



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

August 6, 2013

Re: RIN 1210-AB20
Attention: Pension Benefit Statements Project

Dear Deputy Secretary Borzi:

The steps taken so far by the Department of Labor (Department) and the Department of Treasury to seek comments from the public regarding lifetime income options for participants in retirement savings plans respond to the call for help that the National Institute on Retirement Security (NIRS) heard when we surveyed Americans about retirement security. In [Pensions and Retirement Security 2013](#), 86 percent of Americans agree that leaders in Washington need to give a higher priority to ensuring that more Americans can have a secure retirement. In fact, 62 percent feel that way strongly.

Only a mere two percent of Americans believe that compared to today it will be easier to prepare for retirement in the future. Yet, most employees find that they can only devote several hours a year to managing their retirement accounts. With so much to handle and so little time, no wonder when we asked Americans about features of retirement plans, 92 percent rated getting a monthly check during retirement as appealing.

In reality, most Americans are not on the path to secure retirements today. Households have not saved enough in their Defined Contribution (DC) accounts and most have little idea how much they need to save. So, NIRS appreciates the Department's interest in helping Americans assess their preparation for retirement by requiring estimates on benefit statements of possible streams of lifetime income payments generated by their retirement savings. It should help workers understand whether such income might adequately replace the paychecks left behind once they retire.

NIRS believes that the assumptions used in estimating future retirement income need to be appropriate and realistic in the context for which they are being used to help workers save enough money so that they will be able to retire. Compounding can take a small difference today and magnify it over decades. Therefore, when projecting how much income one might expect in retirement to replace earnings, it is also critical to have a

proper balance between salary growth and investment return assumptions. Not only should the assumptions be reasonable by themselves but the difference or spread between these two assumptions must also be appropriate. For example, the Advanced Notice of Proposed Rulemaking (ANPRM) suggests a safe harbor for assumptions used to produce benefit projections on employees' statements using 3 percent as the assumed wage growth and 7 percent as the assumed rate of return earned by the investments in the account. However these assumptions will tend to provide overly optimistic income replacement projections 40 years down the road and paint a misleading picture of adequate savings.

The [NIRS survey](#) also finds that the youngest members of the workforce, Millennials, are especially cognizant of the challenges presented by the current DC-centric retirement system. Not a single Millennial respondent believed that it would be easier to prepare for retirement in the future. We are concerned if these younger workers see optimistic projections that overstate eventual retirement benefits based on assuming wage growth of 3 percent coupled with investment earnings of 7 percent, these young workers will make decisions not to save enough in the early years of their careers when compounding works with its most powerful force – time. As discussed below, these proposed safe harbor assumptions have a greater spread than those used in the Fidelity model on adequate income and in the Aon-Hewitt study as well as rigorous actuarial experience studies of most public-sector defined benefit plans.

Americans Want Help Achieving Retirement Security

When NIRS probed deeper to find out why Americans believe that compared to today it will be harder to prepare for retirement in the future, [9 out of 10 respondents](#) cited salaries, fewer pensions and longer lives as factors that made it difficult to prepare. More than two-thirds described salaries and fewer pensions as major factors keeping them from reaching an adequate level of retirement security.

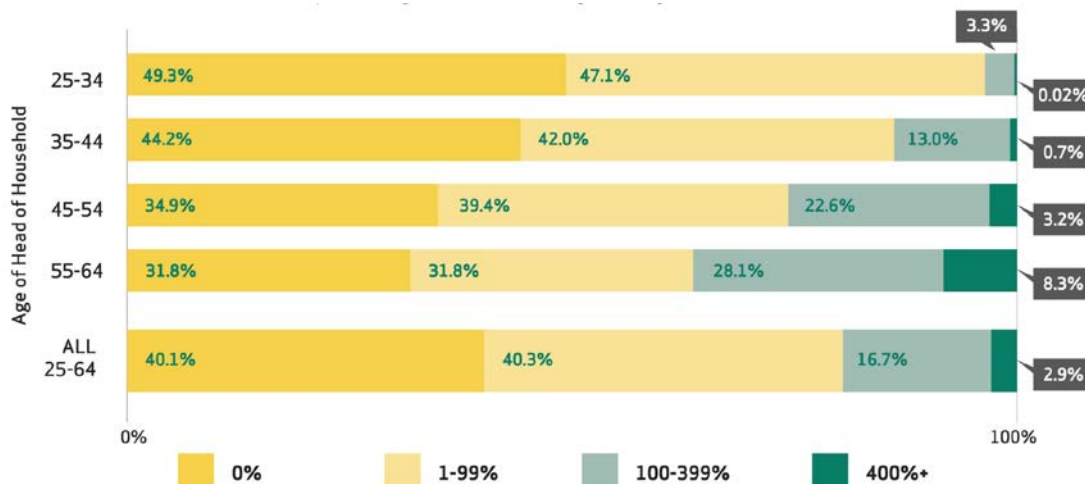
As the Department of Labor documents in the ANPRM, today fewer workers have traditional Defined Benefit (DB) pensions. This trend is now showing up in the makeup of income received by retired Americans. NIRS found that [42.8 percent of persons age 60 or older received DB pension payments](#) in 2010 from either their own or their spouses' employer-sponsored plan, as compared to 51.8 percent in 2003. The mean and median annual values of those DB pension payments received in 2010 per recipient were \$20,943 and \$14,403, respectively. No doubt, the multi-decade trend toward more employees having only DC plans as their only retirement plan is driving the change in income sources among older Americans.

