Response to Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

Department of Labor RIN 1210-AB33

APRIL 29, 2010

Insured Retirement Institute

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210
Attention: Lifetime Income RFI

Re: *RIN 1210-AB33: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans*

On behalf of our member companies, the Insured Retirement Institute (IRI) appreciates the opportunity to respond to the Request for Information (RFI) on lifetime income arrangements from the Departments of Labor and Treasury. We applaud the President's focus on retirement security and his promotion of the benefits of annuities and other guaranteed lifetime income strategies.

IRI is dedicated to the growth and better understanding of guaranteed lifetime income products. IRI represents all segments of the annuity, insured retirement product and retirement planning industries with over 300 member organizations, including insurance companies representing over 85% of the market, distribution firms, including broker-dealers and banks, investment management firms, and industry service providers. IRI's mission is to promote consumer confidence in the value and viability of insured retirement strategies by: supporting and encouraging industry adherence to high ethical principles; promoting better understanding of the insured retirement value proposition; developing and promoting best practice standards to improve value delivery; and advocating before public policy makers on critical issues affecting insured retirement strategies.

As Americans are living longer and facing greater obstacles to saving for retirement, the role of guaranteed investment products in helping investors achieve a financially secure retirement has never been more important. Annuities are the only financial products that guarantee lifetime income throughout retirement. When you consider the retirement reality in America – defined by the unsure footing of Social Security, the near disappearance of pension plans, and the record losses in 401(k) plans – it is clear that Americans planning for retirement must have a second form of guaranteed retirement income.

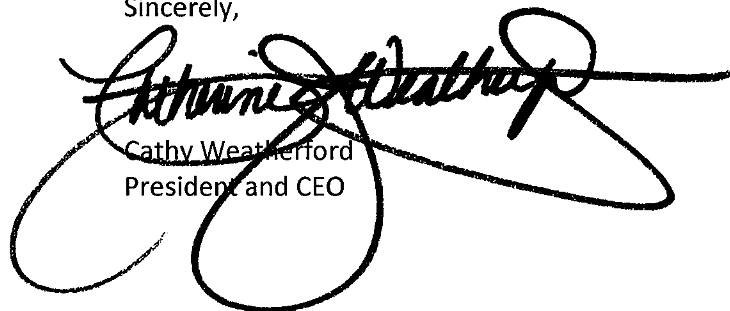
A survey conducted in December by Mainstay Investments of financial advisors found that in the wake of the market crisis most investors were extremely concerned about market risk and that almost all (91%) of the financial advisors surveyed were making changes to their client's retirement portfolios.[1] The increased use of guaranteed income products is a major component of the change, with 75 percent of the financial advisors surveyed stating that they are now selling guaranteed lifetime income products to their clients. Furthermore, among those who do not presently offer guaranteed lifetime products, 20 percent indicated that they plan to offer them in the "near future". We encourage the Administration to take additional steps to continue this trend and help all Americans take advantage of the benefits of guaranteed lifetime income strategies.

IRI responses were developed through a two-month process involving over 70 experts from a wide cross-section of our members who provided input for our response. The IRI working group included guaranteed lifetime income experts from all of the various industries who are members of IRI including: insurance companies, distribution firms, investment management firms, and industry service providers. In order for the Agencies to promote the use of guaranteed lifetime income strategies, we encourage the Administration to take the following steps:

- Implement measures that will incentivize employers to make guaranteed lifetime income strategies available for employees inside employer-sponsored retirement plans;
- Help to make guaranteed lifetime income solutions attractive for investors outside of employer-sponsored plans, including in individual retirement accounts, by incentivizing their use and educating Americans about their benefits;
- Simplify rules and relieve administrative burdens for employers who wish to include guaranteed lifetime income products as investment or distribution options in their retirement plans; and
- Encourage the provision of high-quality educational materials to individuals by eliminating the current administrative barriers and regulatory uncertainty.

We hope that the following responses will be useful as the Administration continues to work toward the goal of helping all Americans achieve real retirement security.

Sincerely,



Cathy Weatherford
President and CEO

[1] MainStay Investments, *"Financial Advisors Study"*, April 6, 2010.

General Questions

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?

