Advisory Council on Employee Welfare
and Pension Benefit Plans

Report to the Honorable Thomas E. Perez,
United States Secretary of Labor

Model Notices and Disclosures for Pension Risk Transfers

November 2015

NOTICE

This report was produced by the Advisory Council on Employee Welfare and Pension Benefit Plans, usually referred to as the ERISA Advisory Council (the "Council"). The Council was established under Section 512 of ERISA to advise the Secretary of Labor on matters related to welfare and pension benefit plans. This report examines Model Notices and Disclosures for Pension Risk Transfers.

The contents of this report do not represent the position of the Department of Labor (Department).

LIST OF COUNCIL MEMBERS

Paul M. Secunda, Council Chair

Mark E. Schmidtke, Council Vice Chair

James I. Singer, Issue Chair

Dennis F. Mahoney, Issue Vice Chair

Jennifer Tretheway, Issue Vice Chair

Ronald Gebhardtsbauer, Drafting Team Member

Jeffery G. Stein, Drafting Team Member

Deborah A. Tully, Drafting Team Member

Joshua Cohen

Christina R. Cutlip

Kevin T. Hanney

Christine S. Hwang

Elizabeth Leight

Deborah L. Smith

Rennie Worsfold

ABSTRACT

The 2015 ERISA Advisory Council examined information needs of plan participants and disclosure practices of plan sponsors when engaging in defined benefit plan risk transfer transactions and drafted Model Notices relevant to these transactions. The work of the 2015 Council built upon the prior work of the 2013 Council which had undertaken a comprehensive study and report on risk transfer practices and highlighted disclosure as an area that could be improved by plan sponsors. Additionally, the General Accountability Office (GAO) undertook a study of risk transfer transactions and issued a report earlier in 2015 that pinpointed specific areas where disclosure could be enhanced. The 2015 Council used both of these earlier reports as foundational elements in seeking to craft Model Notices.

Based upon testimony received during two days of hearings supplemented by submissions of written material from interested stakeholders, the 2015 ERISA Advisory Council formulated and drafted Model Notices and this Report. These documents are intended to be beneficial in providing relevant information to plan participants impacted by risk transfer transactions. Also, these Model Notices were drafted to provide the information in an easily understood format and to enhance rational decision making.

The Council is recommending use of the Model Notices. Risk transfer transactions are by nature inherently complex involving uncertainty. Behavioral finance witnesses cautioned the Council that better information by itself is unlikely to ensure that people make good choices in the cognitively challenging task of choosing between an annuity and a lump-sum payout. Despite the use of Model Notices, there are difficulties that participants are still likely to face in this area.

In drafting the Model Notices, a balance was struck in favor of conciseness due to witness testimony that most participants would not read long notices. This Report serves as a supplement to the Model Notices and includes additional helpful information which was deemed to be too much for a concise notice.

As explained in the Report, there is urgency to getting helpful information to participants who will likely be involved in risk transfer transactions in the next two years. For this reason, the Council has presented to the Department the Model Notices and the Report with the goal that no additional work is needed if the Department chooses to adopt the Model Notices. Some witnesses urged that the Model Notices be submitted to focus groups and that ever-improving interactive technology be used. While these are worthwhile suggestions, there is concern that implementing these suggestions would result in delays in getting helpful information to plan participants.

ACKNOWLEDGEMENTS

The Council recognizes the following individuals and organizations who contributed greatly to the Council's deliberations and final report. Notwithstanding their contributions, any errors in the report rest with the Council alone.

Erzo F.P. Luttmer	Dartmouth College
Annamaria Lusardi	The George Washington University School of Business
William Kadereit	National Retiree Legislative Network
Stephen J. Silverberg	Law Office of Stephen J. Silverberg, P.C., on behalf of National Academy of Elder Law Attorneys
Edward Stone	Edward Stone Law, P. C. on behalf of ProjectSeniorsOrg/Association of BellTel Retirees
Matthew McDaniel	Mercer
Ellen Kleinstuber	American Academy of Actuaries Pension Committee
Roberta Rafaloff	MetLife
Gary Baker	CANNEX Financial Exchanges
Robert Newman	Covington & Burling LLP
Craig Rosenthal	Mercer, on behalf of the American Benefits Council
Jonathan Forman	University of Oklahoma College of Law
Cindy Hounsell	WISER
Jane Smith	Pension Rights Center
Karin Feldman	AFL-CIO
Ted Beck	National Endowment for Financial Education
Karen Richman	University of Notre Dame
Wade Pfau	The American College
Steve Vernon	Rest-of-Life Communications
Stephen Wendel	Morningstar
Aron Szapiro	Morningstar
Larry Good	Employee Benefits Security Administration
Diweena Streater	Employee Benefits Security Administration
Thomas Norris	Employee Benefits Security Administration

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY………………………………………………. 1

II. RECOMMENDATIONS…………………………………………………. 3

III. BACKGROUND………………………………………………………. 4
A. 2013 Council Report
B. 2015 GAO Study
C. Internal Revenue Service (IRS) Notice 2015-49
D. Review of Applicable Existing Law and Regulations Related to Disclosure

IV. REVIEW OF USEFUL INFORMATION PER GAO REPORT …………… 7
A. Key Information No. 1: Benefit Options
B. Key Information No. 2: Lump Sum Calculations.
C. Key Information No. 3: Relative Value of Lump Sum vs. Annuity
D. Key Information No. 4: Positive and Negative Ramifications of Accepting a Lump Sum
E. Key Information No. 5: Tax Consequences
F. Key Information No. 6: Guarantees of Pensions
G. Key Information No. 7 and 8: Instructions and Assistance
H. Special Problems and Information Needs of the Elderly

V. EFFECTIVE COMMUNICATION OF PLAN INFORMATION TO PARTICIPANTS……………………………………………………….. 27
A. Discussion of Behavioral Sciences
B. Discussion of Problems with Financial Literacy
C. Use of Electronic Media
D. Design Elements Based upon Behavioral Research
E. Other Helpful Suggestions Related to the Model Notices

VI. CONCLUDING OBSERVATIONS………………………………………….. 32

VII. APPENDIX…………………………………………………………… 33

I. EXECUTIVE SUMMARY

The Council engaged in an extended process in drafting Model Notices for risk transfer transactions involving lump sums, and insurance company risk transfers. The starting points of the investigation were the 2013 Council Report on Pension Derisking, and the January 2015 Report of the Government Accountability Office (GAO) which is referenced below. The Council published a scope statement which directed the public to the Council's inquiry on what information would be helpful to participants who find themselves in a risk transfer transaction.

The inter-related actuarial and investment issues raised by risk transfer transactions are difficult to understand even for professionals who have spent many years in the field. It is understandable that most participants are confused when faced with the decision of whether to accept a lump sum in place of a pension plan annuity. Participants' confusion is further compounded by the absence of a readily available source of unbiased information to explain the transaction and answer questions. A plan sponsor who offers a lump sum risk transfer has a financial interest in the participant electing the lump sum. Otherwise, the plan sponsor would not be offering the lump sum. Many retail financial advisors have an interest in participants electing a lump sum and rolling it into an individual retirement account (IRA). Where is a participant to turn for objective answers?

It is intended that the Model Notices be used by plan sponsors to provide plan participants with useful information in risk transfer transactions. In addition, this Report serves as an independent source of information which could be made available to participants through the Department's website.

At the May 2015 hearing, the Council heard from witnesses who made recommendations about what to include in the Model Notices and how that information should be communicated to participants. Based in part on the witnesses' testimony, during the months of June and July 2015, the Council drafted Model Notices for the two types of risk transfer transactions. In late July 2015, the draft Model Notices were circulated both to the witnesses who testified at the May 2015 hearing, and to the witnesses who were scheduled to testify at the August 2015 hearing. All witnesses were encouraged to review the Model Notices and provide suggestions to the Council. The Council received a number of helpful suggestions at the August hearing.

In drafting the Model Notices, it was necessary to balance different considerations which worked at cross purposes. For example, there was considerable testimony from behavioral scientists who urged that the Council needed to take a position on risk transfers and present a short and simple message to participants that, for example, electing a lump sum was a poor decision for most participants. Other witnesses urged that the draft notices were too short and did not cover a number of retirement related considerations that are relevant to whether to elect a lump sum. The Council concluded that it had a duty to the Department and the public to provide concise and balanced Model Notices which explain the pros and cons of a risk transfer transaction to participants.

There is urgency to making the Model Notices and this Report available to participants and plan sponsors. In late 2014, the Society of Actuaries released an updated mortality study with corresponding new mortality tables indicating longer lifespans and the future expectations that the trend of improved longevity will continue. As explained below, in July 2015, the IRS announced that it will delay any inclusion of updated mortality results that serve as the basis for the minimum required lump sums provided by plan sponsors until after 2016 to provide sufficient time for review and comment. This could result in lower lump sum payments to participants in 2016 compared to lump sums that would have been calculated if the new Society of Actuaries' mortality tables were used. In addition, if interest rates are to rise, the cost to a plan sponsor of providing lump sums would go down, and plan sponsors could be further motivated to provide a lump sum risk transfer. An additional factor that some have suggested may contribute to increased risk transfer activity is the increase in PBGC premiums through recent legislation including the Surface Transportation Extension Act of 2012 and the Bipartisan Budget Act of 2015. The Council is concerned that delays in the issuance of the Model Notices and this Report, even to pursue the goal of more perfect notices, would be counterproductive to the interests of plan participants who need the information in the Model Notices and the Report.

II. RECOMMENDATIONS

Based upon the testimony and research received and for the reasons stated:

The Council recommends that the Department issue the attached Model Notices and this Report as soon as administratively feasible for the purpose of providing helpful information to plan participants. The Council recommends that the Department:

1. Make this Report and its Appendices available to plan sponsors and participant advocates via the Department's website and encourage plan sponsors to utilize the Model Notices contained in the Appendices to this Report when engaging in a risk transfer transaction. Model Notices should be distributed to plan participants at the earliest stage in the implementation of a risk transfer transaction, and for at least a minimum of 90 days before a transaction occurs or a participant needs to notify a sponsor of an election in the case of a lump sum offer.

2. Encourage plan sponsors to refrain from suggesting to plan participants that:
    i. The applicable mortality tables currently permitted under Code Section 417(e)(3) to calculate lump sums are government approved and
    ii. The applicable discount rates permitted under Code Section 417(e)(3) to calculate lump sums are government approved for purposes of providing a lump sum equivalent to a lifetime annuity.

3. Include a link in the lump sum risk transfer notice to a specially designed web tool to assist participants in researching retail annuities that could be purchased with a lump sum subject to resolving concerns over whether the web tool should be/can be sponsored in whole or in part by a nonprofit entity. A link to a specially designed web tool has been included in the recommended lump sum notice.

III. BACKGROUND

A. 2013 Council Report

In recent years, there has been a noticeable increase in activity by single-employer defined benefit pension plans to offer lump sum distributions to some or all of the plans' participants, many times with a limited election window (lump sum risk transfer). The number of lump sum risk transfer transactions has increased over the past several years due to several factors, including the increase in pension cost volatility to plan sponsors, the rapid increase in Pension Benefit Guaranty Corporation (PBGC) premiums and the approval of lump sum payments to retirees and their beneficiaries in pay status by the Internal Revenue Service (IRS) through a series of private letter rulings in 2012 and 2014.[1] (The IRS has since indicated that no future transactions will be permitted for retirees and their beneficiaries in pay status per IRS Notice 2015-49 which is summarized in Section C below.)

Lump sums shift the risk related to lifetime retirement benefits from the plan to the participants. Other risk transfer transactions can involve the purchase of a group annuity contract by the plan from an insurance company (insurance company risk transfer) which transfers the risk from the plan to the insurance company. In the past, this activity has been referred to as "derisking," which takes the perspective of the plan/plan sponsor that has transferred its risk to the participants or a third party, usually an insurer. More accurately, these transactions are referred to as "risk transfers," which is the term that will be used in this Report.

