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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, DC 20210
Attn: Pension Benefit Statements Project

Re: Pension Benefit Statements (RIN 1210-AB20)

Dear Sir or Madam:

Vanguard[1] appreciates the opportunity to comment on the Department of Labor's (the Department) advance notice of proposed rulemaking (ANPRM) regarding lifetime income illustrations on pension benefit statements provided to DC plan participants. Vanguard supports the Department's efforts to further educate participants about retirement preparedness and income and agrees that forecasting an account balance and presenting it as a monthly income stream can help participants better assess retirement readiness.

In our experience, participants struggle to translate lump sum account balances into future streams of monthly income. That challenge can hamper participants' evaluation of their retirement readiness, often causing them to underestimate or misunderstand the savings rates and investment allocations most likely to generate a reasonable income during retirement. Vanguard's experience serving plan sponsors and participants indicates that varied participant populations are best served by allowing plan sponsors to choose among income modeling tools and approaches that reflect each plan's specific population and provisions. The Department's regulation should provide enough flexibility to allow sponsors and providers to continue using the most suitable modeling tools, whether currently available or yet to be developed.

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[1] Vanguard is one of the world's leading asset managers, managing $2.3 trillion in assets for institutional and retail investors. We are also a leading asset manager and recordkeeper for defined contribution (DC) and defined benefit (DB) plans and Individual Retirement Accounts. Specifically, we manage $580 billion in DC and DB assets and provide recordkeeping and administrative services for 4 million participants in over 3,400 DC and DB plans.

Unfortunately, the Department's decision in the ANPRM to require retirement income projections based on one method – complete annuitization of account balance at retirement – does not comport with plan provisions or participant behavior. Few DC plans offer annuities (except when required to do so, as in a money purchase pension plan), and even participants with ready access to annuitized payments overwhelmingly choose a lump sum when they can because of the loss of liquidity upon annuitization. Moreover, retirement income projections based on annuitization are higher than projections based on systematic withdrawals. These higher projected amounts can both discourage higher savings in the accumulation phase and encourage higher spending than is likely to be sustainable, absent annuitization, in the draw down phase.

Vanguard recommends a number of modifications to the ANPRM, as follows:

- The Department should consider achieving the policy aims underlying the ANPRM through encouragement of voluntary plan sponsor efforts to educate participants about retirement income rather than through mandatory income illustrations on benefit statements.
- The Department should transform its general rule into a flexible safe harbor permitting retirement income projections based on any reasonable methodologies and assumptions taking into account generally accepted investment theories.
- The Department should not elevate complete annuitization of account balances above other approaches, as such annuity illustrations do not reflect plan options or participant preferences and are likely to mislead.
- If the Department wishes to provide a standardized approach for retirement income projections, it should not rely on a complete annuitization safe harbor but, instead, on a systematic withdrawal calculation, which represents a more conservative estimate of likely future income. The Department might also direct participants to the Department's website and retirement income annuity calculator for alternative estimates.
- If the Department adopts a rule mandating specific methodologies for retirement income projections, Vanguard strongly urges the Department to allow multiple identified methodologies, including retirement income projections based on systematic withdrawals.
- The Department should eliminate the proposed requirement to calculate the monthly retirement income that a participant's unadjusted current account balance would generate. This information is likely to confuse participants and undermine the educational value of retirement income projections.
- The Department should improve the assumptions used to generate retirement income projections by (1) reflecting income amounts in current dollars (i.e., adjusted for inflation) through the use of real investment returns, (2) assuming real growth in contributions, and (3) for projections based on annuitization, adjusting annuitization factors by implicit costs and for post-retirement inflation.

Beyond the ANPRM, Vanguard also recommends an expansion of Interpretive Bulletin (IB) 96-1 to distribution guidance, greater fiduciary relief for the selection and monitoring of annuity providers, and enhanced flexibility for electronic delivery of participant communications. The discussion below details Vanguard's recommendations and provides additional comments on the Department's proposals.

1. The Department could advance its policy aims by encouraging voluntary plan sponsor educational efforts

The Department should carefully consider whether mandatory regulation is, in fact, necessary to foster effective participant education concerning projected retirement income and to achieve the attendant benefits of encouraging greater savings. Like many providers, Vanguard has developed a variety of retirement savings and income tools designed to reflect the needs and objectives of participants and plan sponsors. In Vanguard's view, the Department should consider pursuing its policy goals by encouraging more comprehensive participant education by plan sponsors and their service providers regarding retirement income on a voluntary basis, including through statements. This could be achieved through an expanded IB 96-1 and clear fiduciary relief for retirement income projections.[2] A voluntary education and disclosure regime would provide plan sponsors greater flexibility to use the retirement income projection methodologies that most closely align with participant preferences, plan terms and plan investment options and would support continued innovation in educational methods.

2. A variety of income forecasting tools are already available in the market

To help participants understand how current account balances, savings rates and investment allocations may translate into future income, Vanguard currently offers several tools and products that provide individualized projections reflecting each participant's current savings and investment behavior, including a simple tool for providing income projections on participant statements, as well as other more sophisticated and personalized education and advice services.

