AARP Real Possibilities

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Via e-ORI@dol.gov

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

Attention: Lifetime Income Illustration
29 CFR Part 2520
RIN 1210-AB20

Dear Sir and Madam:

AARP appreciates the opportunity to comment on the Advanced Notice of Proposed Rulemaking (ANPRM) by the Departments of Labor (DOL) on the issue of lifetime income illustrations in periodic pension benefit statements of defined contributions pension plans such as 401(k) and 403(b) plans.

As the largest nonprofit, nonpartisan organization representing the interests of Americans age 50 and older and their families, a major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets to supplement Social Security. Millions of our members are employed, full or part-time, with many participating in employer-provided retirement plans. The shift away from defined benefit pension plans to defined contribution plans places significant responsibility on individuals to make appropriate decisions concerning their contributions, their investments and how they will manage their money once they retire so that they will have adequate income to fund their retirement years. Information helping participants to make informed decisions is crucial to their retirement security.

General Comments

We are concerned that - unlike the benefits they have earned in Social Security - many Americans will outlive the retirement assets they have accumulated in 401(k)-type plans due to both inadequate savings, and the combined effects of inflation, longer life expectancies and the overly optimistic assumptions many individuals make when spending down these assets. Effectively managing this decumulation phase of retirement can be especially complicated, but it is essential for the long term well-being of the millions of American workers whose retirement security will depend on a combination of Social Security and the effective management of assets in their 401(k)-type plans.

AARP is therefore pleased to support the purpose of this ANPRM – providing individuals with a better understanding of the lifetime value of their 401(k) plan assets by including in a yearly benefit statement a conversion of their total accrued benefits into a monthly dollar amount as if they had opted to receive a lifetime annuity or similar product. Faced with a lump sum of retirement savings that may be a much higher amount than an individual has ever had and little or no practical experience about how to translate that amount into an income stream, it would be very easy for a worker to assume that he or she is much better prepared for retirement than is actually the case. The proposed income illustration would help them make earlier and better decisions about how much they may need to save and how best to manage their retirement assets.

We do not anticipate that requiring these illustrations and the disclosures that must accompany them will impose anything more than a nominal cost to employers and plan administrators. Most of those costs would come from developing the illustrations and redesigning the statements on which they appear and would come in the short run. The cost of continuing to provide these statements should therefore be minimal. Costs would be even lower if the DOL provided both a uniform formula for determining the regulatory safe harbor illustrations and model language for the disclosures. In addition, protection against liability for employers and plan administrators that use the model language or appropriate alternatives would be helpful.

The Proposed Illustration Should Include Projected Savings Balances

The major goals of the proposed regulations should mirror the three purposes contained in the ANPRM, namely that they should be meaningful to participants and beneficiaries, cost effective for plan administrators, and not disturb current best practices or stifle innovation. One question raised in the ANPRM is whether the proposed income illustration should include income projections for both the current retirement savings balance and projected future balances.

We strongly believe that including both current and projected balances would be most useful, especially for younger savers.

Including income illustrations for both current and projected retirement savings balances would have a greater incentive effect than just including current balances. For younger employees, the very small amount of income that would be produced from their current retirement savings balances may discourage them from further savings and thus have the opposite effect of what is in their long-term best interest and the objective of this disclosure. Including an income illustration for projected balances that assumes continued participation provides a clearer picture of the extent to which the amount that the individual is saving will meet his or her retirement income needs. However, as discussed below, additional and innovative illustrations may be even more effective in encouraging employees to save sufficient amounts and should be encouraged.

We agree with the ANPRM that an income illustration expressed in current dollars is preferable to one that includes the effects of inflation. The current dollar illustration will better enable savers to compare their projected retirement income with their current standard of living. If an illustration is expressed in terms of inflated future dollars, it is very likely that a number of recipients will be misled into believing that they will be much better off than they actually will be and end up saving far too little.

As the ANPRM recommends, for a married saver an income illustration showing the surviving spouse's benefit from a joint and survivor annuity would also be an important feature. Given that the law in most instances requires that married retirees choosing an annuity include a survivors' benefit for their spouse, such an illustration would both be more accurate and would serve as a reminder of the legal requirement. Adding this additional feature of the income illustration need not be more burdensome for the employer or the plan administrator if they are allowed to base the employee's marital status on the worker's federal income tax filing status.