In 2013, the Council issued a comprehensive report on the risk transfer process. The 2013 Council Report included, among other things, recommendations to the Department regarding the information needed by plan participants involved in risk transfer transactions. For lump sum risk transfers, the 2013 Council Report recommended improved participant disclosures in the following areas: (1) Limit election windows to no less than 90 days; and (2) Include "relevant information to enable a participant to make an informed election" concerning such issues as the potential impact of tax penalties, whether an early retirement or other subsidy is included in the lump sum, and a comparison of the lump sum to other benefits under the plan.

B. 2015 GAO Report

In January 2015, the United States Government Accountability Office (GAO) issued a Report titled: "Private Pensions: Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits." The GAO Report identified "Eight Questions that Address Key Factors Participants Need to Know in Order to Make an Informed Benefit Choice." The GAO prepared a table of the "Eight Questions" with sub-questions for each of these primary questions. The Eight Questions and sub-questions in the GAO Report are restated and discussed below.

[1] See IRS Private Letter Rulings 2012-28045, 2012-28051, 2014-2028, 2014-2029, 2014-2030, 2014-2031, and 2014-4031.

In drafting the Model Notices, the Council attempted to address the questions and sub-questions identified in the GAO Report. The Council also reviewed the PBGC webpage titled "Annuity or Lump Sum? Making a Choice" which can be found on the web at: http://www.pbgc.gov/wr/benefits/annuity-or-lump-sum.html. In addition, the Council reviewed the "Fact Sheet" of the Pension Rights Center titled "Should you take your pension in a lump sum?" which can be found on the web at: http://www.pensionrights.org/publications/fact-sheet/should-you-take-your-pension-lump-sum and the Pension Rights Center "Fact Sheet" titled "What happens when a pension is transferred to an insurance company" which can be found on the web at: http://www.pensionrights.org/publications/fact-sheet/what-happens-when-pension-transferred-insurance-company.

C. Internal Revenue Service (IRS) Notice 2015-49

On July 10, 2015, the IRS issued Notice 2015-49. In Notice 2015-49, the IRS stated:

> Those regulations [the 401(a)(9) IRS Regulations] reflect an intent, among other things, to prohibit, in most cases, changes to the annuity payment period for ongoing annuity payments from a defined benefit plan, including changes accelerating (or providing an option to accelerate) ongoing annuity payments. The Treasury Department and the IRS have concluded that a broad exception for increased benefits in Section 401(a)(9)-6, A-14(a)-4 that would permit lump sum payments to replace rights to ongoing annuity payments would undermine that intent.

See Notice 2015-49 at page 3. This IRS Notice effectively disallows lump sum risk transfer transactions involving retirees and others in pay status.

D. Review of Applicable Existing Law and Regulations Related to Disclosure of Pension Plan Benefit Options

There are existing laws and regulations on the disclosure of pension plan benefit options. IRC § 417(e) relates to providing participants with the relative values of the various benefit options within the sponsor's retirement plan. In addition, IRC §402(f) provides a notice on the tax consequences of lump sum distributions.

IRC Section 417: Limits to Relative Value Protections; Shortcomings with IRC §417(e) relative value notice; and Assumptions for Calculating Lump Sums: IRC §417 requires qualified retirement plans to provide survivor benefits to spouses, unless waived by the participant and spouse. The Qualified Joint and Survivor Annuity (QJSA) must be at least as valuable as any other benefit available from the plan. Frequently, QJSAs and early retirement benefits are "subsidized" which means that the plan absorbs all or a portion of the cost of the benefit options and does not take a full actuarial adjustment into account for the greater benefits provided by these options. IRC §411(a)(7)(B) allows lump sums to be less valuable than the QJSA or early retirement benefits by excluding subsidies. The lump sum only has to equal the present value of the accrued benefit at normal retirement age. Plans are not required to include in a lump sum option any subsidies in the QJSA or early retirement benefits.

The IRC §417(a)(3) regulations require plan sponsors to provide a notice explaining the relative value of the QJSA to other forms of benefit, such as a lump sum, by converting them all to the same form of payment. For example, relative value could be provided by showing the present value of the above QJSA in dollars, $120,000 next to the $100,000 lump sum, so that the participant would realize the QJSA is 20% more valuable than the lump sum. There are potential problems with the Code's relative value notice. For example, the notice may come as late as 30 days prior to the distribution, and even this period can be waived. In addition, the notice addresses relative values on the date of the projected current distribution and does not address early retirement benefits, which may include subsidies, or normal retirement benefits that a participant could qualify for at a later date, which may include a QJSA subsidy.

Assumptions for lump sums: For lump sums, the Code and IRS regulations require plan sponsors to provide a benefit that is no less than the lump sum resulting from the use of IRC §417(e)(3) applicable interest rates and a designated mortality table. Plan sponsors may define a different set of assumptions within their plans that result in a lump sum payment that is greater than the IRC § 417(e)(3) minimum required distribution but they cannot pay out less than this amount. Plan sponsors must disclose the interest rates, or in certain cases, provide them on request. As explained below, in July 2015, the IRS announced that it will delay any inclusion of updated mortality results that serve as the basis for the minimum required lump sums provided by plan sponsors until after 2016 to provide time for sufficient review and comment. In addition, a plan sponsor may choose interest rates based upon a "look back" period that can be up to 17 months earlier than the lump sum payment date. This allows plan sponsors to offer lump sums which are not based upon current interest rates. The exact provisions of the look-back period must be included in the plan document and cannot change year over year. In periods where interest rates are decreasing, the use of a look back period will result in lower lump sums than would need to be paid under more current rates and vice versa.

Deferred Benefits: The relative value regulations do not require sponsors to provide comparisons of the relative values between immediate pensions and deferred pensions such as the early retirement benefits and normal retirement benefits which participants can age into. In plans with subsidized early retirement benefits, there could be very large differences in values.

Timing: The relative value notice must be provided within 30 and 90 days prior to benefit commencement; however, this period can be waived. The Council recommends that the Model Notices be provided to plan participants by plan sponsors at the earliest stage of the implementation of a risk transfer transaction.

IRC §402(f) notice on the tax consequences of lump sum distributions: This IRC section requires a notice when there could be a rollover. It is also provided within 30 to 90 days prior to a distribution. It contains information on monies that would be withheld if not directly rolled over to a qualified retirement vehicle, how to do a direct rollover to defer tax, special rules on lump sum averaging to reduce the tax (if applicable), other tax consequences, such as treatment of net unrealized appreciation. However, the 402(f) notice does not include important information on non-tax consequences of getting a lump sum.

IV. REVIEW OF USEFUL INFORMATION ("key information" per the GAO Report, pages 39-49) PARTICIPANTS NEED TO MAKE AN INFORMED DECISION ON RISK TRANSFERS

In drafting Model Notices, the Council specifically addressed the informational gaps identified in the GAO Report issued in 2015. The sections below explain these informational gaps and discuss the decisions in drafting the Model Notices.

A. Key Information No. 1: Benefit Options.

Per the January 2015 GAO report, the following questions should be addressed regarding the benefit options available when a lump sum is offered to a participant.

- What is the monthly benefit amount at normal retirement age (the "do nothing now" or "deferred annuity" option)?
- Is there a subsidized early retirement option?
- What is the monthly benefit amount if payments begin now under the plan (the "immediate annuity" option)?
- What is the lump sum amount (the "lump sum" option)?

When participants receive a lump sum offer from a pension plan, they may not have adequate information about other forms of benefit other than the legally required relative value notice. When a participant elects a form of payment from a plan other than a Qualified Joint and Survivor Annuity (QJSA), if married, or a Single Life Annuity (SLA), if single, at a date other than the normal retirement date as defined under the plan, those options can be adjusted to an amount that is at least equivalent to the SLA at normal retirement date. However, pension plans are permitted to subsidize one or more benefit options, making the subsidized options more valuable than the other options. IRC Section 417(a)(3)-1 requires plan sponsors of qualified retirement plans to provide a relative value notice explaining the QJSA available to the participant under the plan compared to other optional forms of benefit, such as a lump sum, within 30 and 90 days prior to benefit commencement. Plan sponsors must provide this information with respect to optional forms of benefit presently available to the participant.

The Council heard testimony from Ellen Kleinstuber on behalf of the American Academy of Actuaries indicating that plan sponsors could provide the accrued benefit at normal retirement date, which would be useful to participants as they evaluate the benefits currently available to them at the time of the lump sum offer.

Ms. Kleinstuber's testimony specifically noted that:

> providing the amount of the accrued benefit payable at the normal retirement date is important to the decision making process, and should be included in all benefit election packages in a manner that allows the participant to easily identify and compare to the

currently available annuity options. This could be an additional mandated disclosure item that shouldn't create any undue burden on plan administrators to provide.

The Council also heard testimony from Craig Rosenthal on behalf of the American Benefits Council cautioning that information regarding benefits available at a future date can be subject to multiple variables based on external factors such as interest rates that are difficult to predict and explain in a simple disclosure to participants. The Council's Model Notice includes disclosure of the participant's normal retirement benefit.

B. Key Information No. 2: Lump Sum Calculations

Per the January 2015 GAO report, the following questions should be addressed regarding how the lump sum was calculated.

- What interest rates were used?
- What mortality assumptions were used?
- Was the value of any additional plan benefits included in the lump sum?

Because a lump sum is the present value of a stream of annuity payments that would otherwise have been paid to the participant over his or her lifetime, it is critical to understand (1) the mortality assumption, or how long the participant was assumed to live and receive annuity payments, (2) the interest rates used to discount the payments back to the current time to develop the present value and, (3) whether or not those payments include the value of early retirement subsidies.

The January 2015 GAO report noted that:

> Although not all participants would necessarily use information about interest rates, mortality assumptions, or treatment of additional plan benefits to help them arrive at a decision, [the GAO's] discussion with participants informed us that some likely would.

The GAO report and witnesses in their testimony to the Council noted that there is some confusion by participants as to how life expectancy and mortality are taken into account in the calculations. In some cases, participants believe that either the mortality assumption is specific to them as an individual or represents a projection of longevity to a single point in time estimate of how long someone will live. In fact, the mortality assumption represents a series of probabilities of survival and death in each year and the assumption is based on average life expectancies of a population, which is not necessarily sex distinct. Contrary to the retail annuity market, ERISA pension plans must apply the same mortality tables to men and women even though women live longer than men as a group. This means that when a woman tries to purchase a retail annuity with her lump sum, she will generally face a benefit reduction to take into account female mortality tables.

The mortality assumption in combination with the interest rate serves as the fundamental basis for the determination of the lump sum value being offered to the participant. The Council heard testimony from William Kadereit confirming that this information would be useful to participants. Mr. Kadereit specifically stated that:

> [T]here are just two variables in the calculation of the minimum lump sum offer: life expectancy provided by a mortality table and the interest rate used to calculate the present value of benefits owed.

Mr. Kadereit also noted that plan sponsors often apply a look-back rule when determining the interest rate used to calculate the lump sum. This approach allows plan sponsors to base lump sums to be paid during a stability period, which can be up to a one year period, on an interest rate that is set using a look-back month as far as five months prior to the beginning of the stability period. For each pension plan, both the stability period and the look-back month must be defined in the plan document. For many plans where the stability period is a full year, this can result in lump sums which can be based on interest rates that were established up to seventeen months prior to the payment date (assuming payment is made in the last month of the stability period). The ability to use a look-back period for establishing the interest rate for the lump sum calculation is intended to allow plan sponsors sufficient time to determine and communicate the benefit and provide participants with enough time to make their election without changes to their benefit. However, such look-back periods can result in a lump sum calculation that no longer reflects the current interest rate environment by the time the lump sum is received by the participant. In a decreasing interest rate environment, this will result in a lower lump sum value to be paid to the participant compared to the lump sum that would be provided under the most current rates and vice versa. In his testimony, Mr. Kadereit recommended that a comparison of the current interest rates and the interest rate used to calculate the lump sum should be disclosed.