Vanguard's Retirement Income Outlook™ (RIO) module displays participants' projected monthly income at retirement age on participant benefit statements.[3] Specifically, RIO –

- Develops a personalized estimate of a participant's balance at retirement by assuming an annual real (after-inflation) return of 4 percent and ongoing savings at current plan contribution rates.
- Projects retirement income by assuming withdrawals of 4 percent of the estimated balance beginning at age 65.
- Illustrates via a simplified bar chart how specific modest increases in savings rates could improve the participant's estimated monthly income in retirement.

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[2] See sections 9 and 10 below for further discussion of these recommendations.
[3] RIO is available both on statements and online for more than 1.9 million participants in plans recordkept by Vanguard.

Vanguard also offers monthly income projections as components of personalized investment advice offerings. These offerings include the Vanguard® Managed Account Program and Vanguard Personal Online Advisor (VMAP™ and POA), which use an independent methodology developed by Financial Engines, and Vanguard Financial Plan (VFP) and Ask a CFP, which use Vanguard's own methodology. VMAP and POA forecast future account balances and potential monthly income and present that information online and in personalized communications in a simple visual "stoplight analysis" evaluating the likely sufficiency of the participant's current balance, contribution rate and investment allocation. VFP and Ask a CFP provide participants access to a salaried Vanguard certified financial planner to develop a financial plan or ask a range of questions related to various financial planning topics, including retirement income planning.

In the accumulation phase, Vanguard has observed that clear reminders of the long-term effects of current savings and investment behavior through affirmative communications like statements can motivate participants to take positive action. For example, participants who receive investment management or advice through VMAP or POA – which provide personalized projections based on current savings and investments – tend to contribute an additional 1.5 to 3 percent of compensation annually compared to participants who have access to, but do not use, those services.

Vanguard also provides online tools for investors seeking assistance with retirement income modeling, such as interactive retirement savings and retirement income calculators, retirement income and expense worksheets, required minimum distribution estimators, and education and research on retirement investing and income decisions and options. In particular, a new Vanguard tool is designed to allow retirees and pre-retirees to model sustainable withdrawal rates from plan accounts online using stochastic modeling techniques.[4] This retirement income modeler calculates a personalized monthly income stream beginning at retirement with an 85 percent probability of lasting to age 95. The calculation is based on the participant's age and current plan account balance and asset allocation, and runs simulations of thousands of possible economic scenarios to arrive at an income number designed to manage the participant's longevity risk with high probability. The participant may also use the modeler to analyze other possible withdrawal strategies and compare their calculated success rates.

3. The Department's regulation should reflect plan options and participant preferences rather than focus exclusively on annuitization

The scope and variety of Vanguard's retirement income services reflect the differences among plan sponsors and participants in the amount of detail and customization they seek in a retirement income projection and, as they near retirement, the investment or insurance solutions they prefer to use when generating retirement income. This variation in preferences is not surprising given the number of

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[4] As the Department explained in its preamble to the ANPRM, a stochastic model is a tool that estimates probability distributions of potential outcomes by allowing for random variation in inputs over time, usually based on observed historical data for the selected inputs. 78 Fed. Reg. 26727, 26731 n. 8 (May 8, 2013).

competing, and sometimes conflicting, interests that must be balanced when developing a retirement income strategy. In general, longevity risk (the risk of outliving savings) must be balanced against inflation risk (the risk that a fixed payment today will not purchase as much in the future). Investors must also consider their need for access to liquid assets during retirement, along with their goals regarding charitable giving or providing for family needs after death. Importantly, virtually all participants have access to a base of annuitized income through Social Security, and some have access to DB pension payments. In addition, Medicare and, for many, ownership of a primary residence, provide annuity-like benefits, insuring against the rising costs of health care and housing. Overall, these factors reduce the need for annuitized income, and contribute to investors' reluctance to trade lump sum balances for annuitized income. Moreover, as they weigh these competing objectives, retirees must remain aware of factors that were important during the accumulation phase, such as market risk and the effect of fees on a portfolio. Retirement income strategies addressing or eliminating one risk generally introduce or exacerbate another risk.[5]

Annuities do provide one method of generating lifetime income that can be attractive to a small segment of individuals. They are not, however, individuals' preferred method for translating savings into income.[6] Specifically, in DB plans offering a lump sum option, participants more frequently choose the lump sum option.[7] DC plans typically do not offer annuities at all, and when they do, the number of participants selecting that option is extremely small.[8] Indeed, most DC plan participants at retirement age withdraw their account balances from their employer-sponsored plans within 5 years, roll over their savings into an IRA, and make infrequent non-annuitized withdrawals from the IRA.[9] The Department's current ANPRM

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[5] See generally Ameriks, John, Michael Hess and Liqian Ren, "Comparing Spending Approaches in Retirement." Vanguard Center for Retirement Research (October 2010). https://personal.vanguard.com/pdf/icrcsa.pdf

[6] Sales of fixed immediate annuities were $8.1 billion in 2011, out of an eligible rollover market estimated at approximately $360 billion that year. LIMRA, *Retirement Income Reference Book 2013* at 36, 156.

