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401(k), 403(b), 457
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Following are responses to the following: REQUEST FOR INFORMATION REGARDING LIFETIME INCOME OPTIONS FOR PARTICIPANTS AND BENEFICIARIES IN RETIREMENT PLANS, **RIN- 1210-AB33.**

Opinions expressed here are those of the author and not GWN Securities, Inc. and are not intended to constitute investment or tax advice.

Sincerely,

Carlos Tocabens

REQUEST FOR INFORMATION
REGARDING LIFETIME INCOME OPTIONS
FOR PARTICIPANTS AND BENEFICIARIES
IN RETIREMENT PLANS.

RIN- 1210-AB33

General

1. From the standpoint of plan participants, what are the advantages and disadvantages for participants of receiving some or all of their benefits in the form of lifetime payments?

Advantages

- Ability to ensure they do not run out of retirement income
- Reduced need to manage their own savings during retirement

Disadvantages

- Limited access to cash values to help with immediate cash needs
- Limited ability to grow invested assets during retirement
- The promised income may be at risk due to insolvency of the insurer
- Additional complexity during the plan enrollment or distribution decision process

2. Currently the vast majority of individuals who have the option of receiving a lump sum distribution or ad hoc periodic payments from their retirement plan or IRA choose to do so and do not select a lifetime income option. What explains the low usage rate of lifetime income arrangements? Is it the result of a market failure or other factors (e.g., cost, complexity of products, adverse selection, poor decision-making by consumers, desire for flexibility to respond to unexpected financial needs, counterparty risk of seller insolvency, etc.)? Are there steps that the Agencies could or should take to overcome at least some of the concerns that keep plan participants from requesting or electing lifetime income?

There are many factors including all the ones mentioned in the question that explain low usage:

- Many plan participants and individuals do not accumulate sufficient savings to begin with, so the monthly annuity benefit may be viewed as unsubstantial.
- Due to a the dynamics of the modern workforce (that experiences more frequent job changes, layoffs, relocations, etc.), choosing a lifetime income option may not be the

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optimal choice for a substantial portion of account balances available for distribution because they are:

- o owned by individuals who are far from retirement age
- o owned by individuals who still have many working years ahead of them and the situation at retirement may be uncertain
- o probably not significant in accumulated value
- o needed immediately to alleviate current financial duress.

- Annuity products can have many complicated features that are hard to quantify, hard to compare, and can require individual consultation to understand. By contrast, a lump-sum amount has a clear economic value that is easily understood.
- The individual consultation needed to understand and choose among annuity options may be unaffordable for many smaller plans, and for individuals/participants with smaller balances.
- Employers, particularly smaller employers, have limited resources and little time to dedicate to employee benefits education. They often focus the majority of their efforts on just trying to get employees to join the plan and contribute at sufficient levels, while having little time available to dedicate to educating the employees who may at or near retirement age.
- Many participants may not realize they can split their retirement distribution choice - allocating a portion of the distribution to a lifetime income product while retaining another portion as an account balance that can be accessed at any time.

3. What types of lifetime income are currently available to participants directly from plans (in-plan options), such as payments from trust assets held under a defined benefit plan and annuity

Under DB Plans:

In a DB plan, the default payment is a lifetime income stream. However, the participant generally may elect an alternate payment option (such as a joint life, or a 10-year certain payment, or lump-sum) or may select early or delayed retirement. However, the calculation of the adjustment needed to convert the normal benefit at 65 to another payment option is prescribed by plan formula and generally not subject to financial market results or annuity product variables. (Married participants may be required to receive the benefit in the form of a Joint and Survivor annuity, subject to authorized waiver from the spouse.)

- Some DB plans pay the required benefit as a check drawn on the trust assets. Though the future viability of those payments could be at some risk that the trust would become insolvent, the benefits of typical corporate DB plans are insured by the PBGC (within certain limits).

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- Some DB plans may transfer the funding to an insurance carrier by purchasing an annuity that will provide the required benefit payment. The annuity is not purchased until the participant reaches the distributable event (i.e. retirement). The future viability of the benefit payments could be at some level of risk that the insurance carrier would become insolvent.
- Other DB plans may employ a fully-insured approach. Each year they would purchase accumulation units from an insurance carrier that will provide the promised benefit at retirement.

Under 401(k) DC Plans:

- Some plans provide <u>alternate distribution options</u> that include annuity distribution options. Often, this may include a single life or joint & survivor options. This is a selection that the participant generally makes upon exiting the plan, not during the accumulation period. The account value is used to purchase the annuity and the conversion calculation is generally based on the particular insurance carrier's pricing. Under this model, the participant may be able to take his account value and shop for a different carrier and/or a higher guaranteed payment stream.
- Some plans are now providing an <u>in-plan insurance option</u> for participants to select a lifetime guaranteed income option while still in the accumulation phase – long before they actually terminate employment. The guaranteed minimum payment may be purchased (a) through additional fees added to a group of select investment funds – usually some version of asset allocation funds, or (b) by purchasing accumulation units of a special fixed interest account that may not directly participate in or benefit from stock market results, where the crediting interest rate is reduced by the cost of insurance.

Under 403(b) DC Plans:

- Many 403(b) plans are traditionally funded with annuity products – tax sheltered annuities. The products may include a guaranteed minimum benefit, a minimum death benefit, as well as various annuity distribution options. Additional fees to cover the cost of the death benefit and guaranteed minimum benefit insurance (mortality & risk fees) may be incorporated into the accumulation units, while the annuity distribution options would work similarly to the 401(k) <u>alternate distribution options</u> discussed above.
    - Unlike most 401(k) plans (were the funding vehicles were limited to those offered by a single vendor selected by the Plan Fiduciaries), participants in many TSA plans could independently shop among a wide array of Tax Sheltered Annuity products and vendors. Indeed, one participant may have contributed to several different TSA accounts set up with multiple insurance carriers. The various products were treated more like IRA's in their ownership status than typical 401(k) plans. (This model was viable due to the total lack of employer involvement and control. This resulted in all sorts of compliance problems. More

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recently, the IRS has issued new 403(b) regulations that have resulted in many employers reducing or eliminating the ability of participants to shop for vendors.)