Finding ways to mitigate this decline in the DB pension income receipt or income from similar lifetime products is important because [The Pension Factor 2012](#) found that the rate of poverty among older households without DB pension income was nine times greater than the poverty rate among older households with DB pension income.

At the same time, our recent report [The Retirement Savings Crisis: Is It Worse Than We Think?](#) found that 38 million working American households had no retirement savings in 2010. Using data from the Federal Reserve Survey of Consumer Finances, NIRS estimated the median retirement account balance is \$3,000 for all working-age households and \$12,000 for near-retirement households.

The chart below provides a snapshot of the retirement account balances held by our nation’s working households expressed as a percentage of the household’s current income. The reality that [4 out of 5 households have saved less than one times their current level of income](#) in retirement accounts suggest that we are severely underpreparing for retirement. These figures, broken down by age group below, clearly show the importance of motivating workers both to start and to increase their retirement savings.

Retirement account balances as a percentage of income among working households



The Need for Sound Assumptions for Lifetime Income Projections

The Department indicated that it agrees with those earlier commenters who saw a need to change the perception of retirement savings from simply a savings account to a

vehicle for income replacement during retirement. We completely agree, and the volume of comments submitted to the Department on its initial Request for Information attests to the interest in and importance of building a greater understanding of how to achieve what virtually everyone told us was a desired feature of a retirement plan -- replacing their paycheck

Translating the amounts saved in retirement accounts into monthly checks that will replace part of an individual's pre-retirement income is a difficult task for most participants to accomplish on their own. Given that nearly three-fourths of participants indicate that they [spend less than seven hours each year managing their 401\(k\) plan](#) and 45 percent spend less than four hours, creating easy to understand illustrations to show workers' retirement readiness and helping employers put these illustrations into participants' hands is a critically important retirement policy goal. We believe that with appropriate information given to workers on a regular basis, employers can help to motivate workers to increase their savings.

Data from [Pensions and Retirement Security 2013](#) indicate that Americans understand the central role of retirement savings accounts is to fund the replacement of the regular paychecks, which participants will no longer receive when they retire. In fact, [the 92 percent who rated receiving a monthly check during retirement](#) as appealing compared favorably with the 92 percent who also found having a portable benefit in the retirement system appealing.

Determining estimates of the level of income an employee's retirement account might realistically provide, in some cases forty years from now while in other cases just ten or fewer years from today, involves a complex set of assumptions about salary growth, contributions, investment returns, inflation and longevity. Fully understanding how such assumptions interact and impact the estimates is not easy for participants to understand. The Department of Labor is right to seek public comment on the topic as a way to build a better understanding and to ensure that estimates might more accurately project eventual benefits.

Over the years, financial experts have produced illustrations of the power of compounding investment returns. The results can be astounding and help to motivate individuals to increase their retirement savings, but showing compounding's power without proper bounds can lead to overly optimistic and even deceptive illustrations of eventual retirement income. Finding the proper balance among the assumptions, especially those labeled as a "safe harbor," is an important task for the Department and NIRS appreciates the opportunity to share its research and views.

