforfeitable accrued benefit is payable in full, on the participant's death, to the surviving spouse (unless the participants elects with spousal consent that the benefit be paid instead to a designated beneficiary); (b) the participant does not elect to receive benefits in the form of a life annuity; and (c) the plan is not a transferee or offset plan with respect to the participant. 26 U.S.C. § 401(a)(11)(B)(iii).

Revise the Safe Harbor Provision for Selecting Annuity Providers

According to several respondents who favored this option, revising the safe harbor provision would have an advantage of helping to ease concerns of some sponsors of DC plans about offering an annuity as a payout choice. In turn, the availability of an annuity to plan participants could possibly increase the number of retirees who consider it as a way to

withdraw pension benefits for predictable lifetime retirement income. Additionally, this could help participants who would otherwise purchase an annuity in the retail market on terms that might not be as favorable. For example, annuities, especially in larger plans, might be available at institutional prices and thus at lower prices than on the retail market. Annuities at group rates typically have lower prices than individual annuities.[64] Participants might also benefit from the fact that the plan fiduciaries are required to fulfill fiduciary responsibilities for the annuity selection, including the prudent selection and monitoring of products and providers offered in the plan.[65] Individuals on their own might be less likely to be in a position or to have experience to conduct as thorough and analytical a selection as the plan fiduciary, who is required to conduct a diligent analysis as a fiduciary.

However, revising the safe harbor provision could expose participants to additional risks, including the risk that the insurance company providing annuities becomes insolvent and unable to make promised payments. Depending on the specific features of a policy change in this area, it could have the effect of lessening protections and recourse for participants, as compared to the current regulation.[66] For example, some industry respondents proposed eliminating, modifying, or providing specific criteria for the condition in the safe harbor that requires sponsors to assess the ability of an insurance company to make all future payments under an annuity contract. Labor officials said that protecting participants against the risk of insurer insolvency is a key issue as they consider revisions to

[64]In addition, annuities offered in pension plans must offer gender-neutral prices. Arizona Governing Committee v. Norris, 463 U.S. 1073 (1983). By contrast, annuities offered in the retail market, including IRAs that are not employer-sponsored, are not subject to the same rule, and these annuities reflect gender-distinct pricing. Women may find more favorable single-life annuity rates through pension plans, but men may find more favorable prices through the retail market. Annuity prices vary and are affected by such factors as interest rates, mortality rates, and administrative costs.

[65]Under ERISA, a fiduciary is anyone, such as a sponsor, trustee, investment adviser, or other service provider, to the extent they exercise any discretionary authority or control over plan management or any authority or control over the management or disposition of plan assets, or who renders investment advice respecting plan money or property for a fee or other compensation, or has discretionary authority or responsibility for plan administration. 29 U.S.C. § 1002(21)(A).

[66]29 C.F.R. § 2550.404a-4. Prior to the Pension Protection Act of 2006, DC plans were held to the standard of DB plans which is to select the safest available annuity, unless under the circumstances it would be in the interest of the participants and beneficiaries to do otherwise. This was regarded as a more stringent standard. (29 C.F.R. § 2509.95-1.) Pub. L. No. 109-280 § 625, 120 Stat. 780.

the safe harbor regulation, given that retirees may depend on annuities for decades. The insolvency of Executive Life Insurance Company in the early 1990s is a case in point.[67] While states are generally responsible for insurance regulation including the solvency of insurers, the degree of regulation can vary in some aspects. There is also variation in the protections of state guaranty associations to cover policyholders. For example, all state guaranty associations generally protect an annuity's value up to at least $100,000.[68] According to an official from the National Organization of Life and Health Insurance Guaranty Associations, as of May 2011, roughly two-thirds of the associations provide coverage of $250,000 or more, and roughly one-third have limits of at least $100,000 for annuities.[69] Given such variation, some respondents raised the possibility of providing a federal guarantee to help states protect policyholders in cases of insurer insolvency.[70]

Require Sponsors to Offer an Annuity as a Choice

Some consumer and other groups recommended requiring DC plan sponsors to offer annuities as a choice to plan participants, which would require legislative efforts to amend ERISA or the Code. This would make the availability of lifetime retirement income more widespread, although the effect such amendments might have on the rate of participants' adoption of annuities is uncertain. Since its passage in 1974, ERISA has required DB plans to offer such a choice.[71] Similarly, DC plans could be

[67]Although experts said that Executive Life Insurance Company had high ratings from certain rating agencies—A.M. Best, Moody's, and Standard & Poor's—prior to its insolvency, we reported that 44,000 retirees with Executive Life had received only 70 percent of their promised monthly annuity payments for almost 13 months after California regulators seized control of the company. GAO, *Private Pensions: Protections for Retirees' Insurance Annuities Can Be Strengthened*¸ GAO/HRD-93-29 (Washington, D.C.: Mar. 31, 1993). According to data from the National Organization of Life and Health Insurance Guaranty Associations, from 1987 to 2008, at least 64 multistate liquidations of life insurers have involved state guaranty associations.

[68]This value represents the present value of an annuity, which is the amount that would be sufficient, if invested at a given interest rate, to fund the expected future stream of annuity payments. The periodic payment is less than the annuity's present value.

[69]In 2009, NAIC amended its model act to provide an increase in the coverage cap for annuities from $100,000 to $250,000.

[70]For more information, see, for example, GAO, *Social Security Reform: Implications of Private Annuities for Individual Accounts*, GAO/HEHS-99-160 (Washington, D.C.: July 30, 1999).

[71]29 U.S.C. § 1055.

required to offer the choice of an annuity for income in retirement.[72] However, even with greater access to annuities in their plans, participants frequently have foregone this opportunity for lifetime retirement income and many may continue not to use this choice for lifetime retirement income. From the sponsors' perspective, such a requirement could impose greater costs and administrative burdens, and possibly increase their exposure to fiduciary liability. For example, this might involve the selection and monitoring of an annuity provider, including costs to hire any experts to assist with these decisions. As we have previously reported, sponsors may be concerned about being held liable for these decisions and paying any losses to participants in the event the annuity provider cannot meet its financial obligations.[73] Also, the requirements for qualified joint and survivor annuities, including spousal consent to waive the qualified joint and survivor annuity, present administrative burdens and costs, according to several industry groups. A few industry or other groups noted that the administrative burdens or risk of lawsuits could even lead some employers, such as small employers, not to carry DC plans at all.

Encourage Sponsors to Offer a Default Annuity

A default arrangement could increase the use of annuities without an affirmative decision from participants to do so. Certain respondents noted that, to the extent that participants are unlikely to opt out of the default annuity, use of annuities would increase. Accordingly, automatic enrollment and default investments have been adopted in some DC plans when workers save for retirement, partly to overcome such tendencies as procrastinating or not making decisions. With the declining availability of DB plans and the lifetime retirement income they frequently provide, a default annuity in DC plans could help to promote lifetime retirement income for more participants.

Other respondents or experts have noted disadvantages with default annuities, such as irreversibility or financial penalties. Unlike automatic enrollment or default investments to save for retirement, annuitization by

[72]Another approach would allow retirees an option to purchase private sector annuities through a program facilitated by the federal government. Retirees would have a one-time opportunity during their first year of retirement to purchase a basic life annuity, up to $100,000. The federal government would provide record-keeping, marketing, distribution, and other administrative services and pay out annuity benefits with Social Security benefits. The Aspen Institute, *Savings for Life: A Pathway to Financial Security for All Americans*, (New York, N.Y., 2007).