  - Other 403(b) plans behaved more like a 401(k), in that there was only one TSA provider that offered the funding vehicles for all plans.

4. To what extent are the lifetime income options referenced in question 3 provided at retirement or other termination of employment as opposed to being offered incrementally during the accumulation phase, as contributions are made? How are such incremental or accumulating annuity arrangements structured?

Under 401(k) DC plans:

- Traditionally, under most 401(k) plans, lifetime income options were only available as a distribution choice selected by the participant upon exiting the plan at termination or retirement.
- More recently, some vendors are offering options where the selection must be made during the accumulation phase (in some cases the accumulation period must meet minimum requirements – such as five or more years of accumulation before benefits may begin). The participants pay an additional fee, during the accumulation period as well as during the distribution period.
  - Many DC plans use asset-allocation or target date funds as the accumulation vehicle. These plans often offer lifetime guaranteed income coverage as an optional "wrap-around" benefit. Investors selecting the asset-allocation or target date investment alternatives are not generally required to choose the lifetime income coverage. However, if they do select coverage, they can only get coverage for those savings which are retained in the alternatives that are part of the lifetime income platform (i.e. the asset-allocation or target-date funds). Savings transferred out or withdrawn generally will lose the insurance coverage. Coverage is provided for an additional fee, generally tacked onto the assets in the covered funds only (therefore, the investment experience for covered savings will be lower than those who are invested in the same investment alternatives but who do not elect coverage).
  - Other DC plans use a fixed interest account as the accumulation vehicle. These plans provide the lifetime guaranteed income coverage as part of investing in the account. Selecting to contribute to this investment option automatically provides the insurance coverage. Savings transferred out or withdrawn from the account generally will lose the insurance coverage. The fees for the insurance coverage are generally collected by reducing the interest rate that the account would otherwise receive if it did not provide the benefit.

5. To what extent are 401(k) and other defined contribution plan sponsors using employer matching contributions or employer nonelective contributions to fund

lifetime income? To what extent are participants offered a choice regarding such use of employer contributions, including by default or otherwise?

- Some sponsors may allow the ability to split the investment directives of the employer match. This may be limited by the complexity and added cost of having split directives. Currently, I know of no 401(k) plans that offer split directives <u>and</u> in-plan annuities.

6. What types of lifetime income or other arrangements designed to provide a stream of income after retirement are available to individuals who have already received distributions from their plans (out-of-plan options), such as IRA products, and how are such arrangements being structured (fixed, inflation adjusted, or other variable, immediate or deferred, etc.)? Are there annuity products under which plan accumulations can be rolled over to an individual retirement annuity of the same issuer to retain the annuity purchase rights that were available under the plan?

- Any individual or participant who has cashed out of their retirement plan has a wide variety of lifetime income products to choose from. Although a lifetime income product might not be offered by the financial institution where their personal accounts reside, generally there are many sources for purchasing all sorts of annuity products, including fixed annuities, fixed with automatic annual inflation increases, variable, deferred, index, etc. The product choices may be limited by their state of residency and some other factors, but there are still a plethora of choices for someone to select when cashing out of their retirement plan.
- Yes, typically, vendors who offer "in-plan" annuities do offer a product whereby a participant eligible for a distribution may retain the annuity product characteristics by rolling into another product of the same vendor and retain their previous annuity rights.

7. What product features have a significant impact on the cost of providing lifetime income or other arrangements designed to provide a stream of income after retirement, such as features that provide participants with the option of lifetime payments, while retaining the flexibility to accelerate distributions if needed?

The following are all examples of features that can affect the benefit level cost:

- Ability to direct investments into variable options
- Survivor benefits
- Return of principal
- Term-certain payments (i.e. 10 year-certain)
- "High-water" or indexing features (that may lock in higher market values for purposes of determining minimum benefit payments)
- Annual cost-of-living increases
- Unscheduled withdrawals

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8. What are the advantages and disadvantages for participants of selecting lifetime income payments through a plan (in-plan option) as opposed to outside a plan (e.g., after a distribution or rollover)?

	In-Plan	Outside-The-Plan
Advantages of In-Plan Option		
Downside Protection	Some in-plan options may provide the ability to lock in a "high water" mark, i.e. minimize losses during market declines while still in the accumulation phase. This may protect the participant from significant market losses near or at retirement (that may otherwise reduce the guaranteed benefit).	A market downturn near or at retirement age may affect the lump-sum value available to purchase the lifetime income, thereby forcing the participant to accept lower payments or delay an annuity purchase.
Disadvantages of In-Plan Options		
Upside Capture During Accumulatio	A participant's ultimate account value may be significantly reduced by paying extra fees during the accumulation period, thereby actually reducing the maximum benefit (compared to purchasing an annuity at retirement).	The participant is not paying added fees nor being restricted in investment fund choices, so the upside potential may be greater in up markets (over In-plan options).
Complexity	In-plan lifetime income products may be confusing for the average participant to be able to evaluate – especially when a decision made today may not fit their situation decades later – and they may make decisions based on hype or sales pitches that may not be appropriate for them.	Though there is still complexity in choosing among distribution options, there is a more clear financial picture when the participant is at (or close to) retirement. Therefore, they may be better able to evaluate their particular situation.