[7] See, e.g., Mottola, Gary and Stephen P. Utkus, "Lump Sum or Annuity? An Analysis of Choice in DB Pension Payouts." Vanguard Center for Retirement Research (November 2007). https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article/LumpSumOrAnnuity. Some have subsequently concluded that participants in DB plans annuitize benefits at a high rate. See generally Benartzi, Shlomo, Alessandro Previtero, and Richard H. Thaler, "Annuitization Puzzles." *Journal of Economic Perspectives* 25(4) (2011) at 143-164. Examination of DB plan rules more closely, however, demonstrates that higher annuitization rates generally result from the absence of a lump-sum distribution option, rather than the availability of annuitization. See Banerjee, Sudipto, "Annuity and Lump-Sum Decisions in Defined Benefit Plans: The Role of Plan Rules." EBRI Issue Brief No. 381 (January 2013). http://www.ebri.com/publications/ib/index.cfm?fa=ibDisp&content_id=5151. For example, EBRI found that between 2005 and 2010 the aggregate annuitization rate for participants in DB plans between age 50 and 75 with a minimum tenure of 5 years and minimum account balances of $5,000 was 65.8 percent. Within that group of workers, however, those without restrictions on lump-sum distributions annuitized at a rate of only 27.3 percent.

[8] LIMRA reports that when annuities and other guaranteed retirement income products are available within plans, participants' annuity election rate is only 3 percent. LIMRA, *Retirement Income Reference Book 2013* at 163.

[9] On the distribution of plan assets from DC plans at retirement age, see Utkus, Stephen P. and Jean A. Young, "Distribution Decisions Among Retirement-Age Defined Contribution Plan Participants." Vanguard Center for Retirement Research (December 2010). https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article/InvResdistribdecisions. On spending from IRAs, see Poterba, James M., Steven F. Venti and David A Wise, "The Drawdown of Personal

fails to reflect participant behavior and preferences by limiting the required projections to only one method of retirement income generation – complete annuitization.

Despite low rates of annuitization today, some may argue that retirement income projections based on complete annuitization may affect or reframe participant choices and encourage greater annuitization in the future. As noted above, studies of participant behavior when choosing between lump sum and annuity options in DB plans suggest that this is highly unlikely. With respect to DB distributions, a fairly restrictive procedural step – for married couples, notarized spousal consent to waive the annuity form of distribution – is insufficient to lead to widespread annuity adoption in DB plans offering a lump sum.[10] Moreover, recent research on efforts to reframe the annuity decision is based on an assumption that participants evaluate lump sum and annuity distribution options at a single point in time (and do not address the effect of prior repeated illustrations of annuity income).[11] Yet there is no evidence to date indicating that presenting a retirement income projection on a statement will encourage participants to seek additional information about annuities at another (later) time. The Department could influence participant behavior far more effectively by (1) encouraging plan sponsors and providers to provide more comprehensive participant education to participants at the time they make distribution decisions and (2) providing a broader safe harbor to encourage in-plan annuities.[12]

4. **The Department should transform its general rule into a flexible safe harbor allowing retirement income projections based on reasonable methodologies and assumptions**

To improve participants' understanding of the potential monthly value their accounts may provide in retirement, the Department proposes requiring plan sponsors to project a participant's account balance to retirement age reflecting continuing contributions and investment returns, and translate that lump sum account balance into a projected monthly income stream. The Department provides a general rule that would allow reasonable methods based on generally accepted investment theories for projecting account balances, but requires monthly income illustrations to be calculated as though a participant decided to annuitize his or her full account balance. Rather than forcing all plan sponsors to adopt this complete annuitization approach, we believe it is imperative that the Department design a safe harbor to accommodate a variety of reasonable methods of illustrating projected retirement income amounts.

Retirement Assets," National Bureau of Economic Research Working Paper 16675 (January 2011). http://www.nber.org/papers/w16675.pdf?new_window=1.

[10] Mottola and Utkus, *supra* n.7. In a study of two large DB plans, Vanguard found that a total of 78 percent of participants in a final average pay plan and 83 percent of participants in a cash balance plan opted out of the qualified joint and survivor annuity default and chose a lump sum.

[11] As one example, see, e.g., Brown, Jeffrey R., Jeffrey R. Kling, Sendhil Mullainathan and Marian V. Wrobel, "Why Don't People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle." *American Economic Review* 98(2) at 304-09 (2008).

[12] See further discussion in sections 9 and 10 below.

a. A flexible safe harbor will allow existing, well-established practices to continue and will foster further innovation

As detailed above, like many other providers, Vanguard has developed retirement income modeling tools operating at various levels of sophistication to help participants translate lump sums and savings behavior into future periodic income. The industry will continue to develop new tools and products, and changes are already visible on the horizon. For example, strategies using longevity annuities – annuities payable at an advanced age – may be paired with systematic withdrawal approaches to combine flexibility and access with more certainty that a portfolio will last for the required period. As a general matter, there is a great deal of innovation taking place in the market for retirement income and with income illustration and modeling tools. If the Department requires retirement income projections to be based on complete annuitization, the monthly income forecasts displayed on participant statements may bear little resemblance to the form and amount of income available to retirees in the future.