[73]One respondent recommended that a revised safe harbor accompany the requirement that sponsors offer annuities as an option and help to reduce fiduciary risks for sponsors.

default may not allow for a subsequent change.[74] For some participants, default immediate life annuities may not be appropriate given their health and other circumstances. Other types of annuities, such as deferred variable annuities, provide more flexibility to reallocate investments or make withdrawals, yet surrender and other charges and fees may apply.[75] Another disadvantage to a default annuity would be setting a standard level of how much to use for the annuity. The appropriate portion to annuitize may vary among participants, given their particular circumstances such as other sources of income.

Modify Tax Law on Minimum Distributions for Deeply Deferred Annuities

Deeply deferred annuities, or "longevity insurance,"[76] which initiate payments at an advanced age, could provide protection against longevity risk and could do so at a substantially lower price than a traditional immediate annuity.[77] For example, according to one association, the cost of a deeply deferred annuity purchased at age 65 with payments beginning at age 85 is approximately 10 to 15 percent of the cost of an annuity providing the same amount of income that begins payments immediately.[78] Also, longevity insurance provides income at advanced ages, when risks of

[74]Certain respondents mentioned trial annuities, which might allow for flexibility. One proposal developed prior to the RFI would encourage sponsors to offer default trial annuities featuring a 2-year trial period, during which the retiree would receive monthly income unless the retiree opted out and made an affirmative decision to take a lump sum distribution. William Gale, J. Mark Iwry, David John, and Lina Walker, *Increasing Annuitization in 401(k) Plans with Automatic Trial Income*, The Retirement Security Project (Washington, D.C., 2008).

[75]According to SEC officials, while products and their restrictions vary, surrender charges on retail variable annuities often apply during a surrender period of 6 to 8 years. For example, the surrender charge could decrease from approximately 7 percent of the investment amount to zero over the period by 1 percent per year.

[76]These products may be known in the marketplace as "longevity insurance," since the payoff mostly goes to those who surpass their life expectancy at retirement. More generically, it should be noted that any arrangement that provides guaranteed income for life is a form of longevity insurance, that is, protection against some of the financial risks of living a long life.

[77]This is due to a combination of factors: the long deferral period substantially reduces the present value of the eventual payouts; in the case of a "pure" deferred annuity with no death benefit, the long deferral period increases the chance that no payouts will be necessary at all, because of mortality prior to the commencement of benefits; and the higher mortality rates at advanced ages mean that payments would last for fewer years on average.

[78]American Academy of Actuaries' response to the RFI. Available at http://www.dol.gov/ebsa/regs/cmt-1210-AB33.html.

poverty or outliving assets among the elderly may rise,[79] and sets a finite period for systematic or other withdrawals to last. While longevity insurance is available on the retail market, current provisions for required minimum distributions make it challenging to offer this product in DC plans or IRAs, according to certain industry groups. Longevity insurance purchased with tax-deferred funds can pose problems for taxpayers if the insurance does not permit annuity payments to be made until a date that is substantially after minimum distributions must begin—for example, if the contract provides for no payments to be made until age 85.[80]

On the other hand, questions exist about this newer product, according to Treasury officials and certain academic experts. For example, it is unclear to what extent older people might understand and be willing to purchase deeply deferred annuities whose payments may not begin for decades, if at all. Further, a proposed exemption from minimum distributions could potentially reduce revenue to the federal government since a tax exemption for deeply deferred annuities would result in some foregone revenue, although the extent of any foregone revenue is unclear. However, the purpose of the minimum distribution provisions is to ensure that tax-deferred retirement saving is used for retirement rather than estate planning purposes. Depending on how tax expenditures are structured, they also may raise questions about fairness, such as the extent to which low- or high-income individuals would benefit from a proposed exemption.

[79] Besides the use of private sector annuities, longevity insurance could also be provided through approaches such as increasing Social Security benefits for beneficiaries who reach an advanced age. For more information, see GAO, *Social Security: Options to Protect Benefits for Vulnerable Groups When Addressing Program Solvency*, GAO-10-101R (Washington, D.C.: Dec. 7, 2009).

[80] The Code generally requires distributions of tax-deferred funds to begin no later than the calendar year after the taxpayer turns 70 ½. Under Treasury regulations, those distributions would be calculated based on the entire interest, which includes both the account balance, and the value of the longevity insurance (with these rules applied separately to insurance bought under a plan and to insurance bought under all of the participant's aggregated IRAs). To take minimum distributions based on the entire interest including the longevity insurance, the taxpayer could draw down the remainder of his or her 401(k) balance or, in the case of IRAs, make withdrawals from other IRA assets. However, respondents have noted that this approach presents practical difficulties, such as the risk of the other funds being insufficient to meet the minimum distribution requirements before the longevity annuity begins, especially if too large a portion of the total account has been used to purchase the longevity insurance. A taxpayer with an insufficient remaining balance would have to accelerate payments from the longevity insurance and, while the contract could be written to permit such an acceleration, that feature would increase the cost of the longevity insurance. 26 C.F.R. § 1.417(a)(3)-1.

Modify Spousal Protection Provisions

According to several industry groups, changes in requirements about qualified joint and survivor annuities (QJSA), including the procedures to document the spouse's consent, could lower administrative burdens and costs so that sponsors might become more willing to make annuities available. A QJSA generally guarantees payments for the life of the participant and the participant's surviving spouse. Some plans, including DB plans, are subject to requirements to offer a QJSA as a default and obtain spousal consent to not elect the joint and survivor annuity.[81] For DC plans that are subject to the requirements for some or all participants, part of the procedures to elect a distribution other than the QJSA include notarized or in-person consent by the spouse, which some industry groups described as burdensome. However, these procedures have helped to protect spouses of participants with decisions about lifetime retirement income. For example, in DB plans, QJSA requirements under the Retirement Equity Act of 1984 and its implementing regulations sought to ensure that spouses are aware and consent to a pension distribution other than a joint annuity that would provide payments throughout their retirement.[82] The QJSA procedures for DB plans do not apply uniformly to DC plans, and we have previously reported that spousal protections in DC plans already have limitations. For example, a plan participant may withdraw from or roll over an account balance without the consent of his or her spouse.[83] Women on average continue to live longer and be more vulnerable to poverty at older ages than men, and reducing QJSA requirements might further lessen spousal protections in DC plans as compared to DB plans.

Proposed Approaches Vary to Improve Individuals' Understanding about Retirement Income

Improving individuals' financial literacy can be one important component in helping them manage retirement income appropriately. Financial literacy can be described as the ability to make informed judgments and to take effective actions regarding the current and future use and management of money. One way of improving consumer financial literacy is through financial education—that is, the processes whereby individuals improve their knowledge and understanding of financial products, services, and concepts. A wide variety of delivery mechanisms exist to

[81] At least one type of DC plan, known as a money purchase plan, is required to offer a QJSA. Other DC plans such as 401(k) plans may be exempt if they satisfy certain criteria.

[82] 26 C.F.R. § 1.401(a)(20); 1.417(a)(3)-1.

