

# DEFERRED COMPENSATION PLAN BOARD REPORT 09-44



Date: August 6, 2009  
 To: Board of Deferred Compensation Administration  
 From: Staff  
 Subject: Annuity Distributions

*Members*  
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**Recommendation:**

That the Board of Deferred Compensation Administration approve eliminating annuity distributions from the menu of distribution options directly provided by the Plan, and that Plan Document language describing distribution options be revised accordingly.

**Discussion:**

*Background* - Upon separation from service Plan participants have a range of distribution options available to them. Included among these options is taking an annuity distribution.

An annuity distribution involves a participant using his/her account balance to purchase a payment stream from an insurance provider. Annuity distributions differ from the Plan's other distribution options in that, with the former, the participant is irrevocably ceding ownership of the account to the insurance company, while with the latter the participant retains ownership.

The following table lists all of the Plan's distribution options and indicates who maintains ownership of the account and who administers the distribution:

Distribution Method	Participant Retains Account Ownership	Administrator
<b>PARTICIPANT OWNED OPTIONS</b>		
Lump-Sum Disbursement	Yes	Great-West Retirement Services
Partial Lump-Sum Disbursement	Yes	Great-West Retirement Services
Periodic Payment - Fixed Term	Yes	Great-West Retirement Services
Periodic Payment - Fixed Amount	Yes	Great-West Retirement Services
Periodic Payment – Fixed Amount w/COLA	Yes	Great-West Retirement Services
<b>ANNUITY OPTIONS</b>		
Life Annuity	No	Insurance Provider
Life Annuity w/Period Certain	No	Insurance Provider
Joint and Survivor Annuity	No	Insurance Provider
Joint and Survivor Annuity w/Period Certain	No	Insurance Provider
Refund Life Annuity	No	Insurance Provider

Prior to the Plan's redesign in 1999, the City had two providers, Hartford Life Insurance Company and Washington Mutual Bank. The Plan's legacy contract with Hartford Life Insurance, until it ended recently on June 30, 2009, provided the means for any participant to purchase an annuity distribution through Hartford. This was a convenience to the Plan resulting from the unique status of that contract in the program's history.

Staff is recommending that the Plan discontinue offering annuities for the following reasons:

- (A) Low Demand for Annuity Distributions
- (B) Administrative Burden of Offering Annuity Distributions
- (C) Alternate Means of Obtaining Annuity Distributions

Staff will review each of these separately.

*(A) Low Demand for Annuity Distributions* - Great-West indicates that over the past five years, only three participants have purchased annuity distributions (excluding transfers to the Los Angeles Angeles City Employees' Retirement System Larger Annuity Program, which remain an ongoing option for LACERS members in any event).

Annuities are rarely chosen now due in part to changes in Section 457 regulations. Prior to enactment of the 2001 Economic Growth and Tax Recovery Reconciliation Act (EGTRRA), participants in 457 plans could make only one irrevocable distribution election. However, under EGTRRA, participants can now change their distribution elections as often as they wish. For example, a participant could initiate a 30-year periodic payment stream and then, at a later date, choose to stop it, or take a lump-sum withdrawal to deal with an emergency. This kind of flexibility does not exist with an annuity distribution because ownership of the account has effectively transferred to the insurance company. As a result, most participants avoid purchasing annuities in order to keep as many options open to them in retirement as possible.

In addition, the Plan's non-annuity distribution options provide the opportunity to largely duplicate the features of an annuity. Specifically, a periodic payment fixed by dollar amount but with a cost-of-living-adjustment allows participants to create an ongoing income stream that steadily rises with inflation (but which can be revoked or altered at any time if the participant wishes). Finally, annuities typically come at a higher cost to the participant's monthly income because they involve a special State tax upon time of purchase, and because the insurance company compensates itself for the risk that the participant will outlive the assumed lifespan of the distribution. Some participants find the lifetime benefit guarantee to be worth these additional costs, but most participants do not.

*(B) Administrative Burdens of Offering Annuity Distributions* - When the Plan's administrative services were consolidated under Great-West Retirement Services in 1999, the City's Plan had the option of using Great-West's "Annuity Shopping Service."

This service would have provided a resource for participants to obtain annuity quotes from a limited number of pre-screened annuity providers. One of the potential providers was Great-West.