In contrast, a flexible safe harbor clearly permitting retirement income projections based on any reasonable methodologies and assumptions consistent with generally accepted investment theories will allow plan sponsors and service providers to continue providing information about retirement income options through existing approaches while supporting an environment of continued innovation. Our research has shown that no single strategy for drawing down retirement benefits is successful in all environments.[13] In some cases, an annuitization or partial annuitization approach may be most successful; in others, a systematic withdrawal approach is best; in still others, a withdrawal approach modeled on the required minimum distribution tables is most effective. In light of that variation, plan sponsors and service providers should be able to consider all reasonable methodologies for displaying retirement income in light of their plan's provisions and participant demographics.

The Department indicates that it specifically intends its rule to protect current projection and illustration best practices and avoid stifling innovation in this area.[14] To that end, the Department provides some flexibility in the ANPRM through a general rule allowing plan sponsors and providers to forecast account balances using other reasonable methods, provided the projections are based on reasonable assumptions taking into account generally accepted investment theories and provided any projection is expressed in current dollars and takes into account future contributions and investment returns.[15] However, this general rule allows flexibility only with respect to account balance projections, not the translation of those balances into retirement income amounts.[16] In addition, plan sponsors have reasonable concerns that projected balances and income amounts, if not achieved, may lead to litigation and liability. In this environment, sponsors are very likely to seek the protection of the ANPRM's safe harbor (rather than make use of the

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[13] See generally Ameriks, Hess and Ren, *supra* n.5.
[14] 78 Fed. Reg. at 26731.
[15] 78 Fed. Reg. at 26731, ANPRM §2520.105-1(d)(1).
[16] ANPRM §§2520.105-1(d)(1), 2520.105-1(e).

general rule), regardless of whether such an approach best reflects effective educational methods, their plan's provisions, participant preferences, or the most up-to-date behavioral research.

Moreover, plan sponsors and service providers are well-positioned to determine, monitor and, where appropriate, adjust the assumptions underlying retirement income projections over time to reflect a changing economic environment. Specifically, a general and flexible safe harbor for retirement income projections based on any reasonable methodologies and assumptions consistent with generally accepted investment theories will allow retirement income projections to reflect changes in the economy that can affect the continued reasonableness of the Department's fixed safe harbor assumptions. For example, while projected inflation of 3 percent or nominal investment earnings of 7 percent may be reasonable today, those assumptions may not remain reasonable in 10 years. As the ANPRM is currently structured, the Department would either need to issue updated assumptions periodically or risk encouraging plan sponsors to use outdated assumptions. A broadened safe harbor should instead allow plan sponsors to update the assumptions underlying income projections so that they remain reasonable.

A flexible safe harbor would also allow plan sponsors and service providers to provide projections based on alternative scenarios alongside projections intended to satisfy the requirements of the ANPRM. For example, additional projections might be used to illustrate the effect that higher savings rates or different investment returns may have on projected account balances or monthly income. Alternative scenarios could also illustrate the effect of different withdrawal approaches (e.g., partial annuitization) or alternative methodologies, such as stochastic forecasts (e.g., "there's a 5 percent chance your income could be as high/low as $X"). Without a flexible safe harbor, plan sponsors may be reluctant to provide this additional helpful context on participant benefit statements.

In addition, the Department should provide clear fiduciary relief for retirement income projections that conform to the requirements of the ANPRM. To fully address plan sponsor and service provider concerns, the Department should provide relief from participant claims that projections – whether provided on statements or as part of broader participant education efforts – were misleading or breached fiduciary duty if the ANPRM is followed. This would greatly diminish sponsor and provider concerns that reasonable retirement income projections will be mischaracterized in litigation.

b. A rule requiring retirement income projections based on assumptions that do not reflect participant behavior can mislead participants

Because retirement income projections that assume participants will annuitize their entire plan balances do not reflect current or expected future participant behavior, they have the potential to mislead. Without prominent disclosures, monthly income projections based on annuitization will fail to highlight the critical loss of liquidity that occurs upon annuitization. More importantly, because of mortality risk pooling, future income estimates based on annuitization will always be higher – sometimes significantly so – than income estimates from a systematic withdrawal approach. During the accumulation phase, this overstated retirement income can undermine accurate retirement planning and discourage higher saving. In the draw down phase, a participant who does not annuitize, but whose sense of sustainable spending in retirement is based on an estimate calculated under the annuitization approach, may be seriously misled into spending savings too quickly.