[83] GAO, *Retirement Security: Women Face Challenges in Ensuring Financial Security in Retirement*, GAO-08-105 (Washington, D.C.: Oct. 11, 2007).

provide financial education, including classroom curricula, print materials, Web sites, broadcast media, and individual counseling. As we recently testified,[84] at the federal level, more than 20 federal agencies have programs or initiatives related to financial literacy and these efforts are coordinated by the Financial Literacy and Education Commission (FLEC).[85]

Ensuring the financial literacy of older people has become particularly important given the transition to a financial account-based retirement system and the increasing responsibility of individuals to manage their assets in retirement. According to many respondents as well as experts we interviewed, education aimed at helping manage retirement income should cover, in particular, the financial risks faced in retirement, such as longevity risk, inflation risk, and investment risk, among others. Appropriate financial education can help prevent individuals from over-estimating their expected investment returns or sustainable withdrawal rates, which might make it more difficult to maintain their lifestyle in retirement. It can also serve to help individuals understand various difficult choices to mitigate these risks as well as how to evaluate or compare choices, such as what factors to consider. Such education can be particularly important given the complexity of annuities and other retirement investment vehicles. Besides annuities, managing a lump sum distribution and approaches that combine annuities and more liquid assets are other choices for individuals. Individuals or plan sponsors might not be aware that they can pursue combinations of income in retirement, such as annuitizing part of the pension benefit, rather than just all or none of it. Having adequate information on the variety of options available—and their corresponding advantages and disadvantages—allows individuals to tailor their decisions to their particular circumstances.

Various entities proposed policy options that seek to better inform individuals about income in retirement, and these options use different approaches, such as financial education or notices involving pensions. Multiple policy options, such as those offered in response to the RFI or in

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[84]GAO, *Financial Literacy: The Federal Government's Role in Empowering Americans to Make Sound Financial Choices*, GAO-11-504T (Washington, D.C.: Apr. 12, 2011).

[85]In 2003, Congress created the multiagency Financial Literacy and Education Commission, which was charged with, among other things, developing a national strategy to promote financial literacy and education, coordinating federal efforts, and identifying areas of overlap and duplication. Pub. L. No. 108-159, Title V, 117 Stat. 1952, 2003 (codified at 20 U.S.C. §§ 9701–08).

reports we reviewed, could work together to improve financial literacy on income throughout retirement. (See table 5.) Some industry groups or academic experts stated that financial education alone has its limitations and is not the only approach for improving consumers' financial behavior. Financial education may sometimes be more useful as a complement to other tools, such as personalized investment advice or policy options like the use of defaults.

Table 5: Selected Options Proposed by RFI Respondents and Others to Improve Individuals' Understanding about Retirement Income

Policy option	Basic description
Develop and disseminate additional federal government materials	The federal government, as part of its efforts on financial education, would include materials, such as additional publications and interactive tools, on managing pension and other financial assets during retirement.
Require sponsors to provide a notice for plan participants	This would statutorily require that sponsors periodically provide plan participants with a notice on the general financial risks and choices that individuals face in retirement.
Encourage voluntary education in plans by issuing clear guidance	Labor would issue guidance on the types of information that constitute education about income in retirement. Labor's existing guidance, an interpretive bulletin from 1996, specifies the types of general information considered to be investment education rather than investment advice, which is a fiduciary act and carries fiduciary duties and liability.[a]
Require sponsors to provide an estimate of lifetime annuity income on benefit statements	For benefit statements of DC plan participants, sponsors could be required to show an estimate of the balance's equivalent in lifetime retirement income as well as a total account balance. For example, a legislative proposal, the Lifetime Income Disclosure Act, would require Labor to provide assumptions for sponsors to use in providing participants with annual lifetime retirement income disclosures.[b]

Source: GAO analysis of RFI responses and other documents.

[a]29 C.F.R. § 2509.96-1.

[b]S. 267 was introduced in Congress on February 3, 2011, and H.R. 677 was introduced on February 11, 2011. Plan sponsors would receive relief from fiduciary liability for the estimate, to the extent they follow legislative and regulatory provisions.

Develop and Disseminate Additional Federal Government Materials

Currently, federal agencies provide some educational resources for the general public about income in retirement as part of their efforts on financial education. Certain agencies, such as SSA and Labor, have taken various steps, as shown in table 6.

Table 6: Examples of Materials on Income in Retirement from Selected Federal Agencies

Federal agency	Examples of materials on income in retirement
SSA	Various materials on Social Security benefits are available,[a] including Web sites or publications with factors to consider about when to claim benefits as well as many online calculators to estimate benefits or the population's life expectancy.
SSA	SSA's Financial Literacy Research Consortium began in 2009 with cooperative agreements to three research centers to conduct research and develop materials to improve financial literacy and retirement planning. However, according to SSA's FY 2012 budget justification, funding is not provided for the Financial Literacy Research Consortium.
Labor	The online and print publication, *Taking the Mystery Out of Retirement Planning*, includes chapters and calculators to help individuals understand their sources and amounts of income and expenditures before and in retirement.[b] The publication includes a chapter entitled "Making Your Money Last," which provides a few pages on choices like annuities, systematic withdrawals, or combinations of approaches such as partial annuitization.

Source: GAO analysis of agency documents.

[a]An important way for individuals to learn about Social Security benefits is the annual statement provided to workers aged 25 and older, which includes information on the worker's earnings and projected benefits. We have previously reported in 2005 that SSA's goals of the statement include educating the public about Social Security programs, aiding in financial planning, and ensuring the worker's earnings records are complete and accurate. However, in light of the current budgetary situation, SSA recently announced that it has suspended issuing annual statements.

[b]The online version of the publication is available at http://www.dol.gov/ebsa/publications/nearretirement.html.

We found that few other resources on how to ensure income throughout retirement were available from the federal government.[86] With federal financial education, much of the retirement focus has typically been on saving for retirement.

Although many sources of information are available from the private sector, the federal government may be in a position to contribute to financial education on managing pension and other financial assets in retirement. The federal government can produce objective information and partner with organizations outside of the government to deliver its materials, which we have previously reported.[87] Leveraging partnerships

[86]Based on interviews with selected federal entities, as well as our review of the FLEC's Web site and the 2010 study by the RAND Corporation of federal financial and economic literacy education programs. FLEC's Web site is available at http://www.MyMoney.gov. For the RAND study, see Angela Hung et al., *Federal Financial and Economic Literacy Education Programs, 2009*, RAND Corporation (2010). Another resource for retail investors, including retirees, is the SEC Web site, www.investor.gov.

[87]GAO, *Highlights of a GAO Forum: The Federal Government's Role in Improving Financial Literacy*, GAO-05-93SP (Washington, D.C.: Nov., 15, 2004).

with public and private sector stakeholders, the federal government may help to reach many target audiences. This could include those without plan sponsors such as the roughly half of the private sector workforce not participating in a pension or those who have rolled over pension assets to an IRA. Meanwhile, certain research suggests that information from various financial service companies may raise some concerns about possible limitations or conflicts of interest.[88] Regarding conflicts of interest, we recently reported that participants in 401(k) plans may be unaware that service providers, when furnishing education, may have undisclosed financial interests, including on investment funds in their plan or products outside the plan from roll-over balances.[89] Older people without pension plans or who have withdrawn funds from their plans may receive information on products that are not in their best interest or even fraudulent.[90]

On the other hand, certain educational materials from the federal government on income throughout retirement may have some limitations. For example, Labor officials told us that their educational materials on this topic may be fairly general, and plan sponsors may be more aware of participants' circumstances and could better tailor retirement education accordingly.

Require Sponsors to Provide a Notice for Plan Participants

In 2003, we recommended that Congress consider amending ERISA so that it specifically requires plan sponsors to provide participants with a notice on risks that individuals face when managing their income and

[88]William Gale and Ruth Levine, *Financial Literacy: What Works? How Could It Be More Effective?*, (October 2010). John Turner and Hazel Witte, *Retirement Planning Software and Post-Retirement Risks*, Society of Actuaries and Actuarial Foundation (December 2009); John Turner, *Why Don't People Annuitize? The Role of Advice Provided by Retirement Planning Software*, Pension Research Council Working Paper (May 2010).