One helpful step the ANPRM outlines is to balance the “what if projection” with an illustration of estimated income benefits based on the current account balance as a baseline. The ANPRM also suggests that providing both a reasonable standard for the assumptions underlying the projected retirement income benefits and also offering employers a “safe harbor” set of assumptions that would allow employers some certainty under a narrow set of assumptions. NIRS believes that it is important for the Department to make sure that the safe harbor assumptions produce likely outcomes that would be realistic estimates for all employees. For those individuals who would like to see benefit projections based on more aggressive assumptions, those can be completed with often just a few clicks on a website.

In 2010 after the near meltdown of financial markets, NIRS looked at several public pensions that survived the last decade’s two recessions and still maintained solid funding levels. A key finding from our case study analysis in [Lessons from Well-Funded Public Pensions](#) can inform the Department’s work on assumptions. These pension plans had economic actuarial assumptions that were reasonable and that could be expected to be achieved. There is an important interaction between investment growth, inflation and salary growth assumptions when trying to fund income replacement designed to last over the retirement years. While these public sector DB plans used somewhat higher investment return assumptions than the safe harbor, based on the expected returns of their plan assets and patterns of performance, their assumptions about salary growth were more complex and higher than proposed in the ANPRM. Also, the spread between these two key assumptions was narrower than the levels proposed in the ANPRM safe harbor. NIRS encourages the Department of Labor to further consider the sensitivity between the assumed growth in earnings and investments on the income benefit illustrations that will be used to educate employees about the long-term value they can anticipate from their retirement savings.

Why the Proposed Safe Harbor Assumptions May Be Misleading

Over the last decades many workers have had to contend with stagnant wage growth with respect to inflation, which has made it harder for many workers to save for retirement after taking care of their immediate needs. However, the proposed 3 percent growth in wages safe harbor assumption, which would produce no real wage growth over, in some cases, 40 years, is not a conservative assumption in the context of producing income benefit projections. Reducing risk of individuals reaching retirement with inadequate retirement account balances is the underlying purpose of making sure that more workers have the opportunity to consider such projected income illustrations on a regular basis.

Understating assumed salary growth in projections could lead to undersaving while creating an impression that a worker was on track to achieve an adequate level of preretirement income replacement. Because compound investment returns work best the longer money has time to grow, young entrants to the workforce could receive illustrations based on the proposed safe harbor assumptions that end up misleading them. As a result younger workers may not save enough during their most powerful compounding time.

Let me illustrate using the safe harbor assumptions for a 25 year-old employee who retires in 40 years at age 65 and who wisely starts contributing 6 percent of her salary in her 401(k) plan to get the full 3 percent matching contribution from her employer, the \$820,000 she accumulated in her account based on the 7 percent interest rate would replace about 58 percent of her final salary of \$95,000 (based on a \$30,000 starting salary, which increases each year by 3 percent) by paying her a annuity of \$54,800 each year. If instead her actual salary growth was more in line with assumptions most often used in benefit projections of a 4 percent salary growth over her career (a small percent more than general inflation), her final salary would be \$138,500. If she saved only the same dollar amount over her career in the earlier illustration then the \$54,800 would only replace 40 percent of her higher final pay and if same 9 percent of her higher career earnings were saved then she would have an annuity of \$63,500, which would replace 46 percent of her final earnings, significantly less than the initial projection.

In a blog posted on [Fidelity View Points](#) on February 27, 2013, Fidelity noted the ironic nature of relationship between earnings growth and adequate savings rates when it comes to illustrating projected retirement income. Writing about the sensitivity of the assumptions Fidelity used to model age-related retirement savings benchmarks, the author explained its salary growth assumption using Lily, an employee, for an example:

The faster your salary grows and the more you earn, the more you need to have saved in order to replace a given proportion of your final salary in retirement. Conversely, the slower your salary grows, the less you may need to have saved at retirement to maintain your lifestyle.