The Council heard testimony from Mr. Rosenthal on behalf of the American Benefits Council describing why look-back periods are used to determine lump sums. He noted that the establishment of a look-back period for determining the interest rate is

> not done with any bias in mind, rather it is designed to provide knowable rates for participants so that they can evaluate their retirement options without having the figures change dramatically over the course of the months leading up to their retirement…Due to the lead time to prepare a lump sum cash out (typically at least 4-6 months elapse between (1) the date a plan sponsor makes a final decision to adopt a lump sum window and (2) the payment date), it is impossible for a plan sponsor to handicap where market interest rates will be at any future payment date.

Lump sum calculations can be based on the QJSA or SLA available at normal retirement date, but they may also include the value of certain early retirement or optional form subsidies available under the plan. In addition to mortality and interest rates, whether the lump sum calculation itself includes these subsidies would be useful to participants so that they can have a full understanding of the benefits being valued as a part of the lump sum calculations. In the case where a lump sum is determined without consideration of a subsidy offered under the plan and there is no disclosure to that effect, the participant may not realize that they could be sacrificing a benefit under the plan that could be more valuable to them than the lump sum that is being offered. To fully evaluate their choices, participants should be informed of which benefits under the plan are being included in the lump sum calculation.

Mr. Kadereit requested that all of the components of the lump sum calculation should be made available to participants and their advisors to evaluate, should they choose. Further, Mr. Kadereit noted that

> retirees have been disrespected by some who believe that detailed financial information will only confuse retirees and confer little benefit.

Ms. Kleinstuber and Mr. Rosenthal supported the concept that participants receive information regarding the mortality table, interest rate and the inclusion of subsidies. Mr. Rosenthal specifically stated that

> a general description that the mortality assumption represents average life expectancies based on mortality tables chosen by the IRS and participant electing a lump sum may be better or worse off, depending on how long they live and their rate of return. Similarly, information about the effective interest rate (the single interest rate that would derive the same lump sums as the 3-tier IRS spot-segment rates) could be informative.

Similarly, Ms. Kleinstuber noted:

> Requiring a statement of the actual interest rates and mortality table used would improve participant understanding with little additional cost to the plan. To the extent not already disclosed, indicating the annuity amount and assumed form of payment and commencement date upon which the lump sum was calculated could also improve understanding without adding significant administrative cost or complexity…plan participants would gain from an understanding of whether additional plan benefits were included in their lump sum calculation, and believe this information would be best provided through a description disclosure with the benefit election package provided to the participant.

In November 2014, the Society of Actuaries (SOA) published a mortality study which included updated mortality tables for consideration which recognized significantly improved life expectancies than the current tables provided for under Code Section 417(e)(3). The IRS is in the process of reviewing the SOA study to determine the appropriate mortality tables to be used for purposes of determining minimum required distribution assumptions under IRC 417(e)(3). In order to provide time for thorough review and comment, the IRS has indicated that the underlying mortality basis for determining minimum required distribution assumptions under IRC 417(e)(3) will remain unchanged for 2016. (See IRS Notice 2015-53). For U.S. GAAP accounting purposes, plan sponsors must use a mortality assumption in determining balance sheet liabilities that is the best estimate for their pension participant population. With the release of the Society of Actuaries' study in 2014, plan sponsors had to take into consideration the new mortality tables and determine whether and to what extent that information should be incorporated into their best estimate. The result at year end 2014 was that most plan sponsors included some variation of the SOA mortality table, in many cases with modifications (e.g. adjustments to the future mortality improvement projection scale to incorporate credible data from the Social Security Administration) to reflect their own best estimate. Thus, at least until 2017 when the IRS is expected to require an updated mortality table taking into consideration the recent study by the Society of Actuaries, there will be a disconnect between the mortality tables under Code Section 417(e)(3) and mortality tables used for US GAAP reporting purposes.

The practical impact of this delay is to create a financial incentive for plan sponsors to offer lump sums based upon the existing 417(e)(3) mortality tables before 2017 when updated mortality assumptions are expected to go into effect for 417(e)(3) purposes. Use of the existing 417(e)(3) mortality tables results in lower lump sums than would be calculated using more recent mortality experience. Lower lump sums will make it more difficult for a participant to duplicate the plan's lifetime retirement income.

Upon review of the GAO Report and the feedback from witnesses, the Council recommends that the Model Notice to participants include disclosure regarding the mortality table used, the interest rates used, and the date of the interest rates in effect. In addition, the Council recommends that employers include a disclosure about whether or not the lump sum calculation includes the value of any subsidized benefits such as an early retirement subsidy or spousal benefits.

The disclosure of this information may mislead some participants. With respect to interest rates, a participant may look at the three interest rate "segments" under Code Section 417(e)(3) and decide to take the lump sum if the participant believes higher investment returns could be earned in the future. However, this conclusion would be fundamentally in error. The 417(e)(3) interest rates which are used to discount the plan's annuity into a lump sum, are discounted based on the average expected lifetime of the plan participants. Approximately one-half of participants will

live longer than their projected mortality age assuming that correct and current mortality tables are being used. In addition, as explained above, it is not expected that the Code 417(e)(3) mortality assumptions will be updated until at least 2017. In the Model Notice, the Council attempted to make participants aware of this risk.

The Council reviewed two lump sum risk transfer information packets which were used by two Fortune 500 plan sponsors. One of the notices referred to the applicable 417(e)(3) interest rates and mortality tables as government approved. While such a statement references the fact that the interest rates and mortality tables used in the calculations are permissible under government regulations, it may give the impression to participants that these assumptions are actually endorsed by the government with the best interest of participants in mind.

The Council recommends that the Model Notice explain the other options available under the plan, the benefits available at normal retirement, whether any subsidies exist under the plan at other retirement dates or with alternative forms of payment in a manner that can be easily understood by plan participants, as well as the interest rates and mortality tables which were used to calculate the lump sum. Also, because of concerns about misleading plan participants, other materials in the plan sponsor information should not refer to the applicable 417(e)(3) interest rates and mortality tables as government approved.

C. Key Information No. 3: Relative Value of Lump Sum vs. Annuity

Per the January 2015 GAO report, the following questions should be addressed regarding the comparison of the relative value of the lump sum versus the monthly annuity:

- How does the lump sum payment compare to the value of the plan's lifetime annuity?
- Would it be possible to replicate the plan's stream of payments by purchasing a retail annuity using the lump sum?

When faced with the option of a lump sum payment in lieu of an immediate or future annuity from the pension plan, it can be difficult for a participant to understand the difference in the value of these options. Under current IRS regulations, employers must provide a relative value notice to participants when they are making an election under the plan for a form of payment other than a Qualified Joint and Survivor Annuity (QJSA).

While the intent of these notices is to provide plan participants with an understanding of the comparative value of the options they have under the plan, the actual required disclosures within the notice do not fully describe how the various options, including a lump sum payment, may differ. The notice does not necessarily provide participant specific information regarding the benefits that could be paid under the plan in lieu of a lump sum. In addition, if a benefit option is close in value to the QJSA, a plan sponsor can simply indicate that the benefit, in this case the lump sum, has approximately the same value. It can also be difficult to get a complete understanding of how the lump sum compares to the annuity since the relative value comparison

can be based on the same actuarial assumptions that were used to develop the lump sum in the first place and may not necessarily be the most current representation of interest rates and longevity. The GAO noted that many of the lump sum packets that they reviewed contained relative value notices that had "little additional explanation" of the differences in the benefit forms to help participants understand their options.

In addition, the actuarial assumptions used to determine relative value are not participant specific. A comparison of the value between the lump sum and annuity does not take into account the individual's specific circumstances (e.g. how long they may live and how they will invest the lump sum assets). Finally, there is no requirement to compare the lump sum to the value of an annuity payable at normal retirement age or to compare the lump sum to any subsidized benefits the participant could receive at alternative commencement dates.

The GAO's January 2015 report noted that:

> [I]n many (5 of the 11) of the packets, the relative value statements compared the lump sum payment to the value of an immediate annuity starting at the same time as the lump sum payment would occur, but not the value of the deferred annuity available when the participant reaches full retirement age, often at age 65. It was also not clear if any of these packets included the value of a deferred annuity beginning at early retirement age with any additional benefits.

By not providing a full understanding of 1) how the lump sum was calculated, 2) how the relative value was determined and 3) whether subsidized benefits were considered as a part of the calculations, the participant is left without the ability to thoroughly evaluate their benefit options at the time of a lump sum offering and may not be equipped to make the decision that is in their best interest.

Understanding current mortality projections

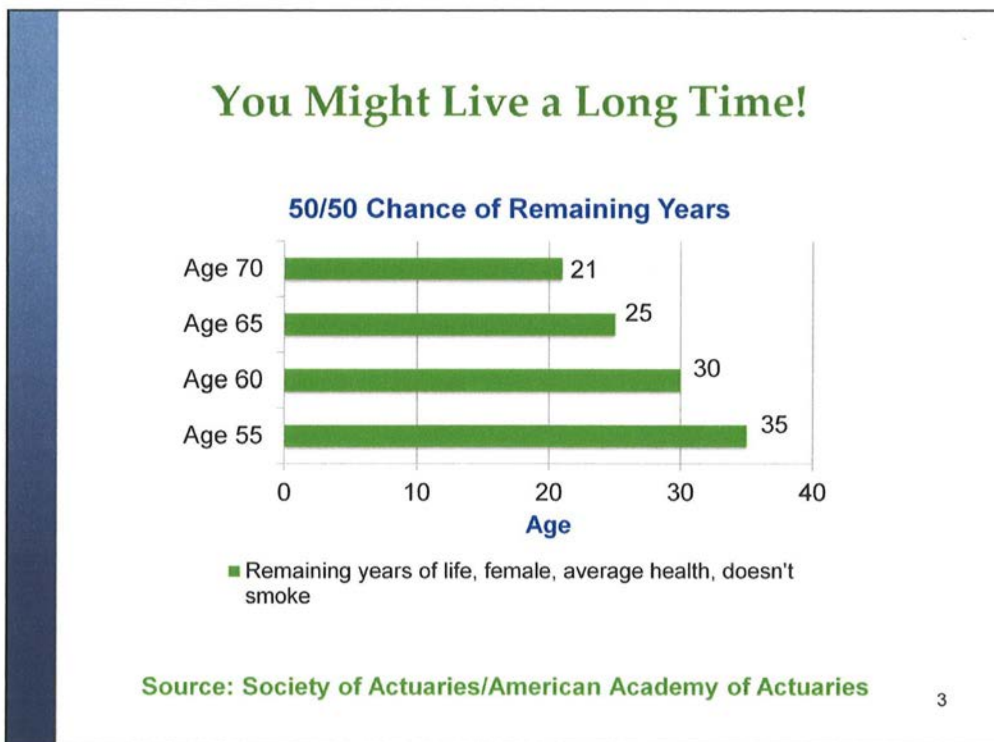
When a participant elects a lump sum, the participant is taking the longevity risk from the pension plan. To take this risk, participants should have access to current information about mortality projections and consider this information. The Council heard testimony that many participants do not have a realistic understanding of their own projected mortality.

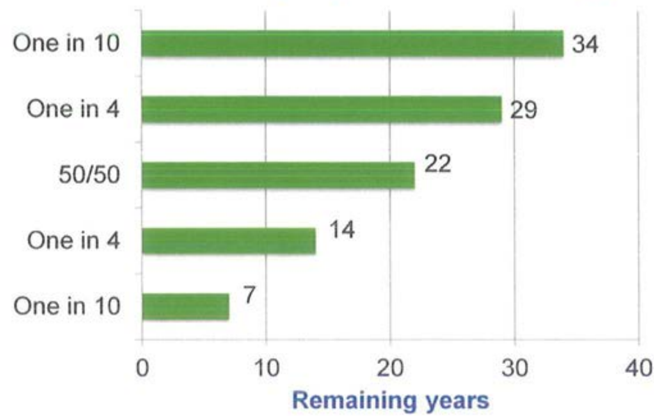
The Council received testimony that in comparing the plan annuity to a lump sum, many participants do not understand current greater longevity rates as compared to their parents' generation. The Council received testimony that it would be helpful for plan participants to see graphs with projections of their mortality. Mortality projection graphs were provided to the Council by a witness based upon 2014 mortality tables from the Society of Actuaries.