[89]GAO, *401(K) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest*, GAO-11-119 (Washington, D.C.: Jan. 28, 2011).

[90]See, for example, Securities and Exchange Commission, Financial Industry Regulatory Authority, and the North American Securities Administrators Association, *Investor Alert: Investment Products and Sales Practices Commonly Used to Defraud Seniors: Stories from the Front Line*; and *Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars*, Sept. 2007. According to an NAIC official, as of May 2011, approximately 27 states have adopted a previous version and approximately 10 additional states have adopted a current version of the model regulation requiring insurance agents to ensure the suitability of annuities sold for the consumer at the time of the transaction. For more information, see GAO, *Consumer Finance: Regulatory Coverage Generally Exists for Financial Planners, but Consumer Protection Issues Remain*, GAO-11-235 (Washington, D.C.: January 18, 2011).

expenditures at and during retirement.[91] The notice could be provided at certain key milestones, including when a participant separates from service or at retirement. Although this policy option has not been enacted, ERISA requires sponsors of DC plans to provide participants a notice as part of their quarterly benefit statements about the benefits of a well-balanced and diversified portfolio as they save for retirement, which includes a link to a Labor Web site for further information.[92] According to Labor and Treasury officials, plan sponsors are not required to provide a notice to participants on managing pension assets in retirement, such as the general financial risks and choices they face. Once retired or outside their plan, individuals might be more susceptible to sales of products that are not in their best interest or even constitute fraud. Without additional information reinforced over time while participating in the plan, participants could later make decisions that fail to sustain their incomes and, as a result, potentially place a heavier burden on public need-based assistance or other resources.

Encourage Voluntary Education in Plans by Issuing Clear Guidance

Labor has provided an interpretive bulletin on participant investment education as distinguished from investment advice in plans, but many respondents observed that this bulletin and industry efforts generally focus on saving for retirement, rather than on income throughout retirement. According to a few industry groups, greater clarity on education as distinguished from investment advice, as related to income in retirement, may allay sponsors' and service providers' fears of fiduciary liability by explaining the types of general information on income in retirement that would not be considered to be investment advice. With such clarity, more sponsors and service providers may pursue voluntary efforts to educate plan participants in general on income and expenses in retirement. Sponsors with assistance from providers could tailor such education to their plan participants. Some plans already offer such education.[93]

[91] GAO-03-810.

[92] 29 U.S.C. § 1025(a)(2)(B)(ii)(II) and (III). This requirement applies to DC plans that are participant-directed.

[93] For example, according to one study of 620 near retirees at two large employers, levels of basic retirement knowledge increased after a retirement seminar, and roughly one-quarter of these individuals reported changes in how they intend to distribute pension benefits from their DB and DC plans. Robert Clark et al., *Pension Plan Distributions: The Importance of Financial Literacy*, Pension Research Council Working Paper (October 2010).

However, any future guidance from Labor on investment education about income in retirement, if poorly implemented, could have potential disadvantages. For example, we recently recommended that Labor evaluate and revise its interpretive bulletin on investment education, including the ability to highlight proprietary funds which may result in greater revenue to the service provider.[94] As Labor officials consider possible guidance on income in retirement, they said that an inappropriate balance between education and advice could result in plan participants receiving so-called "education" from service providers with conflicts of interest and not having recourse against fiduciaries. According to Labor officials, education on income throughout retirement may also involve spending plan assets to varying extents on choices not available in the plan, which could potentially be challenged as unreasonable expenses from plan assets under certain circumstances. Further, while guidance could encourage sponsors to voluntarily provide education, it may not require it. Some sponsors might not provide education on income throughout retirement due to reasons other than fiduciary concerns, such as costs or not viewing it as their role.

Require Sponsors to Provide an Estimate of Lifetime Annuity Income on Benefit Statements

Given the rise of DC plans which provide pension benefits as an account balance, many industry, consumer, and academic groups noted that an estimate on the participant benefit statement could present, or "frame," the pension benefit as a stream of income in retirement rather than just an account balance, which could help to change how participants in DC plans perceive or ultimately withdraw their benefit at retirement.[95] For example, the Thrift Savings Plan, a DC plan for federal workers, recently began to include such an estimate on annual statements for participants,[96] and representatives of a service provider for other plans told us it does so on quarterly statements. In addition, including an estimate of annuity income, as the Lifetime Income Disclosure Act[97] would require if passed, could improve retirement planning by indicating the estimated income stream

[94]GAO, *401(K) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest*, GAO-11-119 (Washington, D.C.: Jan. 28, 2011).

[95]For a discussion on "framing," see Jeffrey Brown et al., "Why Don't People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle," *American Economic Review: Papers and Proceedings* (98:2) 2008.

[96]The Thrift Savings Plan is governed by a statute other than ERISA. For more information, see GAO, *Federal Retirement Thrift Investment Board: Many Responsibilities and Investment Policies Set by Congress*, GAO-07-611 (Washington, D.C.: June 21, 2007).

[97]S. 267 and H.R. 677.

available based on a worker's account balance. This may be a difficult calculation for participants, according to certain experts we interviewed. As workers save for retirement, seeing an estimated monthly or annual income stream as well as an account balance could possibly help them to increase saving and understand how much they actually need to save to last throughout retirement.

However, this proposed option is subject to many assumptions and complexities, and certain industry or consumer groups expressed concerns that an estimate could potentially confuse or discourage participants. Although the current account balance may be simpler to convert to an annuity estimate, a few industry groups cautioned that such an estimate of annuity income could be quite low in some cases and might even discourage saving by those with smaller balances, such as younger participants. However, an estimate based on a projection of the worker's future balance at retirement would entail additional assumptions, such as future rates of return, and raise questions about how to account for investment risk, if at all. Another area of complexity is the level of uniformity or flexibility with assumptions.[98] While some industry groups noted that the federal government could provide uniformity and consistency across plan sponsors by prescribing assumptions for sponsors to use, other industry groups preferred flexibility, such as tailoring estimates to a plan's actual annuity products.

Concluding Observations

Given the long-term trends of rising life expectancy and the shift from DB to DC plans, aging workers must increasingly focus not just on accumulating assets for retirement but also on how to manage those assets to have an adequate income throughout their retirement. Workers are increasingly finding themselves depending on retirement savings vehicles that they must self-manage, where they not only must save consistently and invest prudently over their working years, but must now continue to make comparable decisions throughout their retirement years. Even for the minority of workers with significant retirement savings, making their savings last may prove challenging. However, for the majority of workers who approach retirement with small account balances—workers with balances of $100,000 or less—the stakes are far greater. For

[98]Additional assumptions or complexities exist. For example, it is unclear what, if any, assumptions or caveats would address the tax implications of the estimate, given that account balances are typically tax deferred.

those with little or no pension or other financial assets, ensuring income in retirement may involve difficult choices, including how long to wait before claiming Social Security benefits in order to receive higher benefits, how long to work, and how to adjust consumption and lifestyle to lower levels of income in retirement. Social Security benefits serve as the foundation of income in retirement and a key source of lifetime retirement income, but many older people claim benefits at the earliest age and pass up the opportunity for a higher monthly benefit beginning at full retirement age or later. By claiming benefits early, whether for health or other important reasons, individuals take a smaller benefit when they could potentially work longer and receive a higher monthly benefit. Although retirement savings may be larger in the future as more workers have opportunities to save over longer periods through strategies such as automatic enrollment in DC plans, many will likely continue to face little margin for error. Poor or imprudent investment decisions may mean the difference between a secure retirement and poverty.