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Security of the Guarantee	Unlike a defined benefit pension plan whose benefit payments may be guaranteed by the federal government (via the Pension Benefit Guarantee Corporation), there is no such federal program for defined contribution benefit payments. Therefore, the guarantee as to the minimum benefits is generally based solely on the guarantor's ability to make those payments. A participant using an in-plan option may be making a selection for a product he will not be using for many years or decades, while the financial strength of the insurer deteriorates.	Although the guarantee as to the minimum guaranteed benefits is generally based solely on the guarantor's ability to make those payments, a participant using an out-of-plan lifetime annuity option may be making a selection (and evaluation of the insurer) closer to the actual use of the guarantee (thereby possibly making his conclusions about risk of default more relevant).
Portability	Portability at termination of employment may be restricted with an in-plan lifetime income option. Participants who do not elect to leave their funds in the Plan (or in a qualifying individual investment account with the plan investment provider) will lose the guarantee (possibly after having paid fees during an accumulation period that may have lasted many years or decades).	NA. By purchasing the product at cash-out from the plan, the participant is purchasing an individual product that is fully portable.
Product Choice	The in-plan option may be restricted to a single issuer. Participants may overpay for the guaranteed income insurance because of lack of competition.	The participant is able to choose among any number of products, in addition to any vendors designated by the plan sponsor, resulting in more choices and possibly improved competition.
Management of products	Participants who change jobs frequently could accumulate a confusing array of in-plan annuity products.	NA. The participant does not purchase a product until he is at or near retirement, allowing him to consolidate positions and purchase a minimum number of products.

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Fees	Due to the reality of the modern workforce (that experiences more frequent job changes, layoffs, relocations, etc.), the typical account balance at distribution is (a) probably not significant, and (b) needed immediately by the individual to alleviate current income needs. Therefore, choosing an in-plan lifetime income option could result in paying fees for a benefit that will often not be used. (This may affect lower-paid employees disproportionately since they are often the ones that only accumulate small balances within each plan.)	NA. The participant does not purchase a product until he is at or near retirement, allowing him to defer purchases until such time as it may be more relevant to his needs and perhaps saving on the total fees paid.
Fees	Participants may be locked into a distribution election many years in advance of their retirement date. Altering that election later may result in having paid for a benefit the participant eventually did not use.	NA. Elections are made at or near retirement.
Collateral Damage	If participants are limited to a specific set of investment funds (that qualify for the lifetime income protection), the participant may be adversely affected by the actions of a Plan Fiduciary who later deletes the funds from the plan's investment menu (as required by the plan's investment policy) due to performance issues.	NA. Actions taken by the plan fiduciary to delete designated plan investment alternatives should have no affect on the guaranteed income insurance since it is purchased outside the plan.
Collateral Damage	A participant's rights may be eliminated by a Plan Fiduciary's decision to transfer all plan assets to a new service provider if it is not feasible, or if it too costly, for the new service provider to record-keep and administer "outside assets".	NA. Actions taken by the plan fiduciary to transfer all plan assets to a new service provider should have no affect on the guaranteed income insurance since it is purchased outside the plan.
Access to Funds	A financial hardship withdrawal or loan default could significantly reduce the guaranteed minimum benefit even though the participant may have paid extra fees during the accumulation phase.	No affect.

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9. What are the advantages and disadvantages from the standpoint of the plan sponsor of providing an in-plan option for lifetime income as opposed to leaving to participants the task of securing a lifetime income vehicle after receiving a plan distribution?

Advantages of In-Plan Option

- For In-Plan Options that provide a "high water" mark to lock in minimum guaranteed lifetime income, participants may be reassured that they will receive a benefit that may be protected from certain market losses while still employed.

Disadvantages of the in-Plan Option

The fiduciary responsibility standards imposed by ERISA clearly apply to any decision by an employer to include in-plan lifetime income options. This is particularly challenging for smaller employers already struggling with administering 401(k) plans.

- The Plan's Investment Policy Statement may need to address the inclusion of the lifetime income benefit and how the annuity provider(s) or guarantor(s) will be selected and monitored.
- The Plan fiduciary may be making the selection of an annuity provider years or decades before many participants are even eligible for a payment. During that period, the financial condition or situation may deteriorate significantly and affect their ability to make payments.
- If participants are limited to a specific set of investment funds (that qualify for the lifetime income protection), the Plan Fiduciary may later find itself in a quandary if those investments perform poorly and would need to be unilaterally removed from the plan to satisfy the Investment Policy Statement and to meet its fiduciary duty.
- Actions by the Plan Fiduciary to transfer the plan to another vendor could have an adverse impact on current and former participants who have balances in the annuity product. The Plan Sponsor may not be able to afford the record-keeping and administration costs for the old annuity balances.
- Educating participants is often a critical challenge for employers. Educating participants on the benefits and features of in-plan annuity products may result in more confusion and lower participation rates during initial enrollment.

10. How commonly do plan sponsors offer participants the explicit choice of using a portion of their account balances to purchase a lifetime annuity, while leaving the rest in the plan or taking it as a lump sum distribution or a series of ad hoc distributions? Why do some plan sponsors make this partial annuity option available while others do not? Would expanded offering of such partial annuity options – or particular ways of presenting or framing such choices to participants – be desirable

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and would this likely make a difference in whether participants select a lifetime annuity option?

The prototype plan documents historically used by a large number of 401(k) plans have offered the ability to provide a plethora of distribution options, including installment payments for a fixed period, single-life and joint annuities, along with lump-sum distributions. Generally, the participant could elect to divide the distribution among the options as needed, so it would not be accurate to say that plan sponsors did not allow it but that participants just didn't make the selection.

More recently, annuity distribution options have been less common in 401(k) plans. Some of the reasons why fewer plans have offered annuity choices as distribution options include:

- Rarely did any participants elect an annuity option,
- Explaining annuity options is a complex task, while everyone understands a lump-sum,
- By having a joint annuity option, the plan may be subjected to additional restrictions in the cases where a participant requests a loan or in-service withdrawal,
- Increased fiduciary liability from the selection on an annuity vendor.

One way to increase the use of lifetime annuity use at distribution could be to require plans to designate an annuity as the normal form of distribution, unless a participant makes another designation (such as lump-sum). However, this should only apply to distributions where the participant makes an affirmative application for benefits (i.e. it should not apply to any automatic (small amount) cash-outs or automatic rollovers. It also would not apply to Required Minimum Distributions, hardships and in-service withdrawals.