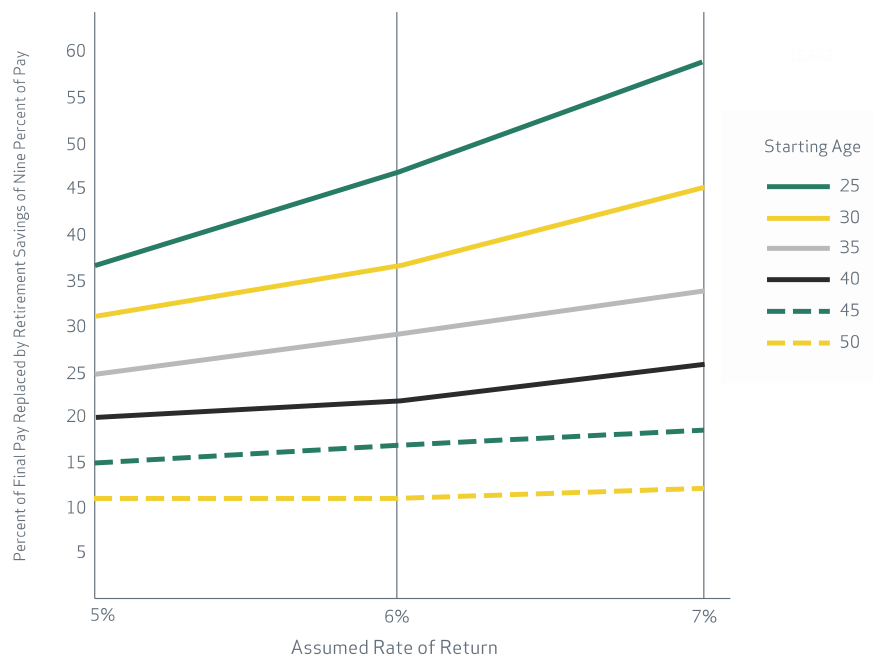
For example, if Lily were to get no real salary growth (keeping up with inflation only), she would need only \$279,000 (in today's dollars), or 7X her ending salary of \$40,000. If that salary grows at a modest 1.5% annual rate after inflation, [she will need \\$577,000, or 8X her higher ending salary.](#)

In its benchmark model Fidelity used a salary growth rate of 4.5 percent, which reflects a modest 1.5 percent growth rate after inflation. A similar study of retirement

preparedness by Aon-Hewitt, [The Real Deal](#), relied on the Aon-Georgia State Replacement Ratio Study, which assumes a 4 percent salary growth rate. In addition, Aon-Hewitt also tested for sensitivity of this assumption by increasing the salary growth rate to 5 percent. When Aon-Hewitt applied the base model to the real life participants of 78 of the nation’s largest employers they found that almost 30 percent of the full career employees were on track to reach a comfortable retirement at age 65.

Aon-Hewitt found that the average retirement savings shortfall for these employees was valued at 2.2 times final earnings so employees could use the realistic results to know that they would need to adjust their retirement savings to reach a more adequate level of income replacement. The Aon-Hewitt baseline projections had a 3 percent difference between the salary growth rate (4%) and its assumed investment earnings (7%) assumptions, while the Fidelity model had an even narrower spread of 1 percent.

Impact of Investment Earnings Assumptions on Benefit Illustrations



This chart shows the variations in the level of preretirement income replacement for projections based on the proposed 3 percent safe harbor salary growth rate with three increasing investment earnings assumptions, ranging from 5 percent to 7 percent, for six sample individuals who start saving in a DC plan at ages 25 to 50 and retire at age 65.

The upward increasing slopes of the lines in the graph, especially sharp for younger participants, illustrate how much the income projections are influenced by expanding

the spread between the two assumed factors. In the cart above, the 2 percent spread yields the most conservative projections while the 4 percent spread results in the most aggressive calculations. More realistic illustrations of eventual income benefits would result by narrowing the spread between the salary growth and investment return assumptions to less than the proposed 4 percent difference in the safe harbor.

Specifically, the low earnings growth assumption – zero real growth – and the 4-point spread between investment returns and earnings growth is unrealistic compared to historical experience and reputable studies of retirement savings adequacy. Therefore, we encourage the DOL, especially for the proposed safe harbor illustrations, to consider using a more reasonable real earnings growth rate and a narrower spread between earnings growth and investment returns assumptions of no more than 3 percent.

We also appreciate the Department's viewpoint of setting the assumptions in whole numbers to avoid giving the participants the false assumption that the projections are exact. Requiring benefit statements to illustrate the projected benefits as dollar amounts appears to reintroduce a suggestion of exactness. Expressing the benefits as a percent of preretirement income replaced by the savings in the account might both reinforce the nature of the estimate while eliminating the complex task of evaluating the benefit level adjusting for inflation.

NIRS appreciates the opportunity to share our experience as to how to make sure that the assumptions set for under the proposed safe harbor for benefit illustrations are both reasonable and appropriate so that estimated lifetime income streams of payments are a valuable and understandable tool for workers to use.

Please feel free to contact me if you have any questions.

With best regards,



Diane Oakley
Executive Director