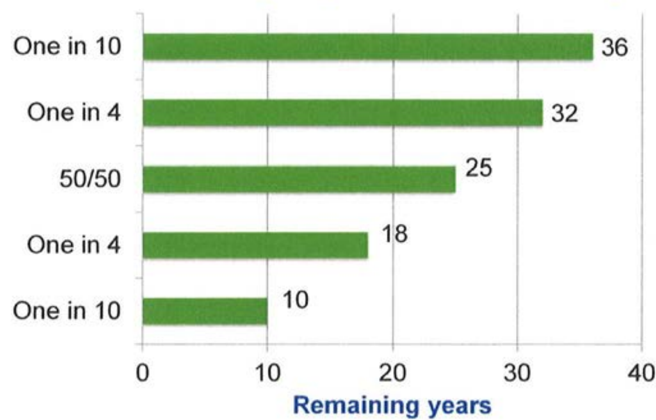
It was not clear that most participants would understand the graphs on mortality. Also, any graph would have to be based upon certain age and sex assumptions, and therefore, most

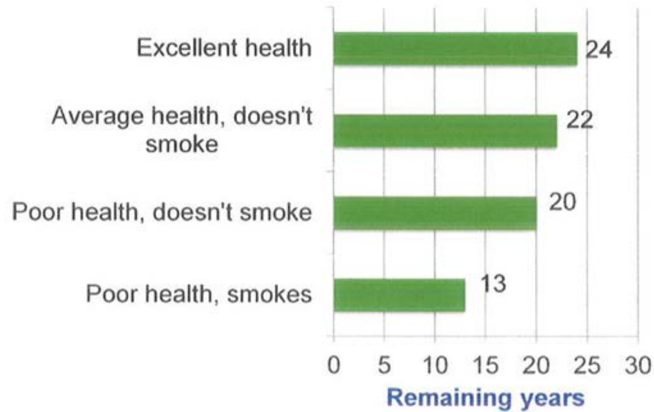
participants would not have the mortality projections for their own age and sex. Finally, including the mortality charts in the Model Notice would enlarge the Notice beyond the length that most participants would read. For these reasons, while the mortality charts may be helpful to some participants, the decision was made not to include the mortality charts in the Model Notice but to include the mortality charts in this Report. (As future data on mortality becomes available, the graphs included in this report could become outdated.)

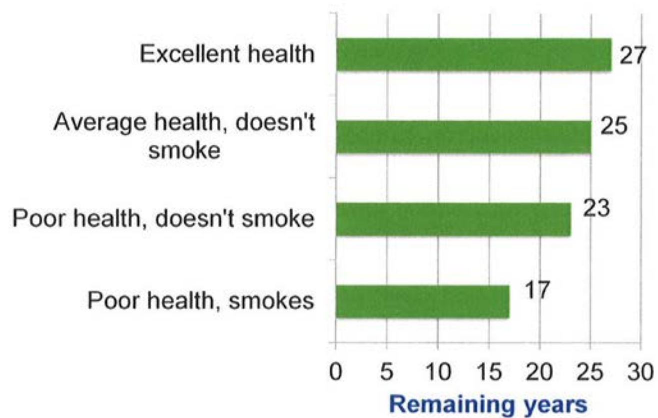
(The following five graphs were compiled by Steve Vernon, FSA, based upon the 2014 mortality tables that were prepared by the Society of Actuaries/ American Academy of Actuaries.)




It's Uncertain How Long
You Might Live!
Odds of living for years shown - Male age 65
One in 10
One in 4
50/50
One in 4
One in 10
34
29
22
14
7
0
10
20
30
40
Remaining years
Source: Society of Actuaries/American Academy of Actuaries
4


It's Uncertain How Long
You Might Live!
Odds of living for years shown - Female age 65
One in 10
One in 4
50/50
One in 4
One in 10
36
32
25
18
10
0
10
20
30
40
Remaining years
Source: Society of Actuaries/American Academy of Actuaries
5


Your Health and Lifestyle Choices Are Important!
50/50 chance of living for years shown - Male age 65
Excellent health
24
Average health, doesn't smoke
22
Poor health, doesn't smoke
20
Poor health, smokes
13
0 5 10 15 20 25 30
Remaining years
Source: Society of Actuaries/American Academy of Actuaries
6


Your Health and Lifestyle Choices Are Important!
50/50 chance of living for years shown - Female age 65
Excellent health
27
Average health, doesn't smoke
25
Poor health, doesn't smoke
23
Poor health, smokes
17
0 5 10 15 20 25 30
Remaining years
Source: Society of Actuaries/American Academy of Actuaries
7

Comparison between the plan's annuity and the retail annuity market.

While the relative value notices required to be provided by plan sponsors compare the annuity offered under the plan to the lump sum option, it does not provide an indication of how the lump sum amount compares to the cost of an annuity an individual could purchase outside of the plan through a commercial insurer. Generally, annuities purchased outside of the plan by an individual participant includes certain insurance charges and fees and are based on different, individual specific assumptions, including gender, which is particularly relevant since women, on average, have longer lifespans than men, making an annuity for them more costly. In addition, insurers often anticipate that individuals purchasing a retail annuity expect to live longer. In the insurance industry this phenomenon where individuals purchasing an insurance product are the most likely to realize the greatest amount of benefit from that product is referred to as anti-selection. Insurers often include this anti-selection behavior into their pricing, increasing the cost to the individual purchasing the annuity.

The Council heard testimony from Roberta Rafaloff of Metlife describing the differences between a retail annuity and a plan annuity. Ms. Rafaloff specifically states:

> Retail annuity expenses can be higher than institutional annuities, because pricing is based on an individual's life expectancy instead of a group's, meaning that payments will likely be lower. There are also fees associated with various retail annuity features.

Included in Ms. Rafaloff's testimony was an illustration (shown below) demonstrating the potential cost disparity between the monthly pension benefit paid out of the plan, the lump sum amount and the retail annuity that could be purchased on the open market for a 65 year old male and female.

Replicating a Monthly Pension Benefit

Age	Gender	Monthly Pension	Lump Sum (LS) Value	Percentage of Lump Sum Used	Retail Annuity Monthly Payout*+
65	Male	$1,000	$165,860	100%	$897
		$1,000	$165,860	50%	$449
65	Female	$1,000	$165,860	100%	$861
		$1,000	$165,860	50%	$430

Assumptions

Mortality:	PPA 2015
Rates:	1.27% For the first 5 years
(April 2015)	3.52% For the next 15 years
LS Conversion Rate	165.8602679 Unisex pricing

* Rounded to the nearest dollar amount

+ Single premium immediate annuity

Numerical illustrations showing the specific pricing differences between a retail annuity and a plan annuity could be useful to participants. However, this information is something that is generally beyond the scope of a plan sponsor's responsibilities. In Ms. Kleinstuber's testimony on behalf of the American Academy of Actuaries, she noted that:

> Pricing of individual annuity contracts takes into consideration factors that are beyond the means of pension plan fiduciaries to evaluate. Therefore, information to estimate the income that could be purchased with the offered lump sum distribution must be assessed outside the plan's communication material.

While providing estimates of commercial insurance pricing is not something that plan sponsors can reasonably do, it would be appropriate for them to provide a statement noting that the lump sum amount may not be sufficient to purchase an annuity outside of the plan that will completely replace the plan annuity. The Council has included such a statement in the Model Notice.

In seeking to better understand the pricing of commercial retail annuities, the Council heard testimony at the May 2015 hearing from Gary Baker of CANNEX Financial Exchanges. CANNEX monitors pricing in the retail annuity marketplace and provides this information to insurers, actuarial firms and other professionals working within the financial services industry. Beyond providing comprehensive testimony on retail annuity pricing, Mr. Baker offered to work with the Department to make retail annuity pricing "benchmarks" available to plan participants through a web-based application. Following his testimony, Mr. Baker dialogued with members of the Issue Group on specifications and developed a fully operational, web-based tool to allow plan participants to compute estimates of current retail annuity prices attainable from insurers licensed in their states of residence. The web tool calculates currently available annuity prices using an average of highly rated insurers domiciled within the plan participant's state of residence. The tool is reversible and can compute either a stream of payments if given a lump sum; or conversely, a lump sum if given a stream of payments.

The Council greatly appreciates Mr. Baker's generosity with his time and expertise to develop an innovative instrument from which plan participants can attain useful information which

previously was difficult to collect, organize and interpret. The Council included a link to the CANNEX calculator within the Lump Sum Model Notice and endorsed it being made available to plan participants.

D. Key Information No. 4: Positive and Negative Ramifications of Accepting a Lump Sum

- What are the potential positive and negative ramifications of accepting the lump sum?
- How could the lump sum affect beneficiaries?
- How could inflation affect the lump sum and the plan's monthly benefits?
- What are the investment risks?
- What are the longevity risks?
- How could spending some of the lump sum affect its value over time?

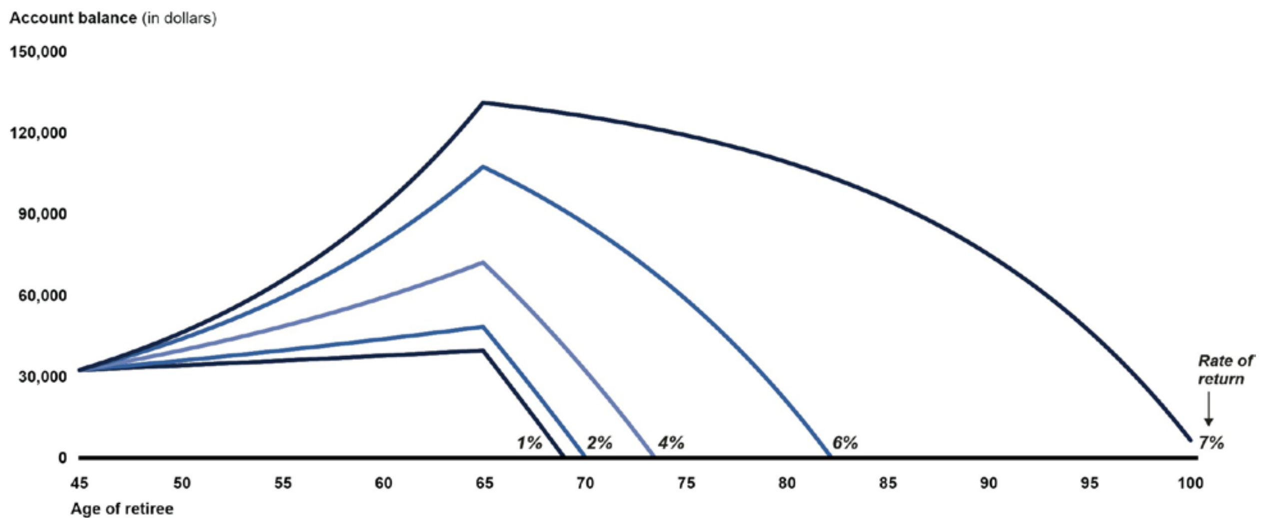
As stated in the GAO report, plan participants cannot make an informed decision on a risk transfer offer unless they receive adequate information on the positive and negative ramifications of accepting the offer as compared with the ramifications of rejecting the offer and continuing to participate in the Plan. For example, the GAO report notes that the risk of individuals and their spouses outliving their assets if they accepted a lump sum distribution is a key concern of participants. There are other widespread concerns such as participants' ability to manage and invest the lump sum on their own, as well as the cost of doing so. On the positive side, the GAO report identified certain advantages for participants, such as the ability to consolidate the lump sum with other investment assets and the potential to leave a bequest to a non-spouse beneficiary. A significant factor for a participant might be the participant's health, as it might affect the projected life span of the individual. Therefore, the Model Notice was drafted to identify these factors.

As discussed in Subsection C above, it is significant for participants to know that they will not be able to purchase a comparable retail annuity with the lump sum proceeds. It is also important for participants to understand the challenges of investing a lump sum to produce lifetime income. The Issue Team struggled with attempting to identify a rule of thumb, such as the oft-quoted 4% rule, to assist participants in understanding the rate of return that would be needed to generate a lifetime income stream. However, it was concluded that there were too many variables in both investment and longevity risks to identify one rule of thumb that fits everyone. For example, it is impossible for an individual to know for a certainty how much income is needed for life when the date of death is not knowable. Also, an assumed uniform rate of return is not realistic particularly if a participant invests in the equity markets. During a steep downturn in the equity markets such as in 2008, if a participant is drawing retirement income on a lump sum, it may be difficult to recover the losses even after the market recovery given that withdrawals will have significantly depleted the initial investable base. For these reasons, the Model Notice provides a short narrative of the investment risks associated with the lump sum.

Several witnesses urged the Council to provide a simple guiding principle. Accordingly, based in particular on testimony by Professor Jonathan Forman of the University of Oklahoma College of Law, the Model Notice states that participants should consider whether they have enough guaranteed income from all sources to pay for basic living expenses, considering inflation, for the remainder of the lives of the participant and his or her spouse.

The Council was provided several graphs that demonstrated the investment risk of running out of money for a participant who invested a lump sum for a lifetime income stream. Each of these graphs had a set of assumptions which would not apply to all participants. Also, including the graphs in the Model Notice would extend the length of the Notice beyond what was felt would be read by most participants. However, the graphs were helpful for illustration purposes and thus included in this Report for participants who want to learn more.

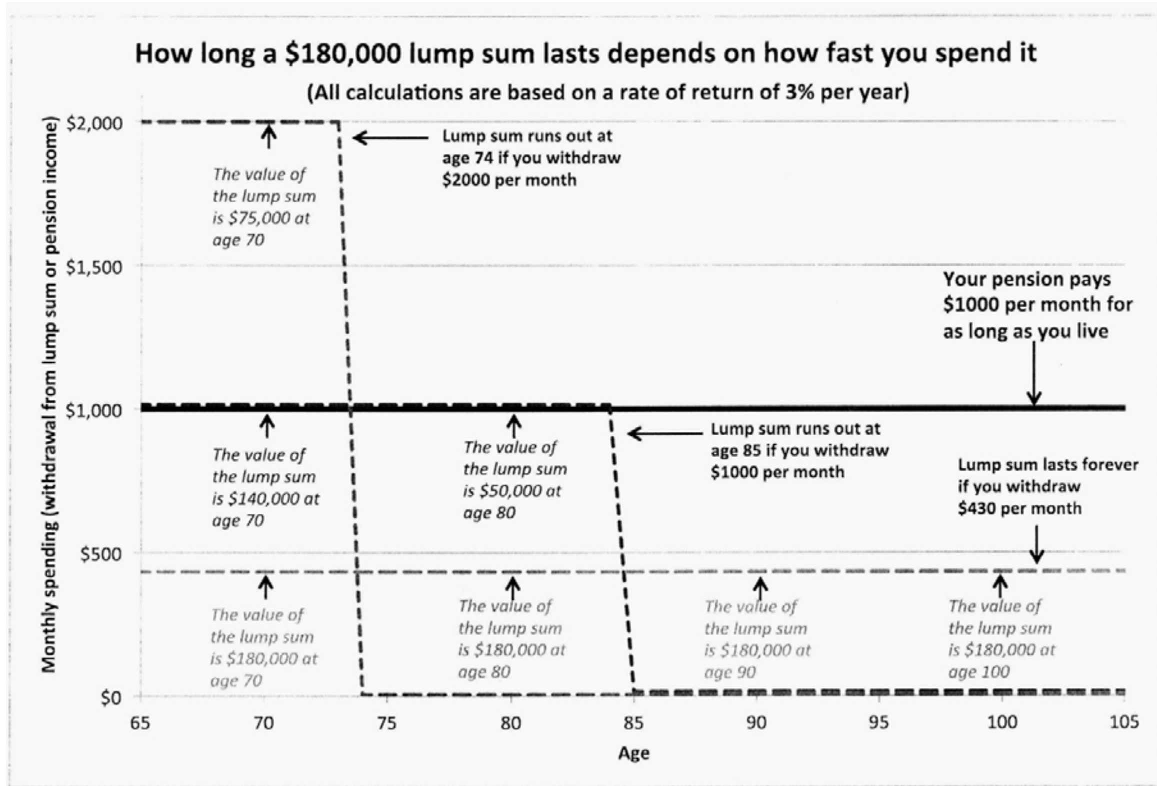
Potential Age When Benefits Would Stop with Lump Sum Spend-down Matching Plan's Monthly Benefit, by Various Rates of Return

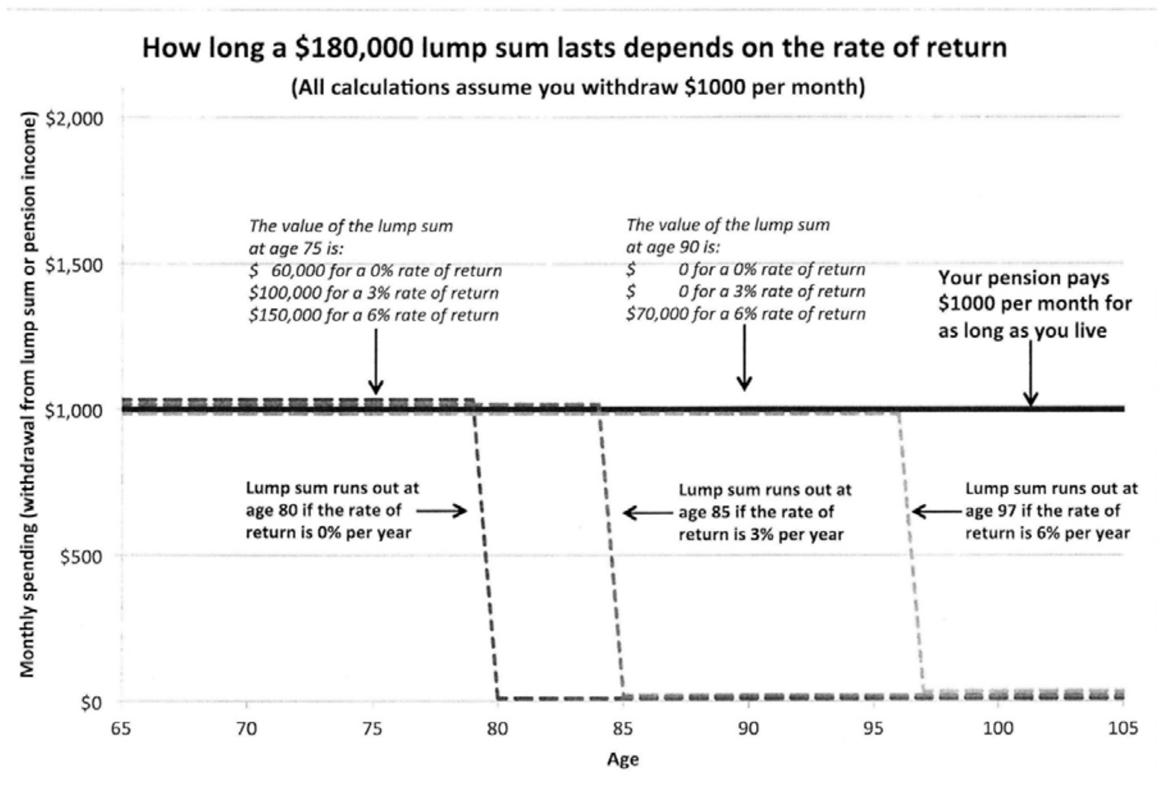


Source: GAO analysis. | GAO-15-74

Note: Hypothetical example of a 45-year-old participant who has accrued a future pension benefit of $10,000 per year ($833 monthly) starting at age 65, but who gives up the guaranteed lifetime pension benefit in exchange for a lump sum of $32,453. (Lump sum amount based on August 2011 § 417(e)(3) interest rates, and § 417(e)(3) mortality, for the 2012 plan year.) The hypothetical participant then rolls the lump sum into an interest-bearing account until retirement, and spends down the account, beginning at age 65, by the original pension amount of $833 per month.

This illustration from the 2015 GAO Report shows how long a lump sum could last an individual under different constant asset return scenarios and a spend down consistent with the plan's monthly benefit beginning at age 65.


How long a $180,000 lump sum lasts depends on how fast you spend it
(All calculations are based on a rate of return of 3% per year)
Monthly spending (withdrawal from lump sum or pension income)
$2,000
$1,500
$1,000
$500
$0
Lump sum runs out at age 74 if you withdraw $2000 per month
The value of the lump sum is $75,000 at age 70
Your pension pays $1000 per month for as long as you live
The value of the lump sum is $140,000 at age 70
The value of the lump sum is $50,000 at age 80
Lump sum runs out at age 85 if you withdraw $1000 per month
Lump sum lasts forever if you withdraw $430 per month
The value of the lump sum is $180,000 at age 70
The value of the lump sum is $180,000 at age 80
The value of the lump sum is $180,000 at age 90
The value of the lump sum is $180,000 at age 100
65
70
75
80
85
90
95
100
105
Age


How long a $180,000 lump sum lasts depends on the rate of return
(All calculations assume you withdraw $1000 per month)
Monthly spending (withdrawal from lump sum or pension income)
$2,000
$1,500
$1,000
$500
$0
The value of the lump sum at age 75 is:
$ 60,000 for a 0% rate of return
$100,000 for a 3% rate of return
$150,000 for a 6% rate of return
The value of the lump sum at age 90 is:
$ 0 for a 0% rate of return
$ 0 for a 3% rate of return
$70,000 for a 6% rate of return
Your pension pays $1000 per month for as long as you live
Lump sum runs out at age 80 if the rate of return is 0% per year
Lump sum runs out at age 85 if the rate of return is 3% per year
Lump sum runs out at age 97 if the rate of return is 6% per year
65
70
75
80
85
90
95
100
105
Age

The above graph was provided courtesy of Erzo F. P. Luttmer. The illustration shown above was based upon data from the 2015 GAO Report.

The Issue Team evaluated how long one could make a lump sum paid at age 45 last in retirement (based on a life annuity that would have been paid out of the plan of $1,000 a month or $12,000 a year) under certain simplistic scenarios where annual asset returns are assumed to be consistent from age 45 to 65 and adjusted thereafter for more modest returns in some scenarios. The scenarios show how long the lump sum could last when assuming the participant drew out the same $1000 per month beginning at age 65 annually as they would have received in the pension plan.

The interest rate and mortality assumptions for determining the lump sum are realistic for an individual receiving a lump sum in 2015.

The scenarios demonstrate the following:

1. If the participant did not invest the lump sum and therefore returned 0% for the entire period, and began drawing down the lump sum by $1,000 a month beginning at age 65, it would only last until age 69.

2. Keeping the pre and post 65 annual return assumption the same at the following rates, the lump sum would last until the following ages:
3% return lasts until age 74
5% return lasts until age 82
6% return lasts until age 93
7% return lasts beyond age 110
10% return lasts beyond age 110

3. Assuming that the post 65 return is reduced to 3% (regardless of the pre-65 return), the lump sum would last until the following ages:
5% return pre-65 reduced to 3% return after 65 lasts until age 78
6% return pre-65 reduced to 3% return after 65 lasts until age 82
7% return pre-65 reduced to 3% return after 65 lasts until age 87
10% return pre-65 reduced to 3% return after 65 lasts beyond 110

4. Assuming that the post 65 return is reduced to 0% (regardless of the pre-65 return), the lump sum would last until the following ages:
3% return pre-65 reduced to 0% return after 65 lasts until age 72
5% return pre-65 reduced to 0% return after 65 lasts until age 76
6% return pre-65 reduced to 0% return after 65 lasts until age 78

7% return pre-65 reduced to 0% return after 65 lasts until age 81
10% return pre-65 reduced to 0% return after 65 lasts until age 92

These calculations are intended to illustrate how sensitive the outcomes are to actual return scenarios. There are many additional scenarios that could be developed (e.g., the returns could vary year over year to reflect market volatility, or more aggressive or conservative returns could be used). Whether someone could benefit from taking a lump sum payment at an earlier age, such as age 45 shown in the illustrations, will depend on the investment abilities of the individual, their risk tolerance, their actual health and longevity, and their other financial resources, all of which are only knowable in hindsight.

The Issue Team also found helpful a chart of the factors to be considered in assessing an individual's ability and willingness to assume risk that was prepared by regulatory authorities in the United Kingdom:

Risk factor	Examples of what the firm is trying to find out	Risk warning required?
Consumer's state of health	Are there aspects of the consumer's health or lifestyle that would make them potentially eligible for a better value annuity – for example, an enhanced annuity?	If yes or unclear, give risk warning
Loss of guarantees	Will the consumer lose any guarantees attached to the pension?	If yes or unclear, give risk warning
Whether the consumer has a partner or dependants	Does the consumer have a partner or dependents who might benefit from a joint life annuity (where they are not already purchasing one)?	If yes, give risk warning
Inflation	If the consumer is seeking to buy a level annuity, do they understand that inflation will erode the real value of the income they receive from their annuity?	If no or unclear, give risk warning
Whether the consumer has shopped around	Has the consumer shopped around different providers before choosing to buy the product?	If no or unclear, give risk warning
Sustainability of income in retirement	Is the consumer expecting the money they take from the pension to help provide an income in retirement?	If yes or unclear, give risk warning
Tax implications	Does the consumer understand the tax implications of taking money from their pension savings?	If no or unclear, give risk warning
Charges (if a consumer intends to invest their pension savings)	Has the consumer considered how the charges they may face when investing their pension savings elsewhere compare with those on their pension savings?	If no or unclear, give risk warning
Impact on means-tested benefits	Is the consumer aware that taking money from their pension may impact on any means-tested benefits they receive?	If no or unclear, give risk warning
Debt	Is the consumer aware that creditors may have a call on any money taken from pension savings?	If no or unclear, give risk warning
Investment scams	Is the consumer aware that investment scams exist, and that they should be careful where they invest money taken from their pension savings?	If no or unclear, give risk warning

E. Key Information No. 5: Tax Consequences

- What are the tax implications of accepting a lump sum?
- How would the lump sum payment be taxed?
- What rollover options are available and what are the tax implications for each?
- Are there early distribution penalties?

The Council recognized, as did the GAO report, that a very significant factor that plan participants must take into account is the tax consequence of accepting a lump sum. Unless the sum is rolled into another tax qualified vehicle, the tax impact of taking a lump sum distribution could have a substantial adverse economic effect on the participant. Therefore, this issue was included in the draft notice. The so-called IRS 402(f) notice provides a thorough discussion of tax issues related to a rollover. The IRS has other helpful publications on the tax treatment of pension distributions.

F. Key Information No. 6: Guarantees of Pensions

- What is the role of the PBGC and what level of protection does PBGC provide on each benefit option?
- What is the PBGC?
- How much of the plan's monthly benefit would be protected by PBGC if the plan is terminated with insufficient assets to pay benefits?

Participants thinking of electing the company pension instead of the lump sum may want to know how safe their DB pension is, before they make a decision. The common advice to take the pension if one expects to live many years, but to take the lump sum if one is sure he/she won't live long, needs to be modified if the pension is at risk of not being paid.

Backed by the Pension Plan Assets: If the company pension plan is well funded (well over 100%), then participants are more likely to get their pensions for the rest of their lives, no matter how long they live, even if the company is weak.

Backed by the Employer/Sponsor: However, if a DB pension plan has a large allocation of funds in stocks (which is a common pension plan investment approach), then it has market risk. Even a plan funded over 100% today could be less than 100% funded in the future, if the stock market declines significantly. In that case, the company will have to contribute more funds into the pension plan, which depends on the strength of the company at that time. If the company is weak or in bankruptcy at that time, there is a third backstop – the PBGC.

Backed by the Pension Benefit Guaranty Corporation (PBGC): The PBGC is a federal agency that insures private sector defined benefit pensions. They take over at-risk pension plans to pay their benefits. Most participants are insured by the PBGC for their full pension paid for the rest of their life. However, that is not always the case, especially in pension plans that pay large benefits or supplemental early retirement benefits, or if the pension plan had greatly improved benefits in the prior five years. The maximum lifetime pension that the PBGC can pay is about $60,000/year for someone age 65 (and about half that for someone age 55). The maximum is reduced by another 10 to 20% if the pension continues for the life of a survivor. These limitations are complex; this report cannot cover all of these details. However, if there were no large benefit improvements in the prior five years, and no one above the maximum, and no early retirement supplements, then the full pensions will generally be guaranteed.

Note that the PBGC also does not guarantee the following types of benefits:

- Disability benefits, if the disability occurs after the pension plan terminates

- Benefits for which the age & service requirements have not been met at termination (e.g., special early retirement benefits)
- Shutdown benefits, if the shutdown occurs after plan termination
- Lump sums exceeding $5,000.

The PBGC has a website discussing these items under the heading "What Termination Means to You." In addition, pension plan sponsors are required to provide a slightly more detailed summary of their guaranteed and non-guaranteed benefits in their Summary Annual Report (SAR) which is tailored to their pension plan. The PBGC's own financial status is reported in detail in an annual report which is available to the public on the PBGC website.

Guarantees of Annuities from Insurance Companies: The Department of Labor has issued regulations on the selection of an annuity provider which includes a useful checklist for both plan sponsors and participants. See DOL Regulations Section 2550.404a-4.

The probability of a highly-rated insurance company going bankrupt is very low. However, if it does happen, it is important to know that each state in the United States (plus DC and Puerto Rico) has a guaranty fund with varying guaranty amounts for the citizens in their state. The amount for each state can be determined from page 3 of a document entitled "The Nation's Safety Net" issued by the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA).
https://www.nolhga.com/resource/file/NOLHGA%20Safety%20Net%202014.pdf

From that document, one can see that most states guarantee $250,000 or $300,000 of the value of an annuity, while three states guaranty less (Massachusetts, New Hampshire, and Puerto Rico only guaranty $100,000), while Connecticut, New York, New Jersey, and Washington guarantee more ($500,000). More up-to-date details on these guarantees can be found at the NOLHGA website. Note that if someone moves to another state, their guaranty will change to the amount in the new state.

It is difficult for most participants to convert a pension annuity to a lump sum. The state guaranty associations convert their limits to an annuity using their state's statutory discount rates and mortality tables, but these can be subject to arbitration and court approval. Applying the 417(e) discount rates and mortality tables, as a proxy for that, suggests that a $250,000 present value guaranty is likely to result in substantially lower protection than the guarantees provided by the PBGC.

G. Key Information No. 7 and 8: Instructions and Assistance

- What are the instructions for either accepting or rejecting the lump sum?
- What needs to be done to make either option?
- What is the deadline for the decision?
- Does a spouse need to grant consent for either election?
- Who can be contacted for more information or assistance?
- What is the contact method for questions?
- Is federal assistance available?

All witnesses stressed that instructions need to be presented in plain language because many plan participants are not financially savvy. The instructions should also be concise and easily accessible. The key item is to specify a contact for further information. For insurance company transfers, a contact at the insurance company, as well as the employer, is needed. Witnesses also advocated additional emphasis on spousal benefits. In general, the GAO report acknowledged that information provided in this area is sufficient based on their review of 11 packets of materials.

H. Special Problems and Information Needs of the Elderly

Annamaria Lusardi, economics and accountancy professor at George Washington University School of Business and founder/academic director of the Global Financial Literacy Excellence Center, testified that many older adults (in particular those 60 and older) display very low levels of financial literacy, perhaps due to age (a decline in cognitive abilities) or a cohort/generational effect, due for example, to the fact that older individuals lived in different economic circumstances and may not have been exposed to financial education in school and/or the workplace.

Stephen Silverberg testified that people in the oldest age group (80 and older) were 8 times more likely to have a disability than those in the youngest age group (younger than 15) - 71% had a disability compared to 8%. The probability of having a severe disability is 1 in 20 for those 15-24 compared to 1 in 4 for those 65-69 (e.g. 8.1 million had difficulty seeing and 7.6 million had difficulty hearing), which impacts the ability to understand and act on notices related to retirement income. To further impact this area, there is a lack of knowledge and expertise in state Medicaid agencies related to retirement and pension plans.

At least with respect to retired participants and beneficiaries, IRS Notice 2015-49 effectively prohibits future lump sum risk transfers for this population.

V. EFFECTIVE COMMUNICATION OF PLAN INFORMATION TO PARTICIPANTS

There are several issues relevant to assuring that information be effectively communicated to plan participants so they can adequately understand both the short-term and longer-term implications of a risk transfer transaction on their financial security. In particular, relatively recent research regarding behavioral finance or behavioral economics provides important insights in this area. This emerging field of study identifies impediments to rational decision making that may result in “less-than-optimal” choices. Plan participants who are presented with the decision to accept a lump sum in lieu of a series of periodic pension payments may make a sub-optimal choice. Accordingly, the Issue Team sought to understand various issues that could result in sub-optimal decisions by plan participants and their possible remediation. Specifically, the Council heard testimony regarding behavioral finance implications and limitations due to inadequate financial literacy. The Council also heard of the potential for breakthroughs in the use of electronic media. Innovative communication approaches might result in a more thorough and comprehensive understanding of the issues being presented in a risk transfer transaction.

The sections below explain the efforts made in these areas and summarize key findings resulting from both the written and oral testimony supplied to the Council.

A. Discussion of behavioral sciences

The term behavioral finance or behavioral economics applies to a relatively new field of study concerned with economic decision making by individuals and groups of individuals. In the past, many classical economic models assumed that individuals were rational decision makers who could be expected to pursue their own self-interest. The field of behavioral economics has shown that decisions by individuals and groups can be less than optimal. As such "behavioral finance and behavioral economics are fields of study that apply the use of scientific research techniques to understand social, cognitive, and emotional biases that affect and influence economic decision making." Oftentimes financial or economic decisions are impacted by how decisions are framed or presented. Also, when encountering particularly complex decisions, individuals often tend to make decisions based upon approximate or "rules-of-thumb" that are not strictly rational analyses.

The Issue Team was fortunate in identifying a study with direct relevance to risk transfer transactions recently completed by noted researchers. Researchers Jeffery Brown, Olivia Mitchell, Arie Kapteyn and Erzo Luttmer published a working paper entitled, "Cognitive Constraints on Valuing Annuities." In this study "a representative sample of about 2000 adults in the United States was asked to make several hypothetical choices between a lump-sum amount and the annuity with which they are most familiar, namely Social Security benefits."

In both written and oral testimony provided to the Council on May 28, 2015, Professor Luttmer summarized and elaborated upon the findings of the study with the following key points:

- For most people, choosing between an annuity and a lump-sum payout is a cognitively challenging task.
- Given that these cognitive challenges are inherent in the choice between an annuity and a lump-sum amount, better information by itself is unlikely to be enough to ensure that people make good choices.
- There is a solid economic case for risk related to defined benefit programs to be transferred from the employers to insurance companies, but only if such transfers do not lead to a decrease in the fraction of the participant's wealth that is annuitized.

Professor Luttmer then offered recommendations regarding information provision and choice architecture factors that allow pension-related risk to be transferred from employers to insurers while guiding participants to keep their defined benefit pension wealth annuitized.

B. Discussion of problems with financial literacy

In addition to the inherent difficulty that researchers Brown, Mitchell, Kapteyn and Luttmer documented as being inherent in the comparative valuations of lump sums and annuities when offered a choice between these alternate payment options, the Council was further cautioned that

the level of financial literacy within the general U. S. population is extremely low. This is particularly the case, indicated Annamaria Lusardi, ". . . when it comes to understanding and managing risk." Professor Lusardi further explained that her research has indicated "that most individuals do not possess the knowledge of the fundamental concepts that form the basis of financial decision making." She indicated that among the elementary concepts where knowledge is lacking are the workings of interest compounding and/or the effects of inflation. When these foundational concepts are not understood, it is difficult to argue that participants are well equipped to deal with sophisticated issues in managing longevity risk or long-term investment management of a lump sum.

Like the aforementioned researchers who studied decisions regarding trade-offs between annuity payments and lump sums, Professor Lusardi concluded ". . . it is unlikely that providing people with more information or the types of information that the GAO Report found missing when participants were offered a choice between a lump sum and annuitized benefits is going to substantially enhance the choice that participants will make." Nevertheless, Professor Lusardi's research also indicated "there are simple yet effective ways to provide information that help people in financial decision making."

Financial literacy challenges are magnified in the Latino community. Karen Richman's research demonstrates that, in general, those born outside the United States distrust the financial system and have a much lower participation in 401(k) plans. These individuals also have the highest propensity to cash out of retirement plans when changing employment or retiring. However, they do embrace financial education, and are major users of mobile apps and social media and the radio.

Professor Lusardi was not the only researcher to suggest that the way in which information was presented to participants was important for cultivating rational decisions. Professor Luttmer emphasized the importance "regarding information provision and choice architecture factors." Specifically Professor Luttmer found it important to "provide information in terms of the consumption or income stream that the participant would have under each choice, rather than in terms of the actuarial value of the choices." Professor Luttmer specifically stated:

> Because a pension offers longevity insurance, the value to the participant is greater than the actuarial value. However, focusing on the actuarial value of the pension encourages the participant to think of the pension as a financial asset rather than as a form of insurance, i.e., it puts the participant in the 'investment frame.' As a result, the participant can be misled into ignoring the insurance value and choosing the option with the higher actuarial value.

C. Use of electronic media

Among the methods Professor Lusardi identified as showing promise were instructional videos and an interactive visual tool that explained and conceptualized risk diversification. Though the findings from this research were preliminary at the time of the hearings, it was suggested "that these types of tools can help people understand financial concepts and learn how to apply them in making financial decisions." Based upon the favorable preliminary research findings

described by Professor Lusardi, the Council further was advised of innovative technologies for presenting the information deemed relevant for risk transfer participant decision making. However, the Council did not have the resources or the expertise within the limited time frame of the project's duration to develop a Model Notice using such technologies. The Council did seek further guidance from behavioral researchers, as described in the next section, and incorporated their findings into the Model Notices which comprise the appendices of this report.

D. Design elements based upon behavioral research

In the second round of hearings held by the Council, testimony was provided by behavioral researchers from *Morningstar* with assistance from a colleague at *ideas42*. Specifically, these researchers reviewed preliminary drafts of Model Notices developed by the Council and made recommendations for improving these communication materials. Some of the insights suggested by Steve Wendel and Aron Szapiro of *Morningstar* and Alex Blau of *ideas42* included the following:

- Using a four-part framework to assess the impact of the communications and to increase their effectiveness.
- Identifying potential obstacles to action and seeking to mitigate the seemingly minor details in the decision making environment that could hamper follow-through rates.
- Delineating the choices to be made and "explicitly making clear the actions that would be most advantageous to readers under each set of circumstances."
- Organizing the text, structure and language of the Model Notice to improve understanding.
- Identifying additional information whose inclusion would enhance understanding and facilitate more informed decision making.

Beyond providing a critique of the preliminary Model Notices developed by the Council, these researchers devoted time and effort to re-draft the preliminary Model Notices to incorporate their suggestions and to illustrate how effectiveness and clarity could be enhanced by using these techniques and findings from research studies. The Issue Team noted improvements in the re-drafted Model Notices and retained many of these suggestions as it further refined the Model Notices contained in the appendix of this Report. The Council greatly appreciates the generosity of time and expertise from Mr. Wendel, Mr. Szapiro, Mr. Blau and their colleagues at *Morningstar* and *ideas42* for the unique contributions they made to the development of the Model Notices.

E. Other helpful suggestions related to the Model Notices

As mentioned in the preceding section, as the Model Notices were preliminarily drafted and circulated to various interested parties for review, there were additional informational elements that were brought to the attention of Council that would be helpful to plan participants. Some of these items were not lacking altogether from the preliminary draft notices, but some items

needed greater emphasis or consideration. Among the items either added or subjected to increased consideration were: inflation risk, sequencing risk, spousal benefits, tax consequences, second languages and sensitivity to cultural differences among various people groups. The Council benefited greatly from the input of these interested groups and the individuals who commented or provided testimony. Wade Pfau, from the American College, was particularly helpful in highlighting the dangers of sequencing risk. He noted:

> Retirees experience heightened vulnerability to sequence of returns risk once they are spending from their investment portfolio. Poor returns early in retirement can push the sustainable withdrawal rate well below what is implied by long-term average market returns.

Several people provided testimony addressing the needs of plan participants. At the August hearings, a participant advocate panel included Karin Feldman from the AFL-CIO, Jane Smith from the Pension Rights Center and Cindy Hounsell from WISER. Various issues were highlighted by this group including the need to focus on spousal benefits and protections. Karen Richman, Ph.D., Director of Academic Programs, Institute for Latino Studies at the University of Notre Dame, noted the challenges in making Model Notices understandable to those whose native language is not English. Mary Ellen Signorille, Senior Attorney at AARP, not only commented on the preliminary draft notice as circulated, but subjected the notice to a readability test by measuring the complexity of word choices. Her testimony, as that of others, contributed to an effort to make the Model Notices clear in both content and language.

F. **Cybersecurity Issues**

The 2015 ERISA Advisory Council in consultation with Department selected two topics for examination: “Model Notices and Plan Sponsor Education on Lifetime Plan Participation” and “Model Notices and Disclosures for Pension Risk Transfers.” The scope statement for each includes a paragraph concerning cybersecurity/cybertheft. Specifically, “Recognizing that much, if not virtually all, of today’s pension information is maintained electronically, the Council intends to devote some of its time to looking at cybersecurity and cybertheft issues and how such issues might inform the Council’s work in notice and disclosure in the context of lifetime participation and risk transfers and/or how such issues might inform an area of study by a future Council.”

At the hearings on May 29, 2015, four witnesses were asked to address the cybersecurity issues in the scope documents and the following questions: “What security and privacy risks must retirement plans in the U.S. address with the procedural prudence required of them under ERISA, particularly as it relates to the electronic maintenance, storage and transmission of information necessary for Plan participants to make informed decisions with respect to risk transfer transactions or lifetime plan participation? How would you suggest Plan administrators and fiduciaries protect the Plan and the Plan participants from those risks? We intend to focus witness testimony on those basic questions. Specific experiences and advice with respect current and emerging risks specific to retirement plans are most welcome. However, experiences and lessons learned from other industries, such as financial services and health care, are also welcome.”

The Council reviewed the written submissions of the four witnesses and heard their testimony. The Council, after discussion on the presentations, concluded that although cybersecurity and cybertheft issues are of growing concern and of vital importance to proper plan administration, this is not a topic that can be addressed adequately within the confines of the scope statements on the two topics for 2015. Therefore, while the Council decided not to hear further testimony on the topic, it recommends that this topic be pursued by a future Council as its own topic, thereby permitting a fuller exploration.

VI. CONCLUDING OBSERVATIONS

It is important to provide sufficient information to plan participants in an understandable form when participants are offered a choice between annuity payments through their qualified defined benefit pension plan or a lump sum distribution in lieu of the annuity payments in a risk transfer transaction. There is a need for clarity in describing to plan participants the issues and implications when plan sponsors choose to transfer benefit obligations to insurers. Better information presented in a more understandable form is both necessary and achievable in these areas. Providing clear and understandable information is possible notwithstanding the complexity of these risk transfer transactions, the future uncertainties concerning the economy and interest rates, and the myriad challenges in effectively communicating relevant information across a diversity of knowledge bases regarding financial literacy.

The 2015 Council was immeasurably aided in its efforts to draft effective Model Notices by the prior efforts of the 2013 Council and the study conducted by the GAO. The 2015 Council also believes that future enhancements could be made to these Model Notices if delivered using innovative technologies and approaches suggested by behavioral researchers. To the extent that the Model Notices developed by the Council are adopted by plan sponsors and contribute to better financial decision making by plan participants, the U.S. private pension system and the financial security of workers will be improved and strengthened.

VII. APPENDIX

A. Lump Sum Model Notice
B. Insurance Company Risk Transfer Model Notice

LUMP SUM NOTICE --
ERISA Advisory Council November 2015
=================
[Note to plan administrators and plan sponsors: This notice should be provided to participants a minimum of 90 days prior to the effective date of the risk transfer decision date along with the initial communications related to the transaction, but in a separate document.]

YOUR RETIREMENT OPTIONS

Overview

Your employer, [Company Name], is offering you the choice between keeping your current pension or receiving a one-time lump sum payment. The choice is up to you, and this notice is based on a model developed by the Department of Labor (DOL) to provide factual, unbiased information about that choice.

Here is the choice you are asked to make:

1. If you want to keep your pension, you do not need to take action at this time. In retirement, you will receive monthly income for the rest of your life (and your spouse's life if you are married); or

2. If you want to give up your pension, you can take your money out now in a lump sum. [One sentence description of what the employee needs to do under this option, such as: To do so, you'll need to fill out a form that your employer provides.] Note -- in many cases, a lump sum will not give you as much income for the rest of your life (and your spouse's life). [Note to plan sponsors: it may be useful to include a Lifetime Income Estimator here. An example of such a calculator is shown in this hyperlink: https://www1.cannex.com/scripts/c22484.asp]

The deadline for your decision is [date]. The rest of this notice provides additional information about these two options.

Common questions

The following table answers common questions that people ask about receiving a one-time lump sum payment versus receiving a lifetime of payments from a pension.

	Lifetime Pension Payments	**Lump Sum**
Will I receive guaranteed income for the rest of my life?	Yes*	No, unless I buy an annuity**
What if I live longer than expected?	I will continue to receive my monthly income	I may run out of money
What happens if my company is not able to meet its pension promise?	Your pension payments are protected*	The lump sum you've already received is not affected
How is the money distributed?	In a series of lifetime monthly payments	All at once
Am I personally responsible for investing the money?	No	Yes
What if the market falls?	My monthly benefit is the same.*	I could end up with less money
Do I pay investment management fees?	No	Yes
What is taxed?	I am taxed as I receive my monthly income	I am taxed on the full lump sum unless I roll it over into an IRA or other qualified plan (IRA withdrawals are taxed when they occur)***
What if I have an urgent need for money?	You cannot take out your money	The lump sum may provide access to some money depending on how it was invested
If I die earlier than expected, can I leave anything for my spouse and children or charity?	Yes, if I chose a survivor benefit (but not to charity)	Only if there is unspent money when I die

* Payments from your pension plan are backed by the assets in the plan, your employer, and the Pension Benefit Guaranty Corporation, subject to certain limits.
** An annuity purchased in the insurance market will generally provide less income than your plan's pension.
*** See also IRS rules on required minimum distributions from an IRA when you are retired and past the age of 70 1/2.

Which might be better for me?

One of the most common questions people ask, of course, is "which might be better for me?" While there are no blanket answers to that question, the following rules of thumb are useful places to start:

- If you do not have enough guaranteed income from other sources, such as Social Security and other pension plans or assets, to pay for your (and your spouse's) costs in retirement (e.g. medical, housing, vacation, etc.) - then keeping your pension may be a good idea.
- If you already have more than enough money for retirement – then the lump sum may provide more flexibility, even though you could receive less money overall.
- If you or your spouse is likely to live longer than average - then a pension is generally better. The money from the lump sum can run out before you and your spouse die.
- If you or your spouse is uncomfortable making investment decisions or calculating complex financial models - then a lump sum may not be a good choice for you.
- If you are currently in a dire medical or other financial emergency - then a lump sum can help cover that emergency. However, once the lump sum is gone it will not help you if a future emergency arises.
- If both you and your spouse do not expect to live a long time - then the lump sum may be more valuable than the pension.
- If you are young and years away from being able to start receiving your pension and worried that inflation will decrease its value - then investing the lump sum might result in more income. However, you must be comfortable with managing your money over a long period of time, even when you are old.
- If your pension plan includes early retirement or spousal benefit subsidies and you were planning to take advantage of these features, but these are not included in the lump sum (see the answer to question 2 below under Additional Questions and Answers) - then your pension annuity may be more valuable to you than the lump sum.

Lump sum payments often *look* much larger than a pension. However, unless you meet the particular criteria described here, you could end up receiving less money in the long run.

Detailed Information about This Choice

1) A pension provides guaranteed lifetime income. With a lump sum, you may not be able to generate income for the rest of your life.

The pension provided under your Plan is a monthly guaranteed paycheck to help you avoid running out of money before you (and your spouse) die. By choosing a lump sum, you are giving up that guaranteed lifetime income. To duplicate the pension payments on your own for the remainder of your life and your spouse's life, you must be able to invest the lump sum to provide you and your spouse with equivalent lifetime income.

2) It is difficult to invest the lump sum to provide equal lifetime income.
Investing on your own is challenging, even if you work with a trusted financial advisor, and you might incur high fees. Have you or your spouse had any experience investing your money on your own? If not, do you want to start now? Your investment will go up and down with the market. Over your lifetime there will be good periods and bad periods. You have to be able to handle these bad times. Even if you are a good investor now, financial skills for many people deteriorate as they get older. If your spouse outlives you, will your spouse be able to handle the investments? And, don't forget that you also have to manage your investments so that you can take money out each month. If you take out too much, you will run out of money.

3) You will want to make sure any advisor working with you has your best interests in mind.
It is sometimes a good idea to work with a trusted financial advisor to help you make important decisions such as whether to take the lump sum or the pension, or how to invest any money that you have control over. If you use a financial advisor, you will want to understand how much they charge and whether they may have a conflict of interest. You may wish to review the Department of Labor proposed regulations on conflicts of interest of financial providers to participants who roll over lump sums to an Individual Retirement Account at: ***http://www.dol.gov/ebsa/newsroom/fsfiduciaryoutreachconsumers.html*** .

[Employer to provide details if independent financial advisors will be made available to participants to assist with issues related to making a decision].

4) Buying an annuity with the lump sum will likely be worth less than the plan's pension.
Generally, payments from an annuity that you purchase on your own will be smaller than the annuity payment provided by the Plan. This is a complicated topic, but there are a number of reasons, which are summarized below. If you wish to make your own comparison between the pension and the annuity you might purchase, be careful to make an "apples to apples" comparison between the Plan's pension and the purchased annuity. The following link contains a tool which can be used to estimate the annuity you could purchase on your own: [Employer to insert tool, such as the tool in this link https://www1.cannex.com/scripts/c22484.asp]

(a) The insurance company will charge a fee for an annuity you purchase on your own while there is no fee for the monthly benefit you would receive from the pension plan.
(b) Insurers assume that people who purchase annuities are generally healthy and expect to live longer and the price of the annuity is increased to take this into account.
(c) Women generally live longer than men, which will result in a more expensive annuity than the plan would provide.

5) You may have to pay additional taxes if you take a lump sum
You will have to pay taxes immediately (plus a 10% penalty the IRS levies on people younger than 59 1/2 who cash out retirement assets), unless you roll over the funds into an IRA or another qualified pension plan in compliance with IRS rules. In that case, you will be taxed when you later withdraw the funds from the new account. It is worth noting that rollovers can take two forms. In a direct rollover, the individual instructs the plan trustee to transfer funds directly to

the IRA or qualified plan and the transaction is complete. With an indirect rollover, the individual receives a check from the plan trustee which has been reduced by a mandatory 20 percent federal withholding tax. In order to complete the rollover within the allowable 60 days, the individual must deposit into the IRA or qualified plan both the amount of the check received and the amount of the tax withholding. Individuals receive a refund of the 20 percent withholding when they subsequently file their tax return. If the individual does not fund the additional 20 percent from personal funds, he or she would owe tax on the 20 percent shortfall for the current tax year. You may wish to consult a financial advisor to discuss your specific tax situation. Guidance on the federal tax consequences of a lump sum distribution is provided in IRS Publication 575 titled "Pension and Annuity Income" (2014) which is available at: ***http://www.irs.gov/pub/irs-pdf/p575.pdf***

6) **Taking a lump sum can have additional ramifications**
You may want to talk to your own professional advisor about the consequences of this decision (which can depend on your state or county). For example, if you roll over your lump sum to an IRA, it may not be protected from bankruptcy or your creditors anymore, while the pension was protected. In addition, state tax laws may tax lump sums, but not pension payments. Similarly, state law could prohibit you from receiving Medicaid, until you spend down a lump sum to a small amount.

Additional Questions and Answers about Your Pension

1) What are my benefit options under the Plan?
If you do not elect the lump sum, your benefit options under the Plan are [to be provided by the employer] [include earliest and Normal Retirement Age single life annuity and Qualified Joint and Survivor Annuity benefits].

2) Is the company offering a subsidy for early retirement and/or spousal benefits?
A pension plan may include special subsidies to pay for spousal benefits or to encourage early retirement. These subsidies may not be included in the lump sum, lessening its value in comparison to a stream of payments from the pension. Your Plan [does/does not] provide a "subsidy" (a benefit of greater value) which [is/is not] included in the lump sum. [Employer to revise as needed].

3) How was my lump sum calculated?
The lump sum amount represents the current value of your pension, based on certain assumptions. The lump sum is calculated by adding up the value of each monthly payment you would receive with the pension, based on the chances that you would live to receive that payment and an interest rate assumption. The assumptions used in calculating your lump sum comply with the minimum lump sum rules and are shown here: [Plan Sponsor to insert the mortality table used, the interest rates used, and the date of the interest rates in effect]. A lump sum may not be a "better deal" even if you believe that you can earn higher rates of return in the future than the interest rates used to calculate your lump sum. Even if you are able to generate high average returns over an extended period, your ability to have higher income over a lifetime

relative to a pension payment can still be challenging if markets are very choppy (i.e. lots of ups and downs) and/or you are fortunate to live longer than is typical.

4) Is my pension insured and what levels of benefits are protected?
Your pension is guaranteed by your employer and backed by the assets in its pension fund. When a pension plan fails, the Pension Benefit Guaranty Corporation (PBGC) steps in and pays benefits, subject to limits set by law. Most people receive all, or close to all, of the benefits earned before the plan failed. Detailed information on the PBGC insurance program is available at the PBGC's website: ***http://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee.html***

5) If I am still not sure what to do, where can I get additional help?
You could seek the help of a financial advisor. The employer offering you this choice may be offering access to advisors to help you with your decision, or you may want to seek out additional help on your own. If you use a financial advisor, you will want to understand how much they charge and whether they may have a conflict of interest. You may wish to review the Department of Labor website at:
http://www.dol.gov/ebsa/newsroom/fsfiduciaryoutreachconsumers.html

For more detailed information about risk transfer transactions, the 2015 Report of the ERISA Advisory Council on Risk Transfer Transactions, and the 2013 Report of the ERISA Advisory Council on Derisking Transactions are available to the public on the Council's website and the January 2015 Report of the U.S. Government Accountability Office (GAO) on Derisking which is available on the GAO website (*www.gao.gov*)

INSURANCE COMPANY RISK TRANSFER NOTICE –
ERISA Advisory Council November 2015
==

UPDATE: [Short Name of Insurance Company] Will Deliver Your [Name of Employer] Pension Benefits

Overview

This notice is for employees who receive pension payments from [name of employer], or who will receive them in the future. [Name of employer] has transferred the pension payment obligation to [name of insurance company] to deliver your regular pension payments starting on [date], under a "group annuity contract." This notice provides basic information about the change.

For more information about this change, you can contact:

[Employer to provide the primary contact at the employer and the insurance company, with name, title, email address, and phone number]

In brief:

1. The company that sends monthly payments will now be [name of insurance company].
2. The amount of money you receive will stay the same.
3. Your pension will no longer be guaranteed by the employer or the federal government; instead it is covered (up to certain coverage limits) by state life and health insurance guaranty associations.
4. If you have not retired yet, contact [name of person] at [employer name] and [name of person] at [insurance company] to make sure they have the correct information about you to calculate your payments – including your age, salary, date of hire, and any survivors benefit you and your spouse have chosen.

Frequently Asked Questions

What happens to my pension when it is transferred to an insurance company?

Instead of receiving your pension annuity from your employer's pension plan, your pension will be converted to an annuity paid by [name of the insurance company]. Like a pension provided by your employer's plan, the annuity provided by [name of the insurance company] offers protection from the risk that you could run out of money before you and your spouse die.

Will the amount of my pension benefit change?

You will receive the same amount from the insurance company that you receive from your pension plan. If you are already receiving your pension, the amount of your benefit check paid to you by the insurance company will be the same as the pension you are currently receiving from the Plan.

If you have not yet retired, to ensure you receive everything you are owed you should:

- Make sure your employer and the insurance company have the correct information about you, including your dates of employment, salary history, and any survivor's benefits you and your spouse have chosen.
- Make sure that you have the most recent copy of your individual benefit statement from your employer, in case there is any discrepancy in how much monthly income you should receive once you start receiving your benefit.

Will my pension continue to be protected?

Yes, but your pension protections will change. Your benefits will no longer be protected by the assets in your employer's pension plan or by the federal pension insurance program, the Pension Benefit Guaranty Corporation. Instead insurance companies are regulated at the state level to make sure they have sufficient funds to pay their obligations. Additionally, state guaranty associations provide protection in the event that insurance companies fail.

What state level protection exists?

Every state, the District of Columbia, and Puerto Rico, has a Life and Health Insurance Guaranty Association, a nonprofit institution established to protect insurance policyholders who live in that state in the event that an insurance company becomes insolvent. All insurance companies licensed to write life and health insurance or annuities in a state participate in that state's Life and Health Insurance Guaranty Association. Policyholders will be covered by the Life and Health Insurance Guaranty Association in the state where the individual resides, assuming the insurance company is licensed in that state. If the insurance company is not licensed in the state where you reside, you should be covered by the guaranty association of the state of domicile of the insurance company. You can contact your state insurance department to find out if the insurance company paying your annuity is licensed to operate in your state. You can get more information about your state Life and Health Insurance Guaranty Association via links on the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) website www.nolhga.com.

What are the guarantee limits for an annuity from an insurance company?

Guarantee limits vary by state. Each state sets its own rules for claims. You can consult the NOLHGA website for more information. If the value of your benefit exceeds the amount protected by your state's Life and Health Guaranty Association, you can submit a claim for the excess in insolvency proceedings against the liquidated company. Your coverage would be based on the value of the future income stream of your annuity payments in today's dollars.

How can I assess the financial health of an insurance company?

Insurance companies file an annual report which is available on their websites. In addition, you should know that your employer has a fiduciary obligation under ERISA to consider the financial health of the insurance company which they select.

Where can I find more information?

[Employer to provide a contact at the employer as well as a contact at the insurance company, including contact names, titles, email addresses, and phone numbers.] For more detailed information, the 2015 Report of the ERISA Advisory Council on Risk Transfer Transactions, and the 2013 Report of the ERISA Advisory Council on Derisking Transactions are available to the public on the Council's website http://www.dol.gov/ebsa/aboutebsa/erisa_advisory_council.html