In order to understand the advantages and disadvantages of any product, it is first necessary to understand the purpose the product is intended to serve. The various guaranteed lifetime income options currently offered by insurance companies are intended to help retirees and pre-retirees address the financial risks associated with retirement. The potential advantages and disadvantages vary not only by individual, based upon their specific circumstances, but also vary somewhat by product type (see response to Question 3 for a more detailed discussion of product features). An important advantage of most guaranteed lifetime income options is the ability to address risks such as:

- Longevity risk – the risk of living longer than anticipated and thus running out of financial resources;
- Investment risk – the risk that invested assets expected to help fund their retirement do not perform as anticipated. Guaranteed lifetime income products vary in terms of how investment risk is addressed. Income annuity products typically offer return on investment rates that are higher than what a participant can earn in a CD or what they might earn from lifetime income products that are not annuitized. Guaranteed lifetime income products that are not annuitized will typically have a lower fixed payout rate than an income annuity but will allow the guaranteed lifetime income payment to increase as a result of positive market earnings while being protected against downside market risk.;
- Sequence risk – the risk that any withdrawals from a retirement portfolio of securities are made in a period of declining asset values, accelerating the possibility that the portfolio runs out of assets prematurely. Poor performance early in retirement when combined with a withdrawal scheme can conspire to deplete the portfolio much sooner than expected, hence the term sequence risk;
- Under-consumption risk – the risk that the retiree compromises his or her lifestyle more than necessary in an effort to combat the above risks;
- Cognition risk – the risk that aging retirees suffer from decline in cognition sufficient to impede their ability to make good decisions on how best to optimize their income portfolio through retirement. Nearly half of those age 80+ experience significant declines in cognitive ability, and managing money through retirement can be challenging even for those with no cognitive decline. The protection against cognition risk is greatest in guaranteed lifetime income products in which participants do not have the option to make subsequent investment or withdrawal decisions inconsistent with the initial decision to receive lifetime income payments.

Allocating a portion of one's retirement income to a guaranteed lifetime income solution offered by annuities can help to mitigate the above risks, and also provides income stability during retirement so that financial worry is replaced with financial confidence and a more enjoyable retirement. Ultimately, a more rewarding and fulfilling retirement can be enjoyed due to the added peace of mind afforded by the inclusion of guaranteed lifetime income solutions into a retirement income portfolio.

Rather than tagging certain product attributes as disadvantages, we will list items that should be taken into consideration when making a decision to buy a guaranteed lifetime income product. As is the case with the advantages, these considerations can vary by product, as well as an individual's objectives and risk profile. It is important to emphasize that consumers and plan sponsors have product options to address most, if not all, of these considerations.

- Flexibility – Some lifetime income products require participants to annuitize some or all of their account balance. Once that occurs, the participant no longer has access to that portion of their account balance to address unanticipated needs that can't be satisfied solely with existing, liquid resources, such as illness. With respect to some products, the participant may not live long enough to receive more than the amount they invested, although this risk can be eliminated with the purchase of optional features that continue payments to heirs of the participant.

- Inflation Risk--In products where the participant's account is annuitized and no optional inflation rider was elected or otherwise no longer invested in the capital markets, participants bear the risk that their purchasing power will diminish over time with inflation. However, this risk can be mitigated with the purchase of optional inflation riders that provide the participant with increasing payments to offset potential increases in inflation. In some of the newer guaranteed withdrawal-type products participants remain invested in the capital markets while receiving protection against downside market risk so the inflation risk is significantly reduced in those products.

- Cost – There is a cost in all lifetime income products for providing the guaranteed payments. With respect to income annuity products the cost is usually factored in to the amount of lifetime income payments. With respect to guaranteed minimum withdrawal type products, the cost is usually an explicit fee charged in addition to the investment management fee associated with the underlying investments. This "guarantee fee" may increase as a result of adding features that may be desirable to participants, such as greater flexibility, the ability to increase lifetime income payments as a result of positive market experience, or other features.