11. Various "behavioral" strategies for encouraging greater use of lifetime income have been implemented or suggested based on evidence or assumptions concerning common participant behavior patterns and motivations. These strategies have included the use of default or automatic arrangements (similar to automatic enrollment in 401(k) plans) and a focus on other ways in which choices are structured or presented to participants, including efforts to mitigate "all or nothing" choices by offering lifetime income on a partial, gradual, or trial basis and exploring different ways to explain its advantages and disadvantages. To what extent are these or other behavioral strategies being used or viewed as promising means of encouraging more lifetime income? Can or should the 401(k) rules, other plan qualification rules, or ERISA rules be modified, or their application clarified, to facilitate the use of behavioral strategies in this context?

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We use automatic savings features successfully in several plans we work with. So, I agree that "behavioral" strategies to increase plan participation and savings accumulation are very desirable.

However, I would caution that use of automatic features to increase use of lifetime income products could actually serve to erode the very savings they are meant to protect if they are not thoughtfully structured.

Furthermore, although a 401(k) is thought of as a retirement plan, many participants don't view it that way. A 401(k) is primarily funded by the participant foregoing current salary. Compare that to a traditional pension plan where the employer primarily funds the plan as true pension benefits without reducing the participant's salary. Therefore, 401(k) participants should have more input as to how they spend their deferred salaries.

Clearly ERISA and 401(k) rules need to modified whether or not use of lifetime guaranteed is desirable, since many such products are being marketed. Smaller employers in particular may not have the expertise to make informed evaluations about such complicated products. Since employees put a great deal of faith (and their retirement nest eggs) in their employers, appropriate guidance should be rendered promptly.

12. How should participants determine what portion (if any) of their account balance to annuitize? Should that portion be based on basic or necessary expenses in retirement?

Great question, except I think the question assumes that most participants would have accumulated sufficient savings to truly have a choice. Much of the research implies that many (if not most) participants have not saved enough for retirement – regardless of whether they annuitize or keep their savings invested.

For those who accumulated sufficient savings, covering basic expenses should be the goal of an annuity strategy.

13. Should some form of lifetime income distribution option be required for defined contribution plans (in addition to money purchase pension plans)? If so, should that option be the default distribution option, and should it apply to the entire account balance? To what extent would such a requirement encourage or discourage plan sponsorship?

Whereas (in the past) it was more common for an employee to work for a single employer throughout their career and receive a single pension benefit, today's workforce is more mobile than ever. Many individuals find themselves working for many different employers and may even have several career changes. They may even accumulate an array of 401(k) and IRA's, some significant, many not-so-significant. They may even need to dip into those savings for unexpected emergencies or large commitments.

There should not be a mandatory distribution option. To begin with, it could complicate an individual's ability to manage their financial affairs. For example, some individuals

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my find that they wish to defer the receipt of income so they could use their savings for travel or other unscheduled needs. Others may find that they prefer to work beyond retirement age and use a lump-sum cash-outs or withdrawals to meet their needs.

Such a requirement in a defined contribution plan might also handcuff the ability of small plan sponsors to design plans that fit their particular situation. The added complexity could reduce plan participation. The certain increase in administrative, compliance, and audit costs will do nothing to help increase plan sponsorship. More complexity rarely results in increased plan sponsorship.

I am certain that many in the industry may push for default lifetime income options. If, as a matter of policy, if using lifetime income features is desirable, it should be promoted first through the expansion of the required notices when a participant applies for a distribution.

If increase use of lifetime income becomes a desirable policy objective, they should only be allowed as the <u>default</u> 401(k)/DC election as follows:

- o For In-Service Withdrawals or distributions after age 59-1/2
- o For accounts that meet a specific minimum cash value (i.e. $50,000)
- o As a lifetime income stream that provides minimum survivor benefits (such as Single-Life with 15 Year Certain)
- o For a portion of the distribution not to exceed 50% of the cash value of employee contributions (for employer contributions, 100%)
- o It should <u>not</u> be allowed at all for "In-Plan" lifetime income products. (Forcing a participant into investment choices that may carry extra fees during accumulation for an insurance coverage that may never be used will only serve to further erode their retirement savings.)

14. What are the impediments to plan sponsors' including lifetime income options in their plans, e.g., 401(k) or other qualification rules, other federal or state laws, cost, potential liability, concern about counterparty risk, complexity of products, lack of participant demand?

All the following are impediments:

- Potential expanded fiduciary liability in the selection of the annuity providers
- Complexity of products and features
- Lack of comparative data on products
- Increased administrative and compliance complexity
- Increased audit/accounting burden (and associated increased in audit costs)

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- Lack of participant demand
- Additional cost to the participant

15. What are the advantages and disadvantages of approaches that combine annuities with other products (reverse mortgages, long term care insurance), and how prevalent are these combined products in the marketplace?

Annuities, and the other financial products (mentioned in the question), can be an important part of a thoughtful financial plan. These products are readily available through the individual marketplace.

Some larger employers may be offer some or all of these products through the worksite – the products are offered as an array of products delivered by various vendors. However, employees generally do not have the expertise and time to appropriately assemble and coordinate the coverage /products on their own, and may purchase unsuitable products based on pitches in group meetings.

16. Are there differences across demographic groups (for example men vs. women) that should be considered and reflected in any retirement security program? Can adjustments for any differences be made within existing statutory authority?

Of course there are differences. For example, women generally have a longer life expectancy than men. Women sometimes also have smaller earnings during their lifetimes from which to accumulate retirement savings, due to exiting the workforce to raise families or because of pay disparity.

I'm not aware of adjustments that could be made using existing authority. I'm also not aware of how you could positively impact most disparities through a retirement plan, other than requiring the use of unisex assumptions in establishing annuity benefit levels.

Participant Education

The Department of Labor issued Interpretive Bulletin 96-1 (29 CFR 2509.96-1) to clarify that the provision of investment education, as described in the Bulletin, will not be considered the provision of "investment advice," which would give rise to fiduciary status and potential liability under ERISA for plan participants' and beneficiaries' investment decisions.