For example, consider a participant with $50,000 in retirement savings at age 40, contributing an additional $5,000 per year (adjusted to increase with inflation at 3 percent.per year), and planning to retire at age 67. Based on the Department' calculator and safe harbor, that participant would have saved approximately $400,000 by retirement age and would have approximately $27,000 in annual income if the participant selected an annuity with no survivor benefit. If plan sponsors and providers present projections calculated using the Department's proposed safe harbor, the participant may skip the fine print and conclude that the projected monthly retirement income of approximately $2,200 ($27,000/12) represents a reasonable monthly withdrawal amount. In our example, if the participant takes that approach, increasing payments by 3 percent per year to reflect inflation and assuming a steady 7 percent rate of return, and fails to annuitize, he or she will run out of money in approximately 22.8 years. Put another way, we calculate that a participant with a portfolio of $400,000 evenly split between stock and bond funds who withdraws $27,000 per year in retirement, adjusted for inflation, has only a 38 percent chance that the participant's assets will last 30 years.[17]

5. **If the Department wants to encourage a standardized methodology for projecting retirement income, it should adopt a systematic withdrawal approach**

Although Vanguard recommends that the Department transform its proposed general rule into a broad safe harbor for retirement income projections based on reasonable assumptions taking into account generally accepted investment theories, we are sympathetic to the notion that there is value in participant access to a standardized approach to retirement income projections. A standardized approach for income projections will allow participants to compare projections across multiple accounts, plans and providers, facilitating planning by participants who typically own multiple accounts in multiple plans. In this regard, we believe a standard approach based on a systematic 4 percent withdrawal rate rather than annuitization would both better reflect participant preferences and encourage higher savings rates. This amount more closely reflects the income potential most participants, who do not annuitize, are likely to have. Further, a retirement income projection based on a 4 percent withdrawal rate will provide a more conservative estimate of future income. Returning to the example above, to provide a retiree with $400,000 in savings a high degree of probability those savings would last 30 years, annual distributions under a systematic withdrawal approach would start at approximately $16,000 per year (or roughly $1,300 a month) in retirement. Those participants who do choose to annuitize some or all of their balances will receive a higher rate of income.

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[17] See Vanguard's retirement nest egg calculator, https://retirementplans.vanguard.com/VGApp/pe/pubeducation/calculators/RetirementNestEggCalc.jsf.

Similarly, the Department could require plans to include, adjacent to the projections on the statement, the web address of the Department's own interactive online calculator providing lifetime income projections.[18] Participants accessing statements electronically could access the Department's calculator and additional information on the Department's website through a single click. Under this approach, participants would have consistent access to a calculator using a standardized methodology for projecting retirement account balances and income. In addition, participants could enter account balances maintained in multiple plans or retirement accounts and thereby generate retirement income forecasts based on their entire retirement savings picture, regardless of plan sponsor or service provider offerings and capabilities.

6. **If the Department does not adopt a general safe harbor for reasonable retirement income projections, Vanguard strongly urges the Department to permit several identified methodologies for retirement income projections to accommodate well-developed current practices**

Although we do not agree with the approach, if the Department continues to embrace a rule that identifies limited permissible methodologies for retirement income projections and that establishes a safe harbor for the underlying assumptions that will be deemed reasonable, Vanguard strongly urges the Department to include multiple identified methodologies in the safe harbor. Such methodologies should include not only retirement income projections based on annuitization but also those based on systematic withdrawals.

In the ANPRM, the Department recognized that translating a lump sum account balance into a potential stream of monthly income can greatly help participants evaluate their ability to support a comfortable retirement – including emergency savings for unexpected needs – based on current savings behavior and account balances.[19] In support of its proposal to require retirement income projections to be based on complete annuitization, the Department notes that this method is the only one that will ensure lifetime income. In doing so, however, the Department fails to acknowledge the importance of methods like systematic withdrawals in allowing participants to reserve assets for unexpected needs, including health care and long term care costs, and substitutes its preference for those of the millions of retirees whose individual preferences may differ.

A safe harbor embracing multiple methodologies for projecting retirement income, including a systematic withdrawal approach based on static or stochastic models, would protect the current state of innovation in the market and allow plan sponsors to match modeling approaches to their plan's terms, overall goals and likely participant behavior.[20]

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[18] This approach would be similar to the Department's communications regarding the importance of diversification under the Pension Protection Act. See Field Assistance Bulletin (FAB) 2006-03 (Dec. 20, 2006).
[19] 78 Fed. Reg. at 26728.
[20] The Department took a similar approach with the final Qualified Default Investment Alternative (QDIA) regulation by including three different investment alternatives in the definition of QDIA. In that regulation, the Department recognized that multiple investment management approaches – from balanced funds, to target date funds, to an

7. The Department should eliminate the proposed requirement to translate the current account balance into a monthly stream as though the participant were retirement age because it is confusing and likely to undermine participant education efforts

The Department's proposal would require statements to provide two sets of projections for participants who have not yet reached retirement age. One set would project each participant's account balance to retirement age reflecting additional contributions and earnings and translate that into monthly income based on certain assumptions. The second set of numbers would translate each participant's current account balance into monthly income as though the participant were retirement age at the time of the calculation. In other words, the second set of numbers would assume no further contributions or investment earnings on the participant's current account balance. In explaining its approach, the Department noted that some commenters favored retirement income estimates based on projected account values, while others favored estimates based on current day values. Importantly, as the Department recognized, few supported providing both illustrations at the same time.[21] Commenters clearly recognized that here, as elsewhere, simplicity is key to participant education. Vanguard is concerned that the "current day" retirement income estimate does not promote the Department's goals and, presented in tandem with projected account balance and retirement income amounts, is likely to confuse participants. Accordingly, Vanguard recommends that the Department eliminate the current day calculation from the regulation.