- Product complexity – There are many products offering lifetime income protection and there is significant product innovation occurring at this time. In order to understand the various product features and evaluate whether a particular product or product feature makes sense for them, a participant will need good educational materials and may need access to a qualified financial professional to answer any of their questions . In the case of an employer plan, the financial professional advising the plan should be able to properly advise the plan regarding the advantages and disadvantages of different products for plan participants. IRI has submitted a proposal to the SEC to develop a variable annuity summary prospectus to make it easier for consumers, plan sponsors, and financial professionals to understand and compare guaranteed lifetime income product options.

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 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?

Many plan sponsors within certain specific market sectors do not offer guaranteed lifetime income distribution options. A survey by Hewitt Associates found that only 14 percent of 401(k) plan sponsors

surveyed offered the option to purchase an annuity upon retirement in 2009.[1] Another survey of large private sector employers by Watson Wyatt in 2009 found that 22 percent of defined contribution plans offer an annuity as a distribution option.[2] A study by the Retirement Security Project at the Brookings Institution reported that nearly 80 percent of defined contribution plans do not offer the option to annuitize assets when workers retire. [3] However, even within those plans that do include guaranteed lifetime income options, the majority of participants elect distributions that do not guarantee lifetime income.

Many consumers do not understand all the risks they will face during retirement, such as longevity, inflation, health, and long-term care issues. They are also unaware that there are guaranteed lifetime products available that can mitigate these risks. This can be attributed to the fact that most educational materials currently provided to plan participants are focused on the accumulation stage, while very little is provided on how to manage the account balance once an individual reaches retirement age.

There is also an inaccurate perception and concern from participants that they will be sacrificing control over their assets and will not have access to the funds in cases where they have lost liquidity in their other investments. Most of these perceptions/concerns can also be overcome by educating individuals and financial advisors about how much of each individual's retirement savings they should receive in the form of guaranteed lifetime income, given the individual's circumstances. Furthermore, there are a number of guaranteed lifetime income investment options that offer participants greater control over their balance, such as deferred annuities that can be converted to income later in life.

A number of biases have also been created against guaranteed lifetime income products. Consumers perceive the products as being too costly compared with other investment options, without recognizing that their comparisons are incomplete. It is difficult to compare guaranteed lifetime income products to other investment options because of the numerous differences in product features. When consumers are made aware of the guarantees that accompany the fees, they can gain a better understanding of the safety these products can provide from long term risks and volatile financial markets.

Many of the factors that contribute to the low usage rate of guaranteed lifetime income arrangements can be overcome with additional education for consumers, plan sponsors, and financial advisors. The Agencies can help by developing regulations to allow and encourage plan sponsors to provide education to plan participants about decumulation and the various products they can use to manage their assets in retirement. These products can play an important role in planning for a secure retirement, and as consumers learn more about the products and understand the benefits of guaranteed lifetime income solutions, we believe that the usage rate will continue to increase.

3. <u>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 payments from insurance contracts held under a defined contribution or defined benefit plan?</u>

Generally, under defined benefit plans, a distribution to a retiree participant is guaranteed lifetime income in the form of an individual or joint and survivor annuity. In large company or governmental entity plans, the payments are made directly from plan assets, which are generally subject to actuarial

[1] Hewitt Associates LLC, "*2009 Trends and Experience in 401(k) Plans*, PM-1139-001-EN.
[2] Watson Wyatt Worldwide, "*Defined Contribution Plan Trends Report",* 2009.
[3] Brookings Institution, Retirement Security Project, "*Increasing Annuitization in 401(k) Plans with Automatic Trial Income*", 2008.

reviews that are intended to assure long term solvency of the plan. In smaller plans, insurer-issued group annuity contracts are purchased by the plan. Income benefit calculations are related to a percentage of an individual's average earnings over the final years of work. In recent years, some retiring participants in defined benefit plans have been offered lump sum amounts equal to the present value of the lifetime income benefit.

In the case of defined contribution plans, such as 403(b), 401(k) and Section 457 plans, many include one or more annuities as an investment alternative (more prevalent for public employers and for smaller plans of private sector employers), while others may limit participant investments to a variety of mutual funds. The standard distribution choices at retirement for these plans are lump sum or systematic withdrawals for a period of years or for life based on an Internal Revenue Code life expectancy calculation. Generally, most participants elect a lump sum distribution, which exposes the participants to investment or life style risks, and results in them potentially outliving their benefits. For this reason, plan sponsors should be encouraged to offer annuities as a distribution option. For those plans or IRAs that either consist of or include annuity contracts, individual or group, such contracts generally offer a broad range of annuitization options. Those options generally encompass most if not all of the options commonly available under defined benefit plans. The contracts also provide additional options, as well as a contractual right to any other form of annuity that is mutually agreed upon by the parties to the contract.