17. What information (e.g., fees, risks, etc.) do plan participants need to make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement? When and how (i.e., in what form) should it be provided? What information currently is provided to participants, who typically provides it, and when and how is it provided to them?

Critical information that participants must receive includes:

- That benefit payments are guaranteed solely by the issuer(s)

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- The projected amount of replacement income which the product will provide
- The cost-of-living adjustments that may apply to benefit payments
- The restrictions on, and affect of, any withdrawals and loans
- Any requirements that contributions be restricted to specific investment options
- Fees applicable to the lifetime income option:
    - during the accumulation period
    - during the distribution phase
    - the maximum fees that apply and under what condition the fees may change
    - to any optional features (and fees)
    - any sales or surrender fees
- Conditions which could adversely affect the income guarantee, including:
    - Future changes to plan service providers
    - Future changes to the underlying investment options
- The lack of the product's portability
- Any free-look period

The information should be provided by the Plan Fiduciary (as is all investment information is currently required to be provided). Any contracts, prospectuses, or disclosures may be prepared by the insurer or other third-parties, but (as with all investment disclosures currently required) the plan fiduciary should be responsible for providing information on any in-plan or designated lifetime income options. The information should be provided at least 30 days prior to the participant being able to select the lifetime income option.

18. Is there a need for guidance, regulatory or otherwise, regarding the extent to which plan assets can be used to pay for providing information to help participants make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement, either via an in-plan or out-of plan option?

Yes. Expenses for providing education should only be payable from plan assets if the guidance is truly independent and unbiased. Such guidance should be akin to the guidance applicable to investment advice, since the selection of one distribution or annuity option over another could provide a direct or indirect benefit to those who provide the guidance.

19. What specific legal concerns do plan sponsors have about educating participants as to the advantages and disadvantages of lifetime income or other arrangements

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designed to provide a stream of income after retirement? What actions, regulatory or otherwise, could the Agencies take to address such concerns?

The legal concerns are focused on increased Fiduciary Liability:

In each of the situations below, a participant that makes a selection that later goes sour may sue the plan sponsor (many years after terminating from the plan) claiming that they were misinformed, did not receive sufficient disclosure about the risks, or were provided incorrect investment advice. Such a claim would be difficult to validate many years after the employee has left employment.

(a) If not properly handled, describing the advantages / disadvantages of lifetime income products could be akin to providing investment advice (which could increase fiduciary liability).

(b) Some participants may misunderstand and believe that lifetime income is equivalent to ”sufficient” income.

(c) Providing education about in-plan or designated lifetime income products could be perceived as an endorsement of the product vendor.

(e) In some cases, there may be a requirement that a participant invest in specific investment alternative (in order to receive the lifetime income benefit), which may provide poorer investment results (and hence low guaranteed income) than alternate investments.

(f) The plan sponsor may be required to take actions (such as terminating a poor-performing fund or vendor) which may unilaterally affect the guarantee provided participants.

(g) Variances in investment results could have a significant impact on the ultimate value of the guaranteed benefit.

Recommended Agency Action

Regulatory agencies should include publishing model language that can be provided to terminating participants, which may be similar to the Tax Notice, describing the different

20. To what extent should plans be encouraged to provide or promote education about the advantages and disadvantages of lifetime annuities or similar lifetime income products, and what guidance would be helpful to accomplish this?

For plans that have “in-plan” lifetime income options, plan fiduciaries should be required to provide sufficient information and education for participants to make informed decisions about all their distribution choices. They should also be reminded of The Department of Labor’s regulation 29 CFR 2550.404a-4 which contains a fiduciary safe

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harbor for the selection of annuity providers for the purpose of benefit distributions from defined contribution plans.

For plans that do <u>not</u> provide in-plan lifetime income options, plan sponsors should be encouraged to provide balanced education about all distribution options (including lifetime income/annuities" and that participants can purchase lifetime income products from various sources. Regulatory agencies should publish model language that can be provided participants, which may be similar to the Tax Notice that is required to be provided to participants who are eligible to receive a distribution.

Disclosing the Income Stream that Can be Provided from an Account Balance

ERISA section 105 requires defined contribution plans to furnish to each participant an individual benefit statement, at least annually, that includes the participant's "accrued benefits," i.e., the individual's account balance.

21. Should an individual benefit statement present the participant's accrued benefits as a lifetime income stream of payments in addition to presenting the benefits as an account balance?

Yes. However, the information should only be required to be provided on an <u>annual</u> basis.

22. If the answer to question 21 is yes, how should a lifetime stream of income payments be expressed on the benefit statement? For example, should payments be expressed as if they are to begin immediately or at specified retirement ages? Should benefit amounts be projected to a future retirement age based on the assumption of continued contributions? Should lifetime income payments be expressed in the form of monthly or annual payments? Should lifetime income payments of a married participant be expressed as a single-life annuity payable to the participant or a joint and survivor-type annuity, or both?

The information provided may depend on whether the plan offers designated products/vendors and whether a specific product has been selected by the participant. Therefore, plans that offer that are selected during the accumulation phase will need to depict more "customized" information that is specific to the product/features selected by the participant.

For plans that provide in-plan lifetime income products, the projections provided should be specific to the product(s) selected by the participant and based on assumptions specific to the participant. If a participant has not selected a product, the assumptions should provide for a "default" product selection. Disclosures should advise participants that the actual income received and guarantees may differ and should highlight the factors that can affect the income.

For plans that do <u>not</u> provide in-plan lifetime income products, the projections should be based on <u>a universal default</u> product based on an agency-published table. Disclosures

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should advise participants that the information is only provided for retirement planning purposes and does not depict any specific product or guarantees.