However, the City's Plan has not elected to use this service thus far. Additional administrative burdens would be created because it would require execution of agreements between the annuity providers (currently Mutual of Omaha and MetLife) and the City as Plan sponsor, which invites contracting questions related to whether the service would first need to be competitively bid (it very likely would, since the universe of potential providers has been screened not by the City but by a contractor). The more convenient option of using Great-West as an annuity provider would also raise the competitive-bid issue, and could further conflict with the objective of avoiding incentives for the Plan Administrator to market a specific revenue-generating product which competes with other non-revenue producing products in the Plan.

*(C) Alternate Means Of Obtaining Annuity Distributions* - Participants have the ability to purchase annuities outside the City's Plan. In 2001 the rules regarding rollovers from Section 457 plans were made significantly more flexible, such that participants could now roll out their funds to any investment provider (including an insurance company) which offered an investment inside an Individual Retirement Account (IRA). Prior to 2001 rollovers were only permitted to other Section 457 plans. This means that participants have the ability to roll their funds to an annuity distribution provider within an IRA.

### Conclusion

Given these three factors, staff recommends that the Board eliminate annuity distributions as part of the Plan's core distribution options. Such an action would require an amendment to the Plan Document to revise Section V(c), "Distribution Methods," as follows (note that staff is proposing eliminating the annuity language as well as correcting one existing typographical error to the language on Item 5):

### **Distribution Methods**

In the event of a Participant's Severance from Employment, the Participant may elect to receive the full amount of Compensation credited to the Participant's Investment Account, plus or minus subsequent investment gains or losses, but less any income tax required to be withheld, in any one of the following methods and in monthly, quarterly, semi-annual and annual payment frequencies:

- (1) **Lump sum payment.** The total benefits payable in one cash payment.
- (2) **Partial lump-sum payment.** Payment of a portion of the Participant's Account.
- (3) **Periodic Payment - Fixed Term.** Amounts payable in equal installments over a period of one to thirty years, e.g. ten, fifteen, or twenty years, not to exceed the life expectancy of the Participant.
- (4) **Periodic Payment - Fixed Dollar Payment.** A fixed dollar amount payment designated by the Participant payable until the account balance is depleted over a time period not to exceed the lesser of a Participant's life expectancy or thirty years.
- (5) **Periodic Payment - Fixed ~~Term~~ Dollar Amount with Cost-of-Living-Adjustment.** A fixed dollar amount payment designated by the Participant payable until the account balance is depleted over a time period not to exceed the lesser of a Participant's life expectancy or thirty years, with the payment amount adjusted annually for a cost-of-living-

adjustment as based on any positive increase in the Los Angeles/Riverside/Orange Consumer Price Index (CPI) as published by the Federal Government. In no case shall a negative reading of the aforementioned Index result in a decrease in a Participant's annual payment.

- ~~(6) **Life annuity.** An annuity payable during the lifetime of the Participant.~~
- ~~(7) **Life annuity with period certain guaranteed.** An annuity payable during the lifetime of the Participant with the guarantee that if at his/her death payments have not been made for the guaranteed period as selected, then payments will continue to the Beneficiary. The guaranteed period to be elected must be either five (5), ten (10), fifteen (15), or twenty (20) years.~~
- ~~(8) **Joint and survivor annuity.** An annuity payment during the lifetime of the Participant and a secondary payee named by the Participant, with payments ending upon the death of the Participant or the secondary payee, whichever is later.~~
- ~~(9) **Joint and survivor annuity with period certain guaranteed.** An annuity payment during the lifetime of the Participant and a secondary payee named by the Participant with the guarantee that if at the secondary payee's death payments have not been made for the guaranteed period as selected, then payments will continue to the Beneficiary. The guaranteed period to be elected must be either five (5), ten (10), fifteen (15), or twenty (20) years.~~
- ~~(10) **Refund Life Annuity**—An annuity payment during the lifetime of the Participant with the guarantee that if at the Participant's death payments have not been made over the period of the Participant's life expectancy, then payments will continue to the Beneficiary, or the Beneficiary may elect a lump sum payment, in an amount equaling the remaining account value.~~

In summary, staff is recommending that the Board approve eliminating annuity distributions from the menu of distribution options directly provided by the Plan. Staff is further recommending that Plan Document language describing distribution options be revised accordingly.

Submitted by: \_\_\_\_\_  
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Approved by: \_\_\_\_\_  
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