The following types of annuity contracts and guaranteed lifetime income products are available through employer-sponsored plans:

IMMEDIATE ANNUITY—An annuity that is purchased with a single lump sum. Income payments begin within a short period—less than 13 months. Immediate annuities can be either fixed or variable.

DEFERRED ANNUITY—An annuity contract that is purchased either with a single premium or with periodic payments to help save for retirement. The contract owner determines the point at which accumulated principal and earnings are converted into a stream of income.

GUARANTEED MINIMUM LIVING BENEFIT (GMLB)—A benefit that protects against investment risks by guaranteeing the level of account values or annuity payments. There are three types—guaranteed minimum income benefits, guaranteed minimum accumulation benefits, and guaranteed minimum withdrawal benefits.

GUARANTEED MINIMUM INCOME BENEFIT (GMIB)—A guarantee that ensures, under certain conditions, that the owner may annuitize the contract based on the greater of (a) the actual account value or (b) a payout base equal to premiums credited with a defined interest rate or the maximum anniversary value of the account prior to annuitization.

GUARANTEED MINIMUM ACCUMULATION BENEFIT (GMAB)—A guarantee that ensures that the contract value of a variable annuity will be, at least, equal to a certain minimum amount after a specified number of years.

GUARANTEED MINIMUM WITHDRAWAL BENEFIT (GMWB)—A guarantee that promises that a certain percentage (usually 5-7%) of a guaranteed benefit base (often paid premiums) can be withdrawn annually until the base is completely recovered, regardless of market performance or the actual account balance, or for the lifetime of the contract owner or both spouses, depending on the type of product selected.

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

In plans that offer them, these options are usually offered only at termination or retirement, although some plans are now offering versions of these products that project lifetime income at any time during the accumulation period. These are generally structured as some form of annuitization of the retirement account currently and in the future if contributions are continued. However, a considerable number of retirement plan accounts are "rolled over" and then used to purchase guaranteed lifetime income annuities or guaranteed minimum benefit income products.

5. To what extent are 401(k) and other defined contribution plan sponsors using employer matching contributions or employer non-elective 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 plans that offer lifetime income options may either require participants to receive life-contingent distributions from the portion of the account allocable to the employer contributions, while others permit but do not require such distributions. Plans that offer lifetime income options typically permit such options to be elected with respect to the employer contributions. We are, however, aware of few, if any, plans that offer a matching contribution for the express purpose of encouraging employees to annuitize or to elect another guaranteed lifetime income option.

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?

Generally, the same guaranteed lifetime income options are available through IRA rollover products as are offered through the in-plan market. Rollover annuities are often attractive to individuals entering retirement, as they provide greater portability, as well as diversity of products and carriers. In general, our member companies report that 50-60 percent of their annuity sales are sold through IRA accounts. Some companies offer products that allow accumulations with guaranteed lifetime income rights to be moved over to an individual contract when that participant terminates. Just as it is important that each individual consult an advisor to assess their circumstances (e.g., health, total savings, liquidity needs) before deciding on an in-plan distribution option, it is also important that an individual consult an advisor before separating from service and choosing an IRA option that best suits their needs.

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?

As with many types of products where optional features can be selected to better meet the client's needs, guaranteed lifetime income annuities and guaranteed living benefit products also offer optional features, and these features come with a cost.

Income Annuity Optional Features

Plain vanilla guaranteed lifetime income guarantees the purchaser that payments will continue for the rest of their life. Many purchasers are concerned about the risk of an untimely and early death, and the possibility that they will not have collected back as much as they paid for the annuity. Some purchasers may also be concerned about the impact of inflation. To offset these risks, there are optional features available. These features include:

- Life Income with Certain Period: Guarantees that payments will last the longer of one's lifetime, or a specified time period, such as 10 or 20 years.
- Joint Life: Guarantees that payments will last until the death of the last surviving annuitant, typically a spouse.
- Life Income with Cash or Installment Refund: Guarantees that payments will last for one's lifetime, and that even if one dies sooner than expected, their heirs will receive back the difference between the cost of the annuity and the payments paid out to the annuitant.
- Inflation Rider: Typically offers the option of picking a range between 1% and 5%, where payments will increase by the selected percentage each year to help offset the impact of inflation on purchasing power. The higher the inflation offset selected, the lower the initial payment will be.