Even for the half of the workforce participating in pension plans, employers as plan sponsors are currently not required to provide notices on the financial risks and choices that participants face in retirement. In our 2003 report, we included a Matter for Congressional Consideration to require sponsors to provide a notice to plan participants on risks in retirement. With the ongoing shift in pension plans and the transition from lifetime retirement income toward account balances, we believe that this continues to be important. Absent such a requirement, many more workers may likely face key retirement decisions without sufficient knowledge to decide which choices are in their best interest. Without objective information from employers and the federal government, even those retirees who have adequate savings may be at risk of not having sufficient retirement income. For those in the already large segment of the population depending on limited retirement savings, making prudent choices is especially important and difficult.

Agency Comments and Our Evaluation

We provided officials from the Department of the Treasury, IRS, Department of Labor, SEC, and the National Association of Insurance Commissioners with a draft of this report. The Department of the Treasury provided comments indicating that the report is a helpful addition to the dialogue and analysis regarding the topic. See appendix VI. Officials from the Department of the Treasury, IRS, Department of Labor, SEC, and the National Association of Insurance Commissioners provided technical comments that we incorporated in the report, where appropriate. We also provided a copy of the draft to officials from SSA for a technical review,

and they also provided technical comments that we incorporated where appropriate.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution until 30 days after the date of this letter. At that time, we will send copies of this report to the Secretary of the Treasury, Commissioner of Internal Revenue, Secretary of Labor, Chairman of the Securities and Exchange Commission, Chief Executive Officer of the National Association of Insurance Commissioners, Commissioner of the Social Security Administration, and other interested parties. In addition, this report will be available at no charge on GAO's Web site at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me at (202) 512-7215 or jeszeckc@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix VII.

Sincerely yours,

Charles Jeszeck
Director, Education, Workforce, and
Income Security Issues

Appendix I: Objectives, Scope, and Methodology

To identify the strategies experts recommend retirees employ to ensure income throughout retirement we interviewed a judgmental sample of a range of financial planners and other financial experts from different academic and industry organizations and a retiree interest group, which were from different geographic areas of the country. As part of these interviews, to ensure we identified strategies that apply to households across the net wealth spectrum and with both defined benefit (DB) and defined contribution (DC) pension plans, we randomly selected five households from the Health and Retirement Study (HRS)[1] conducted by the University of Michigan in the lowest, middle, and highest net wealth quintiles with different combinations of pension plans in the middle and highest quintiles. See appendix III for selected characteristics of these five households. See appendix II for selected financial and demographic data about these net wealth groups. The HRS is a nationally representative longitudinal survey of older adults sponsored by the National Institute on Aging and the Social Security Administration. The survey is administered in waves (generally every 2 years) and includes information on respondent demographics, health status, service receipt, and household characteristics, among other things. An additional HRS dataset, produced by the RAND Corporation, includes recoded variables and more detailed information on household finances. Using RAND's March 2010 compilation of HRS data for waves 1992 through 2008 and HRS data compiled by Gustman, et al., we identified these net wealth groups using 2008 total net wealth data from RAND (including second homes) as well as the present value of households' DB and DC pensions in 2006. We limited our sample to households with a member nearing typical retirement age (aged 55 to 60) in 2008 and adjusted income and asset values for inflation to 2008 dollars. These net wealth estimates did not include the present value of expected Social Security benefits. We assessed the reliability of the data we used by reviewing pertinent system and process documentation, interviewing knowledgeable officials, and conducting electronic testing on

[1]This analysis uses Early Release data from the Health and Retirement Study, the March 2010 RAND HRS, sponsored by the National Institute on Aging (grant number NIA U01AG009740) and conducted by the University of Michigan. These data have not been cleaned and may contain errors that will be corrected in the Final Public Release version of the dataset.

data fields necessary for our analysis. We found the data we reviewed reliable for the purposes of our analysis. [2]

We drew a random selection of five typical households from the first (lowest), third (middle), and fifth (highest) net wealth quintiles. To do so, we further restricted our analysis to households with net wealth within 10 percent of the median for each of these three quintile groups. For example, for the lowest quintile, median net wealth was $2,000 so we selected households with net wealth in the $1,800 to $2,200 range. Based on data for the first (lowest) quintile (see app. III), we selected a single-person household with neither a DB nor a DC pension, two or three living children (not necessarily living in the household), who reported being in “fair” or “good health,” and who did not own a house. Based on data for the third (middle) quintile, we selected two households consisting of married couples that owned their home, with either the respondent or spouse in “good” or “very good” health, and with two living children. From this quintile we selected one couple with only a DB pension and another with only a DC pension. Based on data for the fifth (highest) quintile, we selected two households consisting of married couples that owned their home. We selected one with either the respondent or spouse in “good” or “very good” health, two living children, and who had both a DB and a DC pension. We selected another couple from this quintile with only a DB pension, with members in “fair”, “good”, or “very good” health, and no restriction concerning the number of their living children. This procedure provided five households with characteristics approximately equal to median values for their net wealth quintile in these respects, but may not be in other ways.

We shared data on these households with the experts we interviewed[3] and discussed the strategies that the experts would recommend these households’ utilize and their trade-offs. See the households’ summary financial data in appendix III. We also reviewed company-specific financial product documentation and studies of retirement income strategies such

[2]Survey responses do not consistently match administrative sources of information. Researchers have noted, for example, that where respondents and their employers provided information about whether they had a DB, DC, or both types of pensions, less than half of respondents gave a response that matched information provided by their employer. See Alan L. Gustman, Thomas L. Steinmeier, and Nahid Tabatabai, *Pensions in the Health and Retirement Study* (Cambridge, Mass.: Harvard University Press, 2010), 125.

[3]We did not access any personally identifiable information.

as those describing systematic withdrawals from retirement savings, including the results of Monte Carlo simulations.[4]

To review the choices retirees have made for managing their pension and financial assets for generating income, we analyzed data from the HRS, reviewed others' analyses of the HRS, and analyzed data from the Social Security Administration, compiled by the Office of the Chief Actuary. We reviewed other data sources including data on retirement account holdings from the Employee Benefit Research Institute, labor force participation data from the Bureau of Labor Statistics, and poverty estimates from the Census Bureau's Current Population Survey.

We analyzed data concerning the disposition of pensions using HRS data, including data compiled by RAND and Gustman, et al. We restricted this analysis to workers that reported leaving employment with a DB or DC pension plan and retiring between 2000 through 2006. We also included only respondents that were in the HRS data set during each wave, 2000 through 2006. Furthermore, we assembled and analyzed data for a subset of these respondents that provided information concerning the availability of a lump sum option for their DB pension in the same HRS wave in which they reported a pension disposition.