As mentioned above, an illustration of projected retirement income based on the individual recipient's current and projected balance would be a helpful tool that could help the participant to better plan for their retirement security. However, there will be a temptation to accompany this illustration with a homogenized statement that attempts to describe post-retirement income needs. We believe that it would be impractical to include such "one size fits all" guidance. The diversity of individual and family circumstances, lifestyles, and life philosophies suggest that there are too many variables to permit a clear process for determining the standards that would be necessary ingredients to formulate such a statement. Instead, it would be better to include a brief statement noting that the aggregate amount of income that they will need from the combination of Social Security and other resources may be higher than many people anticipate. In order to encourage people to develop their own estimate of what income they will need in retirement, the annual statement could also include a reference or website where they can determine the amount they will need for themselves. Ideally, that source might be an interactive calculator on the plan, employer's or trusted third party's website that would enable participants to work out a personalized estimate of their retirement income needs.

Disclosures are Important, But Should Not Obscure the Illustration

Creating the income illustration requires many assumptions and calculations, and those assumptions must be disclosed, preferably in clear, understandable language that avoids either legal or financial jargon. In addition, there must be a clear and prominent disclosure that the illustration is an estimate, and not a guarantee of a specific income level once the worker reaches retirement age. And if the specific plan does not offer retiring participants an annuity form of payment, that fact should also be disclosed. It would be very helpful if the DOL would develop sample disclosure language for all of these points with a clear indication that if the employer and plan administrator use it, they could avoid any legal liability for questions of disclosures.

In developing such uniform disclosure language, DOL should keep two considerations in mind. First, if the average saver cannot understand these important disclosures, they will not have any practical use.

Second, the disclosures about how the income illustration was developed should not be allowed to obscure the valuable information that results from that work. To have the most influence, the income illustration itself must be the main focus of attention, and must be simple, prominent and easy to understand. As important as the disclosures are, their placement should be secondary and care should be taken to ensure that the illustration itself is both prominent and clear.

Encouraging Innovations so that A More Complete Retirement Income Picture and the Effects of Increased Saving are Shown Would Make the Illustration Even More Useful

While a decidedly positive step towards enabling consumers to better understand their retirement savings accounts, the proposed rulemaking should take great care to ensure that it does not have the effect of stifling innovation that would produce even more informative disclosures. The proposed DOL regulatory safe harbor should be seen as the lowest level of an acceptable illustration. The final rulemaking should also explicitly encourage providers to develop more comprehensive, but easily understood, disclosures that might show potential retirement income from increased saving rates and income expected from sources such as Social Security benefits, defined benefit pension plans (if any), or other savings. Plans should be encouraged to set up tools that show the current income stream with ones that could be available if the worker changed behavior, such as saving a greater percentage of their earnings. These tools are currently available from many financial service providers and have been shown to have a significant positive impact on participants' contributions.

Studies[1] show that an illustration of the additional income that can be derived from a higher level of saving is likely to stimulate the participant to increase his or her savings rate. We recommend that plan sponsors be encouraged to also include balance projections and income illustrations that show how much retirement income an individual would have if they modestly increased the proportion of their income that they contributed to their retirement savings plan. For instance, in addition to the income illustrations based on their current balances and projected balances assuming their current savings rate, there might be an illustration based on saving an additional one percent of income and another three percent of income. There might also be a reference to a website or calculator where the individual can develop additional illustrations and also quickly increase their savings rate. Such additional illustrations should be based on the same parameters and methodology as the required ones provided by that plan administrator and placed on the page so that all are simple and easy to understand.

Finally, the proposed income illustrations would be even more useful if, on the same page, there is also an estimate of the worker's projected Social Security benefit and any income from a defined benefit pension of which the employer has knowledge. Assuming that the projected Social Security benefit is calculated using approximately the same methodology and assumptions as those used for the illustrations based on retirement savings, this would allow the saver to have a better estimate of his or her total projected retirement income. Such a combination would enable the worker to better understand the importance of saving an adequate amount for retirement to supplement Social Security, and reduce the chance for surprises as they approach retirement age.

Social Security estimates used to be annually mailed by the Social Security Administration to most Americans over the age of 25, but most taxpayers under the age of 60 can now only calculate them online. Several plan administrators have already developed ways to provide estimates of these benefits and in some cases include them on statements. This practice of placing a benefit estimate on statements should be encouraged, and the estimate could come from a calculator or even be provided by the Social Security Administration itself.

Not all innovations beyond the required income illustrations need to be on the written statement, although the statement should be the immediate focus of these efforts. In addition to paper statements, they could also be included on either the plan's or the employer's website in the form of an interactive tool that enables the individual to quickly develop a customized illustration and to immediately make changes to the amount that they are saving. A link to these online tools could also be mailed or emailed to employees at regular intervals, if the employer provides disclosures by email and employees are situated to receive them, on or close to their birthdays or

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[1] Goda, Gopi Shah, Colleen Flaherty Manchester and Aaron Sojourner. What Will My Account Really Be Worth? An Experiment on Exponential Growth Bias and Retirement Saving. Santa Monica, CA: RAND Corporation, 2012. http://www.rand.org/pubs/working_papers/WR873-2.

after a significant promotion or life event such as a marriage, the birth of a child, etc., and if and when salary increases are granted.

Again, the critical element in both the required income illustrations and any additional innovative information that is included on a written statement is ensuring that the material is clear and can be easily understood by the average retirement saver. Special care should be taken to ensure that neither the amount of information provided nor technical and legal qualifications or disclosures obscure the illustration or confuse the recipient. We recommend that providers be encouraged to field test the total illustration with average savers to ensure that it is useful and easily understood.

Assumptions Used to Calculate the Income Illustration

The assumptions used to create the income illustration will be extremely important, and should be both disclosed and in the case of the regulatory safe harbor, re-examined by the DOL on a regular basis to see if they still reflect market realities. In line with our belief in the value of encouraging plan administrators to innovate, we appreciate that the ANPRM proposes both a regulatory safe harbor and to permit plan administrators to adopt a broad array of "best practice" methods. We agree that any final regulation should clearly state that these best practices should adhere to the reasonableness standard, and that the illustrations that are placed on statements should be monitored.

We also agree that income illustrations should be expressed in current dollars and include both future contributions and investment returns. As mentioned earlier, using inflated dollars may lead participants who don't understand that inflated dollars have lesser purchasing power than current dollars into believing that their retirement standard of living would be better than they would actually face if they continue to save at the same rate. Similarly, any illustration that fails to include future investment returns and savings contributions could lead a participant to believe that his or her retirement standard of living would be worse than it actually is likely to be.

The assumptions behind that calculation must be selected with care and reassessed on a regular basis to ensure that the income illustrations remain relevant to current market conditions. We agree that the initial five categories mentioned in the ANPRM, account balance, years remaining before retirement, future contributions from both employee and employer, rate of return, and discount rate used to convert account balances to today's dollars seem appropriate. However, we have some concerns about certain specific assumptions proposed by DOL for the regulatory safe harbor.

The ANPRM proposes that under the safe harbor, contributions would be assumed to increase by three percent annually, that investment returns would be assumed to average seven percent, and that the discount rate would equal three percent. All of these are reasonable and even conservative under normal market conditions. However, normal market conditions will change from time to time, and it is uncertain if those assumed by this ANPRM will remain appropriate in the future.

If a choice must be made, we would prefer to see assumptions that are slightly too conservative and thus underestimate retirement income, than to have assumptions that are too high. For this reason, we agree with DOL's reasoning that contributions should be assumed to increase at the same level as assumed inflation. We note that the ANPRM mentions that while younger employees may receive salary increases that are above the inflation rate, older worker's earnings often rise at no more than the inflation rate even when they continue to work at the same level as before for the same number of hours[2]. Given that the income illustration is more relevant to older workers who are closer to retirement, we believe the lower assumption chosen by DOL is more appropriate.

On the other hand, we have reservations about the long term appropriateness of the proposed seven percent rate of return assumption, especially in today's low interest rate environment and the growing use of passive investments. We agree that fees will lower investment returns and must be taken into consideration when developing long-term return assumptions. We also agree that basing the assumption on past equity returns would be a mistake. It is also uncertain if data derived from such sources as past DOL Form 5500s will be accurate for defined contribution accounts. While DOL's assumptions as contained in the ANPRM are reasonable and conservative for an average portfolio of investments, given the rise of automatic enrollment, we would prefer to see an assumption based on a specific study of defined contribution account investments in such choices as the QDIA.

At a minimum, this and other assumptions should be reexamined and adjusted if necessary at regular intervals. This is also true of the inflation rate assumption of three percent. While this assumption has been used by economists for decades and roughly matches assumptions by the Social Security trustees and actual experience over the last 100 years,[3] there may be future periods that exceed the norm. As an individual participant gets closer to retirement, the prevailing inflation rate will be far more important to their eventual retirement income than long term averages. For this reason, it may be more accurate to use current projected inflation rates for the next five years and the long-term average assumption for periods beyond that.

A regular reevaluation of parameters every five years would ensure that income illustrations remain as useful and relevant to participants as possible. When parameters change, this fact should be prominently disclosed, perhaps in bold type, on the next statement that contains an

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[2] US Department of Labor, Employee Benefits Security Administration, 29 CFR Part 2520, RIN 1210-AB20, Pension Benefit Statements, Advance Notice of Proposed Rulemaking, p. 19.
[3] US Department of Labor, Employee Benefits Security Administration, 29 CFR Part 2520, RIN 1210-AB20, Pension Benefit Statements, Advance Notice of Proposed Rulemaking, Page 20.

illustration. This will assist savers who would compare new statements with those issued in the past to understand why income estimates may have changed.

One approach that may make it easier for plan administrators that choose to use the regulatory safe harbor would be to include a set formula for that safe harbor as part of the final regulations. The calculation method could be in the form of an annotated mathematical formula or even as a computer program that could be downloaded from the DOL website.

Converting balances into an income stream

The major purpose of the income illustration is to provide individual savers with a realistic estimate of monthly income they can expect from their retirement savings. We strongly agree that it would be preferable to show annuitized values rather than estimates of average income from various drawdown scenarios. As past studies have shown,[4] a rule of thumb withdrawal rate may result in savings balances being exhausted during a retiree’s lifetime.

This, however, is also a complicated calculation. The ANPRM provides a lengthy discussion of a proposed method for a safe harbor, which looks to be reasonable. However, as an alternative, the Federal Thrift Savings Plan (TSP) statement may provide a useful model if the TSP information is modified to reflect the cost of annuities purchased in the private sector rather than the lower cost available to federal employees. If an in-plan annuity is not offered, the annuity calculations should be based on gender-specific actuarial assumptions consistent with annuity offerings in the individual market.

As with other parts of the proposal, innovative methods of conversion and especially those that relate directly to products available under the specific plan or through similar providers should be encouraged. Since the amount of income that can be derived from an annuity is directly related to the prevailing interest rates, and since those rates will change from year to year, the income illustration for a retirement savings account could show fairly wide swings from one annual illustration to another. This fact should be disclosed prominently and a link provided to a wider discussion located on either the DOL website or a similar source.

Conclusion

Again, AARP appreciates the opportunity to comment on this Advanced Notice of Proposed Rulemaking. When it goes into effect, such a rule would make it much easier for savers to understand how much retirement income they can expect from their accounts and should

[4] O'Flinn, Christopher and Schirripa, Felix, Revisiting Retirement Withdrawal Plans and Their Historical Rates of Return (May 16, 2010). Available at SSRN: http://ssrn.com/abstract=1641382 or http://dx.doi.org/10.2139/ssrn.1641382.

encourage many to increase the amount they contribute. The details and assumptions of income illustrations are complex, but the sooner that such a regulation can be perfected and implemented, the sooner consumers will benefit. We congratulate the DOL for its efforts on this proposal and look forward to assisting our members and others to make full use of it.

Sincerely,

David Certner
Legislative Counsel and Legislative Policy Director
Government Affairs