Guaranteed Lifetime Income Product Optional Features

- In order to guarantee lifetime income, features like the guaranteed lifetime withdrawal benefit are typical options that come with explicit annualized costs, generally in the 0.5% to 1.5% range. This cost is charged in addition to the fund management expense. The deduction of the fees for the guaranteed lifetime withdrawal benefit helps to offset the expense borne by the insurer– typically investment hedging - of providing the guarantee that income will last a lifetime once withdrawals commence. Features that add cost to these products include providing a joint and survivor benefit instead of a life-only benefit, allowing lifetime income payments to increase based on performance of the underlying account, and offering a degree of flexibility with respect to money moving in and out of the lifetime income investment.

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)?

The answer to this question can depend on the type of lifetime income payment option being considered. While all can be provided under a plan, as noted previously, the availability of such options in-plan can vary based upon a number of factors. An in-plan option, on average, can provide better

pricing for the individual because, in some cases, a group plan can negotiate better rates. However, competition and flexibility in the open market can provide inexpensive options and products that can be tailored to the individual's needs.

In-plan guaranteed lifetime income options generally are more convenient for participants, as the employer has already selected an annuity provider and products. Additionally, participants benefit from the ability to invest over time versus only one period in time. This provides benefits such as dollar cost averaging, the ability of some products to benefit from market gains while being protected from market losses, the ability to make additional contributions over time subject to the plan contribution limits, and the ability to receive ongoing education and support from a plan sponsor. (This can be replicated by individuals in the open market but is less convenient, which arguably reduces the likelihood that individuals will utilize guaranteed lifetime income solutions.) A key disadvantage for participants in selecting an in-plan guaranteed lifetime income option could be flexibility, if the product offered in-plan lacks some or many of the features that a participant could choose in the open market. Options that address inflation, death benefits, and liquidity concerns might not be available in the in-plan option. However, this situation can be avoided by the plan sponsor by choosing products with these features. (Additional choices may be available through the open market outside of the plan.)

9. <u>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?</u>

If a lifetime income alternative is not offered under the plan, then whether the participant identifies a lifetime income alternative out-of-plan may depend upon the participant's level of awareness about lifetime income alternatives generally. However, this awareness may be extremely limited, especially if the plan (which has no lifetime income alternatives) provides little or no education regarding such alternatives. The availability of, and education about, such alternatives under the plan may improve the likelihood that a participant will utilize such an option for some portion of their plan account balance either under the plan or outside of it. One of the key advantages of offering an in-plan option is providing the participants a sense of safety and security about guaranteed lifetime income products resulting from the plan sponsor's inclusion of the option in the plan.

From the standpoint of a plan sponsor, there are both advantages and disadvantages to providing an in-plan option. Some of the advantages of providing an in-plan annuity option include:

- Expanded benefits are provided at a minimal cost to the employer;
- Access to institutional rates that, on average, are better than participants could get elsewhere;
- The fiduciary risk (where applicable; generally, with respect to ERISA plans) of being sued by participants who are surprised with the inadequacy of their savings can be reduced;
- Providing a benefit offering which may help recruit and/or retain workplace talent;
- Increased utilization by participants of guaranteed lifetime income solutions should help to reduce overall costs.

Some disadvantages from the employers' perspective include:

- Concerns about increased fiduciary responsibility (again, where applicable);
- Lack of clarity about appropriate education regarding in-plan guaranteed lifetime income options;

- Administrative burdens of in-plan guaranteed lifetime income, if the employer has any of these responsibilities;
- Lack of clarity about portability of in-plan guaranteed lifetime income options.

Note: These issues are discussed in greater detail in other sections of this letter.