To identify policy options that are available to ensure income throughout retirement as well as their advantages and disadvantages, we collected and reviewed information representing a variety of academic, consumer, industry, and government sources. We analyzed over 40 public comments from diverse groups submitted in response to the Department of Labor's (Labor) and the Department of the Treasury's (Treasury) 2010 request for information (RFI) on lifetime income, and at relevant congressional and Treasury-Labor department hearings. In addition to the RFI submissions,

[4]Monte Carlo analysis is a method of estimating the probable outcome of an event in which one or more of the variables affecting the outcome are random. This use of Monte Carlo simulations is to illustrate how the variability of investment rates of return can affect the balances in a retirement account. Monte Carlo estimation methods utilize not just the average value of a random variable, but also the distribution of values around the average. For example, rates of return in the stock market vary from year to year. The Congressional Research Service determined that the nominal rate of return on the Standard & Poor's 500 index of stocks averaged 10.3 percent over the 1926 to 2007 period, but annual rates of return varied widely around this average, producing a standard deviation of 20.0 percent. Likewise, while the nominal annual return on AAA-rated corporate bonds averaged 6.3 percent between 1926 and 2007, the standard deviation around this average was 7.0 percent. Monte Carlo simulation is a tool to take this variability into account in the analysis.

we also reviewed other publications from a variety of academic, consumer, and industry sources. We reviewed reports from Labor's Employee Retirement Income Security Act (ERISA) Advisory Council, and financial literacy materials on retirement income available from federal agencies including the online version of Labor's *Taking the Mystery Out Of Retirement Planning*[5] and the Financial Literacy and Education Commission's Web site, www.MyMoney.gov. We conducted interviews with a variety of academic, consumer, and industry sources. Interviews with officials of federal government agencies included Labor, the Securities and Exchange Commission (SEC), Treasury, the Internal Revenue Service (IRS), and Treasury staff of the Financial Literacy and Education Commission. Lastly, we reviewed applicable federal laws and regulations.

[5]See http://www.dol.gov/ebsa/publications/nearretirement.html.

Appendix II: Demographic and Financial Characteristics of Households Nearing Social Security Eligibility, 2008

These demographic and financial characteristics are for households in the HRS in which either the respondent or spouse was in the 55 to 60 age range in 2008. Except as noted, the income figures apply to income in 2007 and asset figures apply to assets at the time of the 2008 HRS interview, typically mid-2008. Estimates are expressed in 2008 dollars. See table 8 for confidence intervals of these household characteristics.

Table 7: Demographic and Financial Characteristics of Households Nearing Social Security Eligibility by Net Wealth Quintile, 2008

Demographic or financial characteristic ***(italics indicate income)***	**1st quintile (lowest)[a]**	**3rd quintile (middle)[a]**	**5th quintile (highest)[a]**
The percent of households with income from work and for those with such income, the median amount in 2007	58.7%, *$26,000*	83.5%, *$62,000*	83.7%, *$96,000*
Household's total income	*$23,000*	*$70,000*	*$140,000*
Household's median net wealth in 2008[a]	$2,000	$339,000	$1,508,000
Percent of households with DB pensions, and for those with DB pensions, the median estimated present value[b]	5.9%, $16,000	62.3%, $132,000	69.6%, $357,000
The percent of households with DC pensions, and for those with DC pensions, the median estimated present value[b]	18.9%,$5,000	52.0%, $42,000	64.6%, $174,000
Gross financial assets (excluding pensions and IRAs)	$50	$13,000	$145,000
The percentage of married couples	33.8%	64.0%	83.2%
The percent of households with living children, and for those with children, the median number they had[c]	86.7%, 2.6	88.6%, 1.9	88.4%, 1.9
The median self-reported level of health for the respondent (R) and spouse (S): excellent, very good, good, fair, or poor	4 – fair (R) 3 –good (S)	3 – good (R) 2 – very good (S)	2 – very good (R&S)
The percentage of households that owned a home, and for those that did, the median amount of home equity of their primary and other residences	31.7%, $11,000	93.4%, $107,000	97.8%, $326,000
The percentage of households with a home that had a mortgage	66.0%	75.9%	64.5%
The median combined level of household risk aversion where 1 indicates least risk averse and 6 being most risk averse	4.7 (from 1–6)	4.4 (from 1–6)	3.9 (from 1–6)
The median estimate of the probability of leaving an inheritance of $100,000 or more[d]	0.0%	50.0%	90.0%

Source: GAO analysis of HRS data.

[a]These net wealth groups are based on assets in individual retirement accounts (which are a type of individual retirement arrangement, or IRA), present value of DB and DC assets, and other financial and nonfinancial assets net of debt, but not the present value of Social Security assets. Nonfinancial assets include home equity, business ownership, and the net value of vehicles.

[b]The source of DB and DC pension data is HRS data compiled by Gustman, et al. for 2006. We adjusted the estimated present values of these pensions to express their value in 2008 dollars.

[c]Includes children in the household as well as those living elsewhere.

[d]For couples providing responses, this is the average of both responses.

Table 8 presents the confidence intervals for data in table 7, based on a 95 percent confidence level.

Table 8: Confidence Intervals for Demographic and Financial Characteristics of Households Nearing Social Security Eligibility by Net Wealth Quintile, 2008

Demographic or financial characteristic *(italics indicate income)*	1st quintile (lowest)	3rd quintile (middle)	5th quintile (highest)
The percent of households with income from work	53.8% to 63.6%	79.1% to 87.3%	79.3% to 87.5%
For those with such income, the median amount in 2007	*$23,266 to 30,389*	*$55,570 to $67,569*	*$84,623 to $106,635*
Household's total income	*$20,526 to $25,379*	*$66,256 to $73,806*	*$126,303 to $152,750*
Household's median net wealth in 2008	$422 to $3,955	$312,190 to $367,327	$1,405,301 to $1,610,021
Percent of households with DB pensions,	3.8% to 8.8%	57.2% to 67.4%	64.7% to 74.6%
For those with DB pensions, the median estimated present value	$10,700 to $23,918	$112,145 to $158,908	$289,520 to $432,774
The percent of households with DC pensions, and for those with DC pensions, the median estimated present value	15.0% to 22.8% $3,728 to $7,815	46.8% to 57.3% $32,208 to $60,369	59.6% to 69.6% $132,863 to $211,275
Gross financial assets (excluding pensions and IRAs)	$23 to $111	$10,000 to $17,129	$124,071 to $180,782
The percentage of married couples	29.1% to 38.4%	58.9% to 69.2%	79.2% to 87.2%
The percent of households with living children, and for those with children, the median number they had	82.5% to 90.1% 2.4 to 2.9	84.5% to 92.0% 1.8 to 2.0	84.4% to 91.7% 1.8 to 2.0
The percentage of households that owned a home and for those that did, the median amount of home equity of their primary and other residences	27.1% to 36.3% $5,920 to $19,057	90.5% to 95.6% $99,350 to $120,068	95.5% to 99.1% $301,628 to $379,557
The percentage of households with a home that had a mortgage	57.8% to 74.1%	71.2% to 80.5%	59.4% to 69.6%
The median combined level of household risk aversion where 1 indicates being the least risk averse and 6 being the most risk averse	4.3 to 4.9	4.0 to 4.6	3.7 to 4.2
The median estimate of the probability of leaving an inheritance of $100,000 or more	0.0% to 0.0%	49.0% to 53.0%	84.9% to 90.0%

Source: GAO analysis of HRS data.

Appendix III: Demographic and Financial Characteristics of a Sample of Five Households Nearing Social Security Eligibility

Below are selected demographic and financial characteristics of five households whose retirement prospects we discussed with financial planners and retirement income experts. We randomly selected these households from a sample of near-retirement households in the HRS in which the respondent and spouse were in the 55 to 60 age range in 2008. We selected one household from households in the lowest of five net wealth groups, two households from the households in the middle net wealth group, and two households in the highest net wealth group.

Table 9: Characteristics of Household One, Lowest Net Wealth Quintile

Characteristics	Value for household #1
Gender and age of respondent in 2008	Female, 58
Age of spouse, middle of 2008	NA
Marital status	Single
Net wealth	$2,000
Pension status	No pension
Market value of homes and other real estate	$0
Housing debt	$0
Present value of DB plan	$0
Value of DC plan	$0
Value of IRA assets	$0
Value of vehicles	$2,000
Value of business assets	$0
Value of other financial assets	$0
Nonhousing debt	$0
Total income	$22,000
Income from earnings	$22,000
Expected annual Social Security benefit if first taken at age 66 (respondent)	$11,000
Self-reported health status (respondent/spouse)	Fair
Living children	3
Respondent's estimate of the probability that they will leave a bequest of $10,000 or more	10%
Respondent's estimate of the probability that they will leave a bequest of $100,000 or more	0%
Level of risk aversion on a scale of 1 to 6, with 6 being the most risk averse (respondent)	3

Source: GAO analysis of HRS data.

Table 10: Characteristics of Household Two, Middle Net Wealth Quintile

Characteristics	Value for household #2
Gender and age of respondent in 2008	Female, 57
Age of spouse, middle of 2008	57
Marital status	Married
Net wealth	$349,000
Pension status	DC only
Market value of homes and other real estate	$280,000
Housing debt	($128,000)
Present value of DB plan	$0
Value of DC plan	$133,000
Value of IRA assets	$8,000
Value of vehicles	$8,000
Value of business assets	$0
Value of other financial assets	$50,000
Nonhousing debt	($3,000)
Total income	$115,000
Income from earnings (respondent/spouse)	$33,000 $78,000
Expected annual Social Security benefit if first taken at age 66 (respondent/spouse)	$14,000 $24,000
Self-reported health status (respondent/spouse)	Very good Very good
Living children	2
Respondent’s estimate of the probability that they will leave a bequest of $10,000 or more	100%
Respondent’s estimate of the probability that they will leave a bequest of $100,000 or more	100%
Level of risk aversion on a scale of 1 to 6, with 6 being the most risk averse (respondent/spouse)	Don’t know 5

Source: GAO analysis of HRS data.

Table 11: Characteristics of Household Three, Middle Net Wealth Quintile

Characteristics	Value for household #3
Gender and age of respondent in 2008	Female, 57
Age of spouse, middle of 2008	57
Marital status	Married
Net wealth	$373,000
Pension status	DB only
Market value of homes and other real estate	$170,000
Housing debt	($17,000)
Present value of DB plan	$31,000
Value of DC plan	$0
Value of IRA assets	$128,000
Value of vehicles	$50,000
Value of business assets	$0
Value of other financial assets	$10,000
Nonhousing debt	$0
Total income	$57,000[a]
Income from earnings (respondent/spouse)	$8,000 $26,000
Expected annual Social Security benefit if first taken at age 66 (respondent/spouse)	$6,000 $12,000
Self-reported health status (respondent/spouse)	Good Good
Living children	2
Respondent's estimate of the probability that they will leave a bequest of $10,000 or more	100%
Respondent's estimate of the probability that they will leave a bequest of $100,000 or more	100%
Level of risk aversion on a scale of 1 to 6, with 6 being the most risk averse (respondent/spouse)	6 6

Source: GAO analysis of HRS data.

[a]Includes $22,000 from a pension or annuity.

Table 12: Characteristics of Household Four, Highest Net Wealth Quintile

Characteristics	Value for household #4
Gender and age of respondent in 2008	Male, 59
Age of spouse, middle of 2008	57
Marital status	Married
Net wealth	$1,597,000
Pension status	DB only
Market value of homes and other real estate	$300,000
Housing debt	$0
Present value of DB plan	$492,000
Value of DC plan	$0
Value of IRA assets	$625,000
Value of vehicles	$35,000
Value of business assets	$0
Value of other financial assets	$145,000
Nonhousing debt	$0
Total income	$112,000
Income from earnings (respondent/spouse)	$64,000 $42,000
Expected annual Social Security benefit if first taken at age 66 (respondent/spouse)	$22,000 $16,000
Self-reported health status (respondent/spouse)	Very good Good
Living children	0
Respondent's estimate of the probability that they will leave a bequest of $10,000 or more	85%
Respondent's estimate of the probability that they will leave a bequest of $100,000 or more	10%
Level of risk aversion on a scale of 1 to 6, with 6 being the most risk averse (respondent/spouse)	5 6

Source: GAO analysis of HRS data.

Table 13: Characteristics of Household Five, Highest Net Wealth Quintile

Characteristics	Value for household #5
Gender and age of respondent in 2008	Female, 57
Age of spouse, middle of 2008	60
Marital status	Married
Net wealth	$1,518,000
Pension status	DB and DC
Market value of homes and other real estate	$1,100,000[a]
Housing debt	($36,000)
Present value of DB plan	$29,000
Value of DC plan	$30,000
Value of IRA assets	$140,000
Value of vehicles	$10,000
Value of business assets	$0
Value of other financial assets	$380,000
Nonhousing debt	($135,000)
Total income	$119,000[b]
Income from earnings (respondent/spouse)	$0 $52,000
Expected annual Social Security benefit if first taken at age 66 (respondent/spouse)	$0 $18,000
Self-reported health status (respondent/spouse)	Poor Good
Living children	2
Respondent's estimate of the probability that they will leave a bequest of $10,000 or more	98%
Respondent's estimate of the probability that they will leave a bequest of $100,000 or more	80%
Level of risk aversion on a scale of 1 to 6, with 6 being the most risk averse (respondent/spouse)	5 4

Source: GAO analysis of HRS data.

[a]This consists of a primary residence valued at $700,000 and other real estate valued at $400,000.

[b]This includes $65,000 of capital income, such as gross rental income, dividends, interest, and other asset income.

Appendix IV: Retirees' Disposition of Pensions

Table 14 provides estimates and confidence intervals for estimates of the percentage of workers who reported the disposition of their pension upon leaving work with a DB pension and retiring. Based on analysis of our sample of HRS respondents, we are 95 percent confident that the actual proportion of workers is between the low and high percentage indicated in each cell. See appendix I for details concerning our methodology for developing these estimates.

Table 14: Confidence Intervals for Estimates of the Percentage of Workers That Left Employment with a DB Pension and Retired Indicating the Disposition of Their Pension, 2000 through 2006

	Was a lump sum option available?		
DB pension disposition	**A. Yes, either full or partial lump sum available for one or more DB pension**	**B. No**	**C. All**
Receiving benefits	68.3% (60.7 to 75.8%)	77.3% (70.0 to 83.6%)	67.8% (64.8 to 70.8%)
Expect future benefit	18.4 (12.3 to 26.0)	18.7 (12.8 to 26.0)	15.0 (12.5 to 17.4)
Cash settlement	8.6 (4.6 to 14.4)	3.8 (1.6 to 7.2)	7.9 (6.3 to 9.6)
IRA rollover	10.3 (5.8 to 16.7)	1.1 (0.2 to 3.6)	6.4 (4.9 to 8.4)
Total number of observations	208	247	1336

Source: GAO analysis of HRS data, including pension data compiled by Alan L. Gustman, Thomas L. Steinmeier, and Nahid Tabatabai, *Pensions in the Health and Retirement Study* (Cambridge, Mass.: Harvard University Press, 2010).

Note: Respondents may have chosen a combination of options, so the sum of percentages in each column may exceed 100.0 percent. Analysis is limited to respondents age 60 or older in 2006 in the HRS 2000 through 2006. Estimates concerning those that had an option or did not have an option to take a lump sum were based on responses concerning this option during the 2000 through 2006 period.

Table 15 addresses the dispositions of DC pensions by workers who left employment with a pension and retired.

Table 15: Confidence Intervals for Estimates of the Percentage of Workers That Left Employment with a DC Pension and Retired Indicating the Disposition of Their Pension, 2000 through 2006

DC pension disposition	Estimate with (confidence interval) (percent)
Amount left in account	38.8% (35.3 to 42.3%)
IRA rollover	30.3 (27.1 to 33.6)
Convert to annuity	6.1 (4.5 to 8.0)
Withdrawal	15.8 (13.4 to 18.2)
Transfer to new employer	0.2 (0.02 to 0.7)
Total number of observations	1,109

Source: GAO analysis of HRS data, including pension data compiled by Alan L. Gustman, Thomas L. Steinmeier, and Nahid Tabatabai, *Pensions in the Health and Retirement Study* (Cambridge, Mass.: Harvard University Press, 2010).

Note: Respondents may have chosen a combination of options. Analysis is limited to respondents in the HRS 2000 through 2006.

Appendix V: Selected Types of Retirement Income Arrangements and Products

Table 16 describes selected types of arrangements which are tax-advantaged and products that may provide retirement income. They include tax-advantaged retirement arrangements, annuity products, and investment products. This list is not meant to be exhaustive, but rather to provide a sense of certain types of financial arrangements and products that may provide income throughout retirement.

Table 16: Descriptions of Selected Retirement Income Arrangements and Products

Type of arrangement or product	Basic description
Tax-advantaged retirement arrangements	
Defined benefit (DB) pension plans	DB plans promise to provide a benefit that is generally based on an employee's years of service and, frequently, salary (i.e., for "traditional" pension plans; "hybrid" pension plans, such as cash balance plans, may use a formula to determine benefits that may be expressed as a hypothetical account balance). Income taxes typically apply when pension benefits are taken.
Defined contribution (DC) pension plans	DC plans provide benefits based on contributions and investment returns to individual accounts for employees. The employee, the employer, or both periodically make contributions and/or direct investments (e.g., 401(k) plans, 403(b) plans, 457 plans, money purchase plans, stock bonus plans). For tax-qualified plans, income taxes are typically deferred on contributions and investment earnings until withdrawals of pension benefits.
Individual retirement accounts[a]	Individual retirement accounts are retirement savings arrangements that allow the holder to make tax-deductible and nondeductible contributions to an individual account and to preserve assets from pension plans on a tax-deferred basis under certain conditions. Amounts withdrawn from traditional individual retirement accounts are fully or partially taxable in the year withdrawals are made. A variation is the Roth individual retirement account, which, under certain conditions, allows the holder to make nondeductible contributions to an individual account and realize tax-free growth of the balance from interest, dividends, and capital gains, with tax-free withdrawals in retirement.
Annuity products	
Immediate fixed annuities	Immediate annuities are insurance products that provide immediate income for a pre-determined period of time such as for the life of the contract holder or a specified number of years. Payments promise a set regular amount based on a certain interest rate.
Immediate variable annuities	Like immediate fixed annuities, these contracts provide immediate income for a pre-determined period of time. Unlike immediate fixed annuities, the payments may increase or decrease based on performance of underlying investments the purchaser selects.
Deferred fixed annuities	Deferred annuities generally have an accumulation, or investment, phase as well as the option of a payout, or income, phase. There may be a one-time purchase or a series of purchases made over time. Payments from the annuity for a set regular amount are to begin in the future rather than immediately. An example of a variation is a deeply deferred annuity, also known as commercial "longevity insurance," which may begin payments starting after a late age, such as 85.

Type of arrangement or product	Basic description
Deferred variable annuities	Deferred annuities have an accumulation and potentially a payout phase where the accumulation and regular payments may vary based on performance of underlying investments the purchaser selects. The payout phase may feature fixed or variable payments.
Indexed annuities	Indexed annuities offer a return computed by reference to (but not necessarily the same as) an outside index such as the S&P 500 Composite Stock Price Index, often promising a minimum contract value regardless of index performance.
Annuities with guaranteed living benefits	Newer annuities, including variable annuities, frequently offer optional features that provide various protections or guarantees, subject to certain restrictions. For example, a minimum withdrawal benefit provides for periodic withdrawals of a specified percentage of the investment (e.g., 5% to 7%) and further provides that the insurance company will continue payments of that amount if the account is depleted by reason of permitted withdrawals and/or investment performance. These withdrawals generally will continue until the original investment has been recouped or, in the case of a so-called "lifetime withdrawal benefit," for the life of the contract owner.
Investment products	
Mutual funds	Mutual funds are pooled investments in a portfolio of securities that are managed professionally. Investors buy shares in the fund, which represents an indirect ownership interest in the fund's securities. Mutual funds may include stocks, bonds, cash instruments, as well as combinations of these asset classes (e.g., balanced funds, payout funds, target-date funds).
Payout funds	These funds combine an investment portfolio with a distribution, or payout, component. They may serve in place of systematic drawdowns by making payments of a certain percent or for a particular period of time.
Target-date funds	Target-date funds, or lifecycle funds, allocate investments among various asset classes with the goal of reducing investment risk as the retirement date approaches. These funds differ widely in their allocations among asset types before, at and during retirement.
Treasury Inflation Protected Securities (TIPS)	TIPS are Treasury securities indexed to the rate of inflation. Both interest payments and the return of the principal at maturity are adjusted for inflation.

Source: GAO analysis of government and industry documents.

[a] IRA also refers to individual retirement arrangements, including individual retirement accounts and individual retirement annuities.

Appendix VI: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 3, 2011

Charles A. Jeszeck, Director
Education, Workforce, and
Income Security Issues
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: GAO Report on Retirement Income (GAO-11-400)

Dear Charlie:

Thank you for sending us the draft of GAO's report titled, "Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices" (GAO-11-400).

The report provides information and analysis pertaining to key issues that were raised in the Request for Information (RFI) that the Department of the Treasury and the Department of Labor published on this subject (at 75 FR 5253, Feb. 2, 2010). As we have stated on previous occasions, the RFI was intended to invite comments on whether, and, if so, how, to give participants better options for managing retirement savings or accessing lifetime income or other arrangements that are designed to provide a stream of income after retirement.

The report is a helpful addition to the ongoing dialogue and analysis regarding the importance of steps that might be taken to address the risk of outliving one's retirement savings and to give people additional options to manage those savings during their lifetime after retirement. We will take the information and analysis in the report into account as we consider guidance to issue in response to the public comments we have received.

Very truly yours,

J. Mark Iwry
Senior Advisor to the Secretary
and Deputy Assistant Secretary
for Retirement and Health Policy
(Office of Tax Policy)

Appendix VII: GAO Contact and Staff Acknowledgments

GAO Contact

Charles Jeszeck, (202) 512-7215 or jeszeckc@gao.gov

Staff Acknowledgments

In addition to the contact named above, Michael J. Collins, Assistant Director; Joseph A. Applebaum; Carl S. Barden; Susan C. Bernstein; Jason A. Bromberg; Michael Brostek; Tara E. Carter; Patrick S. Dynes; Sharon L. Hermes; Mitchell B. Karpman; Gene G. Kuehneman Jr.; Mimi Nguyen; Benjamin P. Pfeiffer; Bryan G. Rogowski; Matthew J. Saradjian; Roger J. Thomas; Frank Todisco; Karen C. Tremba; and Walter K. Vance made key contributions to this report.

Related GAO Products

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Defined Contribution Plans: Key Information on Target Date Funds as Default Investments Should Be Provided to Plan Sponsors and Participants. GAO-11-118. Washington, D.C.: January 31, 2011.

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