At a high level, the Department's stated goal is to assist participants in managing their retirement assets to provide income for life by educating participants about the savings, asset allocation and draw down decisions that are necessary to maintain their current lifestyle with an adequate cushion for emergencies or illness.[22] To accomplish this goal, the ANPRM is designed to help participants recognize the link between current savings behavior and future outcomes and, implicitly, how changes in that behavior (e.g., greater savings) may improve future outcomes. In short, the Department is seeking to improve the intertemporal thinking of participants – to better consider future outcomes compared to present needs. To most effectively help participants understand this tradeoff, information must be clear and simple. With two sets of numbers, participants face the difficult challenge of comprehending and reconciling two differing estimates. Moreover, the effect of projected retirement income estimates, which can powerfully illustrate the link between current behavior and potential future outcomes, will be undermined by the presence of current day estimates, which are designed to ignore the potential effect of participants continuing their current behavior. The dissonance between projected account balances and income and estimates based on current balances alone is likely to be most evident for young workers. Retirement income projections presented thoughtfully, however, can have the greatest effect for these workers, because they have so much time yet to save. Vanguard encourages the Department to eliminate the current day estimate and

investment management service – could be reasonable default investment alternatives for participants, depending on the plan sponsor's investment philosophy and evaluation of its plan demographics.

[21] See 78 Fed. Reg. at 26729.

[22] *Id.* at 26728.

provide participants the best chance of understanding and addressing the valuable information included in these retirement income projections.

8. The Department should make a number of necessary modifications to the assumptions included in the ANPRM

To the extent the Department chooses to adopt multiple, more narrowly identified approved methodologies based on, for example, systematic withdrawals and annuitization, the Department should modify the proposed assumptions underlying such projections. Specifically, Vanguard recommends that the Department (1) state all retirement income projections in current dollar terms (i.e., net of inflation) by using a simpler, real rate of return of 4 percent, (2) provide for growth in contributions reflecting real wage growth, not just inflation, and (3) for projections based on annuitization, reflect both implicit costs and the effect of post-retirement inflation.

Vanguard strongly encourages the Department to express all values in current dollar terms, by basing retirement income projections on real returns rather than separate inflation assumptions and nominal investment return assumptions. Academic research in financial literature and behavioral economics has shown that individuals have a poor understanding of the impact of inflation. An individual earning $60,000 a year today and considering a future income of $20,000 a year from a retirement plan account may mistakenly conclude that the plan account will replace one-third of his or her current income at retirement—when it will most certainly be much lower due to the significant erosion in purchasing power. To avoid participant confusion between current and future values, we would suggest a 4 percent real return assumption in lieu of the Department's assumption that annual wages (deferrals) grow with inflation of 3 percent, and annual returns at a nominal 7 percent. There is then no need to adjust future income values separately for inflation.[23]

Implicit in the Department's assumptions is that wages (and deferrals) rise at the rate of inflation. Yet it is a well-established financial planning practice to grow both investors' retirement income goals and retirement plan contributions at a greater rate, such as 1 percent above the rate of inflation. As the Department recognizes, investors' financial goals for retirement tend to grow with real wages, not just the rate of inflation.[24] Increasing contributions by inflation alone, as the Department proposes, may tend to understate potential income relative to typical goals and planning.

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[23] Using 4 percent as a real rate of return (which is roughly equivalent to a 7 percent nominal return) is a useful starting point for retirement income projections. Nevertheless, a static return assumption does not reflect the effect of investment risk on retirement outcomes. Accordingly, as noted above, we encourage the Department to provide that, in addition to any standard income illustration that may be required under this regulation, plan sponsors and service providers may display the potential effect of alternative return scenarios – including both stochastic models reflecting investment risk or static models assuming lower rates of return (e.g., a real return of 2.5 percent to reflect long-term lower returns on stocks and bonds).

[24] See 78 Fed. Reg. at 26731 & n.11. The Department acknowledges literature showing that workers' wages tend to grow rapidly when young, but at a rate similar to inflation closer to retirement. See, e.g., Murphy, Kevin M. and Finis

We believe if the Department chooses to proceed with annuitization as a method for projecting retirement income, such projections should reflect market rates for inflation-protected annuities (rather than relying on interest rate and mortality assumptions specified by the Department). Specifically, the Department should consider publishing market rates for inflation-protected annuities for plan sponsors and service providers to use when forecasting retirement income payments based on annuitization. If the Department were to adopt this approach, there would be no need for separate assumptions regarding interest or mortality, and the implicit costs of annuities would already be reflected in the market rate annuity payouts reported by the Department.

Even if the Department does not wish to base annuitized projections on market rates, the relevant annuitization assumptions should nonetheless be based on inflation-protected annuities. The Department's current proposal appropriately reflects the significant effects of inflation on future account balances and income by requiring account balance and retirement income projections to be adjusted for inflation. However, the Department fails to recognize the similar erosion of purchasing power that will occur once amounts are annuitized, unless a participant selects an inflation-protected annuity. To provide participants a meaningful estimate of a lifetime monthly income amount, annuity-based projections should reflect the payouts that would provide protection from inflation.

Likewise, if the Department pursues specified assumptions rather than publishing market rates, its assumptions should contain a large enough internal "load" to compensate for actual implicit costs in the annuity marketplace. The Department's current proposed annuity illustration ignores the often significant financial and practical costs of such products, which could result in the illustration being misleading to participants. While traditional income annuities do not typically charge explicit fees, they carry insurance loads reflecting, in part, operating costs, risk charges, marketing and distribution expenses and profits of the insurer. Studies comparing the value of annuities available in the market to hypothetical, actuarially fair annuities (similar to the annuity calculations proposed in the ANPRM) show that, on average, annuities actually available in the market cost approximately 15 to 20 cents per dollar of premium based on the mortality rates of the population at large, and 5 to 10 cents per dollar of premium based on the mortality rates of the population purchasing annuities.[25] To reflect this cost and provide a more realistic forecast of an annuitized monthly payment, the Department should include a reasonable representation of this cost factor in its assumptions. This may be done, for example, by reducing the lump sum account balance used to calculate projected monthly retirement income by a factor intended to reflect the annuity's cost.

Welch, "Empirical Age-Earnings Profiles," *Journal of Labor Economics*, Vol. 8, No. 2 (Apr. 1990) at 202-229. When limiting wage growth to inflation alone, the impact of assuming lower wages earlier in a participant's career compounds to a much greater degree than the impact of forecasting based on potentially higher than anticipated wages near retirement.

[25] See, e.g., Mitchell, Olivia S., James M. Poterba, Mark J. Warshawsky and Jeffrey R. Brown, "New Evidence on the Money's Worth of Individual Annuities," *American Economic Review* 85(9) (December 1999) at 1299-1318; Brown, Jeffrey, Olivia S. Mitchell, and James M. Poterba, "Mortality Risk, Inflation Risk, and Annuity Products," NBER Working Paper No. 7812 (July 2000). http://www.nber.org/papers/w7812.pdf?new_window=1.

9. The Department should encourage more comprehensive participant education concerning retirement income by expanding IB 96-1 to include distribution guidance

As the Department indicates in the preamble to the ANPRM, it intends the proposed monthly income projections to allow participants to make more informed retirement planning decisions and, where appropriate, to lead to specific changes in participant behavior, like increased contributions.[26] In Vanguard's view, the Department should consider pursuing these goals by encouraging more comprehensive participant education about retirement income and distribution matters.

To effectively educate participants about the likely retirement income a lump sum balance may produce, the Department should encourage plan sponsors to present these projections in context. As the Department recognized in the ANPRM, clear information about the assumptions and methodology underlying retirement income projections can help participants better understand not only those projections, but the general factors (like investment returns, continued growth in contributions, and inflation) that affect income in retirement. Nevertheless, disclaimer text accompanying benefit statement income projections, without more, is a poor vehicle for effective participant education, and it is unlikely that all participants will recognize or fully appreciate the caveats applicable to such projections.

In this regard, the Department may provide the greatest assistance to participants by expanding its lifetime income guidance to cover not only illustrations on participant benefit statements but also general participant education regarding distribution options. Specifically, the Department could improve participant awareness of the important considerations associated with retirement income projections and draw down alternatives by expanding IB 96-1 to address distribution guidance. Through an expanded IB 96-1, the Department should confirm that, when providing education describing the retirement income or distribution phase and related draw down options, plan sponsors (and the service providers they engage) are not fiduciaries with respect to the plan solely as a result of this education. In light of the fact that participants often make income and draw down decisions after moving balances out of the plan, the Department should also encourage sponsors to educate participants about distribution options and draw down strategies that may be available outside the plan. Today, sponsors are concerned that participants may perceive such income and distribution education as fiduciary investment advice or as endorsement of a particular firm, distribution method or product. Accordingly, helping sponsors and providers draw a clear line between broad education regarding retirement income on the one hand and specific endorsements and investment advice on the other would be extremely valuable.

Expanding IB 96-1 to address distribution guidance would give plan sponsors and service providers more flexibility in providing comprehensive, customized guidance about the factors participants should consider when developing a retirement income plan. Importantly, an expansion of IB 96-1 to distribution education would allow plan sponsors and service providers to incorporate what we continue to learn about the best

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[26] 78 Fed. Reg. at 26728.

ways to teach participants about retirement income, whether through technological advances, behavioral economics, or product and plan design changes.