Rollover IRA annuities can be attractive from the standpoint of the employer because:

- The employer has no fiduciary obligations;
- Employees can choose from a wide range of product options and carriers;
- Employees can consult outside advisors to determine the appropriate amount to annuitize based on their unique circumstances.

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

Most, if not all, of the plans that do offer an annuity distribution option would permit a participant to annuitize a portion or all of their account. IRI believes that other commentators are better positioned to respond to this question.

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 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 mean 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?

Behavioral strategies have been used with considerable success in the accumulation phase of retirement planning. Many plan sponsors have now adopted automatic enrollment plans in which plan sponsors unilaterally enroll their employees into the plan if they do not act to enroll on their own. Automatic enrollment involves the employer's selection for the participant of his or her compensation deferral rate as well as the investment option (the "default fund") in which deferral amounts are to be invested. Even plans that are not automatic enrollment plans may have a default fund for participants who do not make an investment election. The Pension Protection Act created a strong public policy in favor of such arrangements, although it did not resolve certain state payroll restrictions for non-ERISA plans.

Default options in the decumulation phase of retirement planning would be more complex, as each individual's situation is unique based on their total expenses, assets, other sources of retirement income, liquidity needs, health, and bequest motives. Given this complexity, we would suggest that, if

the Agencies are interested in using behavioral strategies, tax incentives and relief from administrative burdens might be easier to implement in the short term.

12. <u>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?</u>

The decision about whether and how much to place in a guaranteed lifetime income product must be made in the context of each participant's individual circumstances, including their income and liquidity needs, health, alternative sources of retirement income, and bequest motives. Investors generally should cover their necessary expenses through guaranteed income such as pensions, Social Security, and guaranteed lifetime income products. In determining how much to place in a guaranteed lifetime income product, individuals should consider:

A. Necessary expenses in retirement – mortgage, utilities, groceries, clothing, healthcare, prescriptions, taxes, etc.

B. Sources of predictable income – pensions, Social Security, annuities, dividends, etc. to help cover those necessary expenses.

C. Discretionary expenses in retirement – hobbies, travel, entertainment, etc.;

D. Health condition, risk aversion, and other factors.

How much individuals invest in guaranteed lifetime income products will depend on several factors, such as what their expenses are compared to the size of the portfolio and how much of their necessary expenses they wish to guarantee.

13. <u>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?</u>

A few major issues must be addressed before plan sponsors could be required to offer guaranteed lifetime income distribution options. There is a need for fiduciary relief for ERISA plan sponsors, in light of the additional fiduciary liabilities that could otherwise flow from such a requirement, for their selection of guaranteed lifetime income products in retirement plans and their encouragement of participants to elect guaranteed lifetime income payouts. There is also a need for relief from some of the administrative burdens currently borne by plan sponsors. A more comprehensive discussion of these issues is included in our response to question 14. If the Agencies act to relieve these problems, we believe that plan sponsors might be more willing to add the option and a mandate might not be necessary. Agencies might need to reconsider a proposed mandate if these problems are addressed and plan sponsors fail to begin to offer these options.

It is premature to establish a requirement that employers offer guaranteed lifetime income as the default distribution option. Guaranteed lifetime income may not be appropriate for all individuals. Because each individual's financial needs are different, guaranteed lifetime income is not a "one size fits all" solution. The amount of one's retirement savings that should be taken in the form of guaranteed lifetime income should be determined only after careful consideration of one's total finances, expenses,

health, and future income needs. Additionally, requiring a retiree to annuitize at a specific point in time is inappropriate, since the time at which a retiree annuitizes can have significant financial implications. Even if the plans choose to make guaranteed lifetime income the default option, we would not support the use of a default that would cause a participant's entire account balance to be irrevocably converted to an annuity or other guaranteed lifetime income form of benefit. While in some cases it would be prudent for an individual to use their entire account balance to receive guaranteed lifetime income, in most cases it would be more suitable for only a portion to be placed into these products. According to a study by the Retirement Security Project, in order to generate sufficient income, between 33 percent and 75 percent of a retiree's account balance should be converted to an annuity.[4] If the liability and administrative burdens are not addressed plan sponsors would likely be discouraged from plan sponsorship if these requirements were instituted.

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?

[Section I] Impediments Due to Potential Liability

One of the key impediