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Putnam Investments' Response to DOL Advance Notice of Proposed Rulemaking on Lifetime Income Illustrations

We thank the Department of Labor (DOL) for the opportunity to provide comments on the Advance Notice of Proposed Rulemaking regarding the proposal to require lifetime income illustrations on pension benefit statements under section 105 of ERISA. Putnam Investments considers itself a leader in regard to enabling 401(k) participants to focus more clearly on their estimated monthly income in retirement. We have twice had the opportunity to share our approach with staff members of the Department of Labor in Washington.

Now several years into our efforts to assist participants in making better retirement savings decisions through a focus on estimated monthly income, we would like to share our approach and insight in this area as the DOL moves forward with rulemaking. Based on Putnam's experience, we recommend that the DOL consider a number of modifications to the proposed rules described in the advance notice. These include:

- Allowing greater flexibility in income projection and balance conversion methodologies so as to enable greater personalization for participants. Also allowing consistency between the numbers reported on pension benefit statements and those presented through innovative user experiences that some providers are already offering or developing.

- Avoiding the establishment of rigid safe harbor methodologies and assumptions that could well calcify into de-facto industry standards and potentially undermine current and future innovation by providers intended to help participants estimate their income in retirement.

- Eliminating the requirement that an income amount be reported based on the participant's current balance. We view this as largely meaningless to most participants and likely to shift focus away from their long-term savings plan and toward their current balance. We believe that this would be a step in the wrong direction.

Putnam President and CEO Bob Reynolds has repeatedly stated that, "The best measure of success for any retirement system is its ability to reliably replace — for life — the income people made while working."

With this principle in mind, Putnam's approach to the 401(k) marketplace has been to build an interactive, online user experience for plan participants that seeks to move their focus away from just current account balances and allocations and toward their estimated monthly income needs in retirement. Our goal is to help motivate plan participants to make better savings and investment decisions that will lead to more successful retirements.

In 2010, we rolled out our Lifetime Income experience built around Putnam's Lifetime Income Analysis Tool (LIAT). LIAT aims at creating a qualitatively different way for participants to experience and interact with their retirement savings plan. It provides a personalized estimate of the participant's retirement savings plan including current balances, future employee contributions and company matches, and projected Social Security benefits; outside retirement savings, if provided by the participant, are also factored in.

The analysis is based on a retirement age selected by the participant and on investment returns that reflect the actual asset allocation of the participant's account, and uses stochastic ("Monte-Carlo") models. The income estimate is based on gender-specific mortality tables and assumes periodic withdrawals from savings that remain invested throughout retirement. All results are presented in today's dollars, better enabling participants to understand and analyze the results.

Through LIAT, participants are able to compare their personalized income needs in retirement with their current progress toward meeting those needs. Participants can immediately model and assess the impact of the changes they can make to their savings (deferral amounts), retirement age, and investment mix (asset allocation). And with one action — in a meeting, by phone, or online — they can confirm these changes effective as of their next paycheck.

The Lifetime Income Analysis Tool is designed to move participants away from an often paralyzing discussion of how they need to save millions of dollars in order to successfully retire toward an understanding of the long-term impact of their current saving behavior within their plan — along with specific, actionable steps they can take to help improve it.

Through this whole effort, we have learned that:

- Participants better understand and respond to monthly income retirement stated in current dollars than to a simple statement of total retirement plan balances and allocations (which are, however, also available on our site).

- While estimates may not always be precise, they can and should be personalized to individual circumstances in order to provide meaningful information to participants.

- Comparison of the monthly income participants are on track to create with the amount they are reasonably estimated to need in retirement creates a powerful motivation for them to "close the gap" — most often by increasing their savings rate, which is, in our view the dominant variable in determining retirement readiness in the future.

- 30% of individuals who use the Putnam experience, including the Lifetime Income Analysis Tool, change their deferral rate, and 8 out of 10 of them increase the amount they are saving. On average, deferral rates among such participants have increased by 18%.

Putnam supports the spirit behind the DOL's Advance Notice of Proposed Rulemaking regarding lifetime income illustrations — namely, to show participants their plan balance converted into a projected monthly income stream in retirement. However, we do have concerns that the rule proposes a highly standardized approach that, among other factors, utilizes a fixed retirement age and investment rate of returns that are not based on the actual asset allocation of participant accounts. We are also concerned by the exclusion of Social Security benefits and outside retirement assets from the proposed projection.

In addition, we are quite concerned about the fact that the only allowable approach for converting balances to income is annuity-based. Since the vast majority of participants do not annuitize their retirement savings at retirement, this conversion approach provides a number that may not be relevant to most participants' experience. Further, we believe that even for those retirees for whom annuitization may make sense, it is unlikely that annuitizing their entire savings balance will be an optimal solution for all.

Further, the proposed annuity-based conversion process is unlikely to generate an accurate income estimate. First, it is based on currently prevailing interest rates. It seems unlikely that current rates would be a good estimate of prevailing rates for a participant not planning to retire for 20 or 30 years. This is particularly true today during this period of artificially low rates, when estimates will likely understate the actual income potential for future retirees.

Even more concerning is the fact that the annuity conversion method described does not include costs. Annuities tend to be rather costly financial services products and often it is the underlying costs of these products that lead retirees to conclude that alternative methods of converting their savings into income are preferable. The exclusion of such costs could, ironically, lead to an overestimation of the monthly income a participant is on track to create — and thus have the unintended consequence of leading participants to save less than they need to.

The rule as described in the Advance Notice would require Putnam retirement plan clients' benefit statements to reflect numbers that are different from those participants are provided today on the plan's website through our Lifetime Income experience. This difference will create participant confusion, require explanation and most importantly, divert participant attention away from a process and approach that we believe is clearly working today.

As such, we strongly recommend that the DOL provides significantly greater flexibility in both the projection and conversion methodologies such that highly personalized, more accurate projections like those calculated through Putnam's Lifetime Income Analysis Tool can be shared on statements as a means of meeting these proposed regulations.

Under this scenario, we would see the inclusion of these projections on statements as a further opportunity to engage participants in a Lifetime Income experience with clearly demonstrated positive results. It is worth noting that current FINRA rules do not allow us to use our current projections on statements because the investment returns we project are calculated using a stochastic methodology. Therefore, in addition to broader methodological flexibility, we would look to the DOL to coordinate with FINRA to allow the results of these methodologies to be presented on statements.

In conjunction with greater methodological flexibility, we would ask the DOL to reconsider the establishment of safe harbor assumptions — as opposed to allowing a multiplicity of "reasonable" income projection methods.

The codification of safe harbors would very likely have the effect of establishing standardized practices within the industry for the calculation and reporting of monthly income projections. To gain the protections provided by these safe harbors, plan sponsors will likely want to follow them (and require their providers to follow them for their plan's pension benefit statements) even if they are less personalized, accurate, and useful than those that could otherwise be delivered by their plan provider.

Clearly, this could have the unintended effect of shutting down innovation in this area, just at the point in time when providers like Putnam are demonstrating the positive benefits of innovation. To replace and undercut current and future innovations with less personalized and actionable results seems to us to be a step in the wrong direction.

As to the specific safe harbor assumptions proposed, in addition to the concerns raised earlier, we have a particular concern about the rate-of-return assumption used in the projection methodology. By using a fixed rate of return, the methodology completely ignores the asset allocation of the participant's account. Surely, a 7% rate of return assumes a very high allocation to equities that is not indicative of the actual allocations of many participants. In fact, many might consider 7% to be aggressive — even for an all equity portfolio.

Further, the fixed rate-of-return assumption ignores investment risk. Suggesting to participants that they can comfortably expect a 7% return year in and year out on their retirement savings could well lead them into a false sense of security about the value of their future retirement savings. As a result, it may lead them to make less than ideal decisions about their investment allocations and savings rates.

Our final concern is with the requirement that monthly income calculations be reported based on both current and projected balances. In our view, a monthly income calculation based on projected balances makes the most sense since it demonstrates to the participant the value of sticking to a long-term savings and investment plan.

A current balance-based calculation, on the other hand, would be largely meaningless to the vast majority of participants, except those that are very close to retirement. Worse yet, for younger participants whose projected incomes based on current balance will typically be very small, such an estimate could have the same demotivating effects we see today when participants compare their current balances with the multi-million dollar savings numbers that balance-based retirement savings calculators generate.

The goal of presenting monthly income calculations to participants should be to encourage better long-term savings and investment decisions. In our experience, income estimates based on balances and contributions projected forward to a personalized retirement date are highly effective in achieving that goal.

In conclusion, Putnam Investments welcomes and supports the DOL's efforts to present monthly income in retirement calculations to participants. However, we believe that in order to avoid undercutting the current benefits of innovation in this space and discouraging future innovation, it is critical that the final rules be modified to allow greater methodological flexibility, avoid safe harbor assumptions that may codify less than ideal standards, and focus on those numbers that are most likely to motivate positive savings and investment decisions by participants.

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