H. C. FOSTER & COMPANY

Retirement and Welfare Plan Actuaries

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A Retiree's Quandary – Fall 2020

Recent retirees with no monthly income from traditional pension plans must invest their retirement savings in secure, income generating investments. A retiree knows:

- Fixed income investments at currently low interest rates will likely not generate sufficient income
- Effective Interest Rates (EIRs) on investments must exceed inflationary losses of purchasing power
- The retiree's retirement assets may be depleted before he and/or his spouse pass away
- Only liquid assets can take advantage of asset gains from market value increases
- Asset preservation under the retiree's control for emergencies and beneficiaries is a high priority
- A Single Premium Life Annuity (SPLA) from a life insurance company will pay life time income
- No matter how soon death occurs, the life insurance company keeps the remainder of the Premium
- A SPLA can pay survivor income, but the monthly income to the retiree is reduced
- A retiree does not want to deplete his estate of the single premium cost of a SPLA

Aside from the purchase of a residence earlier in life, the retiree's retirement plan investments may be the most important financial decision affecting his or her future financial security. The following single premium costs are for a $1,000 monthly single life annuity at age 65 for a male:

Insurance Company			IRS Mandated Present Values for LSD Equivalents						
Issuer	SPLA Cost	EIR	IRS Notice	MPVSRs 1st	MPVSRs 2nd	MPVSRs 3rd	Single Sum Cost	EIR	30-Yr Treasuries
“ Minnesota Life	$206,612	1.85%							
New York Life	213,675	1.55%	2019-03 Dec. '18	3. 43%	4.46%	4.88%	$164,975	4.05%	3.36%
Penn Mutual Life	207,900	1.79%	2020-01 Dec. '19	2.04%	3.09%	3.68%	188,850	2.70%	2.28%
Pacific Life	210,970	1.66%	2020-45 June '20	1.08%	2.78%	3.47%	199,915	2.15%	1.38%
Symetra Life	212,314	1.60%	2020-57 July '20	.74%	2.57%	3.32%	205,430	1.90%	1.49%
American General	212,766	1.58%	2020-72 Sept. '20	.52%	2.22%	3.03%	212,009	1.61%	1.36%
American National	213,675	1.54%`	A $1,000 monthly life annuity at a 5.5% EIR has a present value of about						
Mass Mutual	215,517”	1.47%	$141,000 for a male age 65 under the same mortality table.						

Notes:

1. The SPLA Costs shown in quotation marks are from the IMMEDIATEANNUITIES.com website during December 2020. All measurements are based on the applicable 2020 PPA '06 Mortality Table for Lump Sum Distributions (LSDs).
2. The Present Value Equivalents are the LSD present values IRS mandates for private sector defined benefit pension plans. These are from the Minimum Present Value Segment (interest) Rates (MPVSRs) of recent monthly IRS Notices.
3. The EIR is the single interest rate equivalent of the segment interest rates from the Notices under the MPVSRs.
4. These results show that investment returns from SPLA contracts fall short of the returns IRS mandates for LSD present values, and only recently have barely exceeded 30-Year Treasury Rates. The Treasury Rates and MPVSRs are reported in the Notices for the previous month.
5. The annuities website shows a “PAYOUT RATE” of about 5.75% that is the ratio of the annual payment to the annuity cost, not the investment yield the unwary reader might suspect.

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We conclude the following from the above results:

1. Life annuity payments include the investment return on the SPLA premium cost and should include a return of the SPLA premium cost through the end of life; but, there is no return of the purchase cost if the annuity payments are less than corporate bond returns on the premium cost.

2. A SPLA contract is default-free if the life insurance company is financially secure, but the purchaser receives very little or no risk premium in exchange for a complete forfeiture of his SPLA contract cost.

3. A rational investor can tolerate a fair amount of default risk to obtain higher investment returns and retain control of his retirement assets. Corporate bonds pay a "risk premium" above default-free U.S. Treasury returns for monetary inflation and to compensate the investor for the added risk of default that is more certain with "junk bonds".

4. A retiree's best option may be to diversify his investments through a discount broker or through equity purchases directly from multiple public companies to minimize purchase costs.

5. Investment selections depend on the retiree's personal situation and tolerance for investment risk.

The Department of Labor's (DOL's) efforts to implement regulations requiring investment sources to disclose the costs and investment returns from investment alternatives has met with stiff resistance. See our Spring 2015 Newsletter that discusses the final regulation published in the Federal Register on February 3, 2012 and the regulations defining a pension "fiduciary" under ERISA Section 3(12) (A) published in the Federal Register on April 20, 2015. Disclosures remain inadequate, and participants are slow to understand the disclosure information that is provided.

Pension litigation reveals some pension investment pitfalls. Listed below are excerpts of some of the litigation actions taken from the *Q2 2020 legal overview report* published by Pensions & Investments.

Neuberger Berman paid $17 million to settle an ERISA complaint against the company's 401(k) plan fiduciaries alleging that plan executives improperly retained a high-fee underperforming Neuberger fund.

J.P. Morgan Chase paid $9 million for 401(k) plan participants who claimed that fiduciaries retained expensive investment options and failed to look for cheaper and better-performing replacements.

Wilmington Trust paid $19.5 million in a class-action lawsuit while denying allegations during its acquisition of Martin Resource Management Corp. Plan that the acquisition was partially financed through loan proceeds at expense of plan participants with millions of dollars of debt payable.

Putnam Investments agreed to pay $12.5 million to settle an ERISA suit alleging that the plan failed to maintain a prudent investment lineup.

Liberty Mutual Group's 401(k) plan participants filed an ERISA lawsuit against the firm claiming that they made irresponsible investment options and failed to properly monitor record-keeping fees.

U.S. Bancorp Pension Plan's fiduciaries received a favorable ruling upon appeal from the Supreme Court ruling that participants of funded defined benefit plans do not have standing to sue plan fiduciaries for mismanagement.

Fidelity Investments reached a $28.5 million settlement with former 401(k) plan participants who accused the plan's fiduciaries of ERISA violations in the case of Moitoso et al. vs. FMR LLC et al.

Please call or e-mail questions and comments.