10. To encourage more widespread availability of annuities as plan distribution options, the Department should provide fiduciary relief for selection and monitoring of annuity providers

In February, 2010, the Department and the Treasury Department issued a joint Request for Information (RFI) seeking comments addressing, in part, ways that annuities may be further encouraged within retirement plans.[27] This ANPRM is a result of the Department's consideration of comments it received in response to that RFI. If the Department wants to encourage plan sponsors to offer annuity options, greater fiduciary relief for the selection and monitoring of such options is likely to have a more direct effect than retirement income projections based on annuitization. Plan sponsors often find it difficult to assess the creditworthiness of insurers and to evaluate the fees associated with annuity products. Sponsors also face long-term risk associated with insurance products. Even if a particular annuity is a prudent option at the time a contract is issued, sponsors may be concerned about the residual risk of insurer insolvency over time. The Department's October, 2008 revised regulation regarding prudent annuity selection and monitoring is welcome.[28] However, under that regulation, fiduciaries must undertake a systematic due diligence process to evaluate the value and soundness of a specific annuity contract and provider and, if unable to perform that analysis, must hire an independent expert to assist. In-plan annuity options introduce administrative complexity, as well, which can present challenges for recordkeeping systems and limited portability for participants.[29] Even if the annuity-based projections described in the ANPRM were to increase participant demand for in-plan annuity options (we are skeptical), plan sponsor concerns regarding fiduciary oversight, contract liquidity, fees, and complexity would remain. Vanguard would welcome the opportunity to continue to engage with the Department on potential modifications to the annuity selection regulations that may serve to encourage the availability of in-plan annuity options.

11. Vanguard supports enhanced flexibility for electronic delivery of participant communications

We recognize that the ANPRM does not address the use of electronic methods to distribute the required retirement income projections. However, Vanguard appreciates the guidance the Department has issued regarding participant benefit statements in FAB 2006-03, and encourages the Department to confirm the applicability of FAB 2006-03 to the statement income illustrations proposed in the ANPRM. More broadly, we urge the Department to provide expanded flexibility regarding electronic delivery of participant communications.

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[27] Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans, 75 Fed. Reg. 5253 (Feb. 2, 2010).
[28] Selection of Annuity Providers – Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58447 (Oct. 7, 2008).
[29] For more discussion, see Burns, William J. and Stephen P. Utkus, "DB in DC: Deferred Annuities in Defined Contribution Plans." Vanguard Center for Retirement Research (May 2008). https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article/ResNoteDeferredAnnuities.

Electronic methods of communication can result in a much more engaging and effective participant experience. This is particularly the case with respect to information like retirement income projections, which can vary greatly depending on the assumptions used. Participants benefit from interactive tools showing them how, for example, small increases in contributions today can result in a significant increase in retirement assets and income in the future. Where communications are easily integrated into the recordkeeping system, as they are in the case of online participant benefit statements, participants may be able to act on presented information and illustrations by increasing contributions with just a few clicks.

Over the past 10 years, the percentage of participants who contact Vanguard each year regarding their accounts has slowly increased from around 50 percent to 57 percent, whether by contacting phone associates, using the voice-response system, or through the internet.[30] Use of the internet and other electronic forms of communication over that time has eclipsed other methods of accessing plan information. For example, when measured by total contacts, web contacts accounted for 95 percent of all participant contacts with Vanguard-administered plans in 2012.[31] In the next 10 years, Vanguard anticipates more significant changes in participant access methods as mobile applications become more prevalent and are further integrated into participants' daily lives. Vanguard is eager to work with the Department to expand its electronic communication and delivery guidance, in this and other regulations, to help ensure that participants may realize the improved educational experience, convenience and outcomes that can result from technological advances.

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Vanguard appreciates the Department's careful attention to the issues of retirement readiness and income illustrations and the opportunity to comment on the ANPRM. We agree that retirement income projections can provide participants a helpful framework to evaluate and improve retirement savings. However, plan sponsors must be given sufficient flexibility and protection when providing such projections, and these projections must reflect participant preferences, plan terms, and the products and services that are actually accessible in the market. If you have any questions or require any additional information, please contact me or Stephanie Napier, Senior Counsel, Legal Department, at (610) 503-1377.

Sincerely,

Stephen P. Utkus

Stephen P. Utkus, Principal
Institutional Investor Group

cc: J. Mark Iwry, Department of the Treasury

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[30] *How America Saves 2013 – A Report on Vanguard 2012 Defined Contribution Plan Data* at 90-91. https://institutional.vanguard.com/iam/pdf/HAS13.pdf.

[31] The overwhelming majority of participant transactions (82 percent) and exchanges, deferrals, and contribution allocation changes (90 percent) also occurred on the internet. *Id.* at 92. Since 2003, the percentage of participants contacting Vanguard via internet has increased 63 percent, while the percentage of participants registered for internet access has increased 84 percent. *Id.*