Projections should otherwise include certain uniform features (so it is easier for employers to communicate those features using standardized language and easier for employees to evaluate projections and compare products as their employment changes from one employer to the next). This would include the following uniform features:

- Retirement age (67)
- Benefit frequency (Monthly)
- Benefit type (Payable as a single-life annuity with 15-year certain survivor benefit*)
- Annual cost-of-living increases (3%)

The benefit depicted by the uniform features should be designated as a payment option that <u>must</u> be available to participants if the plan allows lifetime income options.

*Since actual marital status at retirement is impossible to project decades in advance, I think illustrating a joint-life to married individuals while showing a single life to others would not acknowledge the reality that many married individuals mat divorce and single individuals may marry later, others may not marry but may have life-partners, and yet others will want to leave some benefit to their heirs. A single-life annuity with 15-year certain survivor benefit may provide a safer middle ground that could help make it easier for plan fiduciaries to explain.

Illustrations should include (both) a benefit that only incorporates current account values alongside one that assumes continued contributions. This will help promote the value in continuing contributions as well as the possible consequence of breaking the pattern.

23. If the answer to question 21 is yes, what actuarial or other assumptions (e.g., mortality, interest, etc.) would be needed in order to state accrued benefits as a lifetime stream of payments? If benefit payments are to commence at some date in the future, what interest rates (e.g., deferred insurance annuity rates) and other assumptions should be applied? Should an expense load be reflected? Are there any authoritative tools or sources (online or otherwise) that plans should or could use for conversion purposes, or would the plan need to hire an actuary? Should caveats be required so that participants understand that lifetime income payments are merely estimates for illustrative purposes? Should the assumptions underlying the presentation of accrued benefits as a lifetime income stream of payments be disclosed to participants? Should the assumptions used to convert accounts into a lifetime stream of income payments be dictated by regulation, or should the Department issue assumptions that plan sponsors could rely upon as safe harbors?

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As discussed in #22, the assumptions may depend on whether the plan offers designated products/vendors and whether a specific product has been selected by the participant. Therefore how the benefit is depicted could be affected by product features and pricing.

For plans that make available in-plan lifetime income products, the assumptions used should be specific to the product(s) selected by the participant and based on assumptions specific to the participant. If a participant has not selected a product, the assumptions should assume a "default" product selection.

Otherwise, assumptions should be mandated by regulation and should be uniform assumptions (available from a table published from the appropriate government agency). Using uniform assumptions for plans that do not offer specific products would help:

- Avoid the cost of hiring actuaries
- Provide consistent results among different employers and vendors
- Avoid confusion among employees
- Facilitate cost-effective universal education efforts
- Promote savings goals

Uniform actuarial assumptions should include:

- Expense load
- Unisex Mortality*
- Conservative pre-retirement interest rate assumption of 7% for calculating accumulations

Caveats about plan assumptions should be included and full disclosure should be made available to participants.

24. Should an individual benefit statement include an income replacement ratio (e.g., the percentage of working income an individual would need to maintain his or her pre-retirement standard of living)? If so, what methodology should be used to establish such a ratio, such as pre-retirement and post-retirement inflation assumptions, and what are the impediments for plans to present the ratio in a meaningful way to participants on an individualized basis?

No, income replacement ratios should not be depicted.

Although income replacement ratios can be useful when an individual is calculating their retirement income needs, as a practical matter they may be difficult for an employer to establish when they do not have all of an employee's financial data. Additionally, year-to-year fluctuations in income and market performance can skew the projections in

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opposite directions year-after-year. This could result in projections that are not meaningful and potentially counter-productive.

For example: Assume that an employee is experiencing a period of unusually low income – such as during unpaid leave, reduced work hours, etc. By incorporating the lower income into an income replacement ratio calculation, the individual may be lead to believe that their current account balance will provide a much bigger portion of their retirement income needs (than it actually may).

401(k) and Other Plan Qualification Rules

Income Tax Regulations that apply specifically to lifetime annuities include: 26 CFR 1.401(a)-11, 26 CFR 1.401(a)-20, 26 CFR 1.401(a)(9)-1 through 26 CFR 1.401(a)(9)-9, 26 CFR 1.417(a)(3)-1, and 26 CFR 1.417(e)-1.

25. How do the 401(k) or other plan qualification rules affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income? Are there changes to those rules that could or should be made to encourage lifetime income without prejudice to other important policy objectives?

While life expectancy has risen significantly, most individuals are not accumulating significant retirement assets. Focusing on making small balances "last" overlooks the obvious need to first ensure individuals accumulate savings that can make a real difference. No changes should be made to encourage the use of lifetime income options, unless significant changes are made in making it easy for employers to offer successful plans that are successful at accumulating significant savings.

26. Could or should any changes be made to the rules relating to qualified joint and survivor annuities and spousal consents to encourage the use of lifetime income without compromising spousal protections?

Yes. Spousal consent rules are outdated and reflect a period in our history when men were primarily the ones covered by pension plans and non-working spouses needed protection. Revised rules should allow individuals more freedom to decide what to do with their deferral savings.

27. Should further guidance clarify the application of the qualified joint and survivor annuity rules or other plan qualification rules to arrangements in which deferred in-plan insurance annuities accumulate over time with increasing plan contributions and earnings?

Yes.

28. How do the required minimum distribution rules affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income? Are there changes to those rules that could or should be made to encourage lifetime income without prejudice to other important policy objectives? In particular, how

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are deferred annuities that begin at an advanced age (sometimes referred to as longevity insurance) affected by these rules? Are there changes to the rules that could or should be considered to encourage such arrangements?

The goal of Required Minimum Distribution (RMD) rules is to accelerate the receipt of deferred retirement income and the collection of tax revenue, while lifetime income options are concerned with providing a minimum guaranteed lifetime income.

RMD rules apply to qualified plans, IRAs, and generally apply to Qualified Plan Distributed Annuities. They require that minimum payments begin by age 70-1/2 (or, for qualified plans, at actual retirement from employment if later). These requirements may be at odds with an individual's desire to conserve savings and postpone receipt of income (in order to maximize the amount of the payout at a later time).

Longevity insurance is a form of lifetime income that defers the payout to an advanced age (i.e. 85), providing for minimum guaranteed income (for someone who expects to live beyond the normal life expectancy) with minimal or no survivor benefits to maximize the payout. The goals of RMD is at odds with the goals of longevity insurance.

As life expectancy continues to increase, many individuals may find that they have not accumulated enough assets for a long life in retirement. They may elect to work much longer, perhaps into their 80's. Others may have accumulated assets, but wish to preserve part of those assets due to the longer lifespan. The RMD rules are in conflict with these objectives.

Clearly the outdated RMD rules could result in many individuals being forced to deplete retirement savings while they may still have many years to life. It could be particularly onerous on single individuals. The RMD rules should be eliminated or revised in a manner that allows one to preserve retirement assets until much later by changing the required beginning date to Age 85, and allow for distributions that assumes life expectancy to age 121.

29. Are employers that sponsor both defined benefit and defined contribution plans allowing participants to use their defined contribution plan lump sum payouts to "purchase" lifetime income from the defined benefit plan? Could or should any actions be taken to facilitate such arrangements? Should plans be encouraged to permit retirees who previously took lump sums to be given the option of rolling it back to their former employer's plan in order to receive annuity or other lifetime benefits?

I am not aware of employers that allow purchasing of pension benefits using defined contribution balances.

Terminated and retired participants are already capable of choosing from a large array of lifetime income products available in the individual market:

(a) Since defined benefit plan funding status could be subject to financial market performance and the plan sponsor's ability to make future contributions, it

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could be riskier for a participant to deposit his DC lump-sum value into the defined benefit plan instead of purchasing an annuity directly.

(b) Depositing the DC lump-sum balance into a DB plan to obtain lifetime income through the pension plan may not provide a larger annuity benefit (than purchasing an individual annuity) unless the former employer's defined benefit trust is subsidizing the annuity (and the employer is willing to take on the potential funding liability).

(c) Will such converted balances be covered under the PBGC insurance program? Will the federal government be taking on additional liabilities for underfunded plans? At what levels would benefit amounts be covered?

Based on these issues, I do not believe these arrangements should be facilitated.

Selection of Annuity Providers

The Department of Labor's regulation 29 CFR 2550.404a-4 contains a fiduciary safe harbor for the selection of annuity providers for the purpose of benefit distributions from defined contribution plans.

30. To what extent do fiduciaries currently use the safe harbor under 29 CFR 2550.404a-4 when selecting annuity providers for the purpose of making benefit distributions?

I am not aware of any plan sponsor that is even aware of the safe harbor when selecting annuity providers.

31. To what extent could or should the Department of Labor make changes to the safe harbor under 29 CFR 2550.404a-4 to increase its usage without compromising important participant protections? What are those changes and why should they be made?

There is no modification of the safe harbor itself needed except to specifically state that it applies to "in-plan" lifetime income providers, as well as designated Qualified Plan Distributed Annuities. Additionally, due to the recent increase in the marketing of these "in-plan" lifetime income products, the DoL should focus efforts to further educate plan fiduciaries regarding their responsibilities with regards to choosing an annuity provider.

32. To what extent could or should the safe harbor under 29 CFR 2550.404a-4 be extended beyond distribution annuities to cover other lifetime annuities or similar lifetime income products? To which products should or could the safe harbor be extended?

The DoL should specifically state that fiduciary responsibility and the safe harbor apply to all designated lifetime guaranteed income products, whether they are "in-plan" products of those provided by the plan to fund distributions.

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ERISA Section 404(c)

ERISA section 404(c) and 29 CFR 2550.404c-1 provide defined contribution plan fiduciaries with limited relief from the fiduciary responsibility provisions of ERISA where a participant or beneficiary exercises control over the assets in his or her account.

33. To what extent are fixed deferred lifetime annuities (i.e., incremental or accumulating annuity arrangements) or similar lifetime income products currently used as investment alternatives under ERISA 404(c) plans? Are they typically used as core investment alternatives (alternatives intended to satisfy the broad range of investments requirement in 29 CFR 2550.404c-1) or non-core investment alternatives? What are the advantages and disadvantages of such products to participants? What information typically is disclosed to the participant, in what form, and when? To what extent could or should the ERISA 404(c) regulation be amended to encourage use of these products?

Such products are being actively marketed and we're seeing many national providers offering a version. They are often designed as a directed investment of the participant, with the benefit "wrapped" around existing designated/core investment alternatives, which are already incorporated as part of the 29 CFR 2550.404c-1 investment alternatives. For example, the lifetime income guarantee might be offered (for an additional fee) as a benefit for investing in a core group of asset allocation or target retirement funds.

The information provided to participants could be described as a combination of marketing materials and disclosures. The materials include illustrations of how the lifetime income products may protect participant savings during extended periods of poor market returns, particularly during the distribution phase.

The materials may also describe:

- The additional fees that are collected for providing the guarantee
- The investment alternatives which may be used without losing the guarantee
- The limitations on portability

There are no changes to ERISA 404(c) that should be made.

The disadvantages to participants as they relate to exercising control under ERISA 404(c) are as follows: In contrast to traditional annuities chosen at distribution, in-plan lifetime income products collect fees many years in advance of the participant being eligible to receive the benefit. If the investment alternatives to which the participant is limited-to (in order to receive the benefit) later becomes inappropriate, risky, or underperforms, the participant could lose the lifetime income guarantee merely by transferring his funds to other investment alternatives (i.e. exercising control). Other disadvantages have been discussed under question #8.

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34. To what extent do ERISA 404(c) plans currently provide lifetime income through variable annuity contracts or similar lifetime income products? What are the advantages and disadvantages of such products to participants? What information about the annuity feature typically is disclosed to the participant, in what form, and when? To what extent could or should the ERISA 404(c) regulation be amended to encourage use of these products?

Many plans, particularly those funded using group variable annuity contracts, already have (or could have) the ability to offer more traditional lifetime income products once a participant is eligible for a distribution. The contracts may stipulate the rate tables, expenses, etc., that apply if the participant selects the option.

These annuity options are typically set up as distribution alternatives to lump-sum and installment payments. Therefore, the participant does not need to elect the option until termination, retirement, or other distributable event (and is not charged a fee until he makes that election).

The information provided to participants may include information that explains the benefits of annuities, along with fees/expenses and the calculation of the benefit. However, that information might not be provided until the participant requests it (For example: A retiring participant may be provided with distribution election forms and only after the participant requests information specific to the annuity option is more detailed information provided.)

ERISA 404(c) could be amended to encourage use of these products as follows:

- Provide additional limited protection if the employer meets the annuity safe harbor under 29 CFR 2550.404a-4 (for selecting an annuity provider) and the plan allows in-service withdrawals at Age 59-1/2 so that participants may elect a distribution or conversion to an annuity product.

Qualified Default Investment Alternatives

ERISA section 404(c)(5) provides that, for purposes of ERISA section 404(c)(1), a participant in a defined contribution plan will be treated as exercising control over the assets in his or her account with respect to the amount of contributions and earnings if, in the absence of an investment election by the participant, such assets are invested by the plan in accordance with regulations of the Department of Labor. The Department of Labor's regulation 29 CFR 2550.404c-5 describes the types of investment products that are qualified default investment alternatives under ERISA section 404(c)(5).

35. To what extent are plans using default investment alternatives that include guarantees or similar lifetime income features ancillary to the investment fund, product or model portfolio, such as a target maturity fund product that contains a guarantee of minimum lifetime income? What are the most common features currently in use? Are there actions, regulatory or otherwise, the Agencies could or

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should take to encourage use of these lifetime income features in connection with qualified default investment alternatives?

Few plans are currently using QDIA's that include lifetime income guarantees.

In-plan Lifetime income features were relatively rare in DC plans due to lack of availability from product vendors, but many national vendors have rolled out such products or are developing new products. This is particularly true of insurance companies which offer DC variable annuity products. The industry buzz is high, and I would expect a large segment of DC sponsors to evaluate these products in the near future.

Many DC plans use asset-allocation or target date funds as their default investment alternative, particularly to take advantage of the additional fiduciary protection afforded those defaults if they are deemed as Qualified Default Investment Alternatives. These plans may offer lifetime guaranteed income coverage as an optional "wrap-around" benefit to these investment alternatives. Investors selecting the asset-allocation or target date investment alternatives are not generally required to choose the lifetime income coverage. However, if they do select coverage, they can only get coverage for those savings which are retained in the covered alternatives (i.e. the asset-allocation or target-date funds). Savings transferred out or withdrawn generally will lose the insurance coverage. Coverage is provided for an additional fee, generally tacked onto the assets in the covered funds only (therefore, the investment experience for covered savings will be lower than those who are invested in the same investment alternatives but who do not elect coverage.

For example, assume the SmallCo 401(k) offers four investment alternatives: Money Market (Fund A), Balanced (Fund B), Bond (Fund C), Equity (Fund D). Of those funds, Fund B is designated as the plan's default investment alternative. The SmallCo 401(k) plan also offers optional lifetime guaranteed income coverage, with the following features/requirements:

- Only savings invested Fund B may be covered by the lifetime income guarantee
- To be covered, the savings must have been in Fund B for a minimum of five (5) years
- Participants may elect out of the coverage at any time
- Savings removed from Fund B (through withdrawals, loans, transfers to non-covered investment alternatives, or transfers to other plans) lose the insurance coverage
- At separation of employment, the participant may retain the coverage by keeping the covered savings in the designated investments (Fund B) or by rolling over into a designated product of the vendor.

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- Participants take installments payments from Fund B that may not exceed a specified amount (5% of the adjusted value at in the covered accounts at distribution).
- If the covered assets in the Fund B are depleted below the amount needed to fund the specified distribution, then the insurer will make the benefit payments for the remainder of the participant's life (or specified period).
- If the SmallCo 401(k) plan is transferred to another vendor by the Fiduciaries, only Fund B savings that are retained (with the vendor providing the insurance) will be continue to receive coverage.

Note that some plans may elect to integrate lifetime income coverage into their default investment alternative. This could have a significant affect on the number of participants enrolled in such features, particularly for plans that also utilize auto-enrollment or easy-enrollments.

Regulation specific to default investment alternatives (with regards to lifetime income alternatives) should be focused on protecting participants, not specifically encouraging the use of lifetime income products as default investment alternatives.

One important modification to regulation should be to bar the automatic use of lifetime income solutions as a default option in DC plans, except in cases where the funds involved are only attributable to Employer contributions, because:

- A very large percentage of participants – particularly younger participants – may be uninvolved. These types of participants often are auto-enrolled in DC plans, or allow their affirmative savings election to be auto-invested in "default" options.
- Participants who are auto-enrolled or auto-invested may not be aware that their current investment returns are being reduced to purchase the lifetime income coverage. Over time, reductions in account balances could be significant – a 0.90% annual fee could reduce account balances by 9% in just 10 years.
- Participants who are auto-enrolled or auto-invested may roll over amounts (in some cases, significant amounts) into the plan which will be automatically directed to the covered default options.
- Participants who are auto-enrolled or auto-invested may eventually transfer out of the default investments (to other plan alternatives) and not realize they paid for a benefit that will never be exercised.
- Many American workers, particularly younger workers, change jobs frequently due to layoffs and career changes. Participants who are auto-enrolled or auto-invested may cash out early to meet immediate needs between jobs and will lose the insurance benefit they paid for.

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Where the funds are strictly attributable to Employer contributions, <u>and</u> the default investment otherwise would qualify as a Qualified Default Investment Alternative, regulation should permit (and provide additional protection to plans) that use lifetime income products as the default. This would presume that the fiduciary has also met the safe harbor requirements of 29 CFR 2550.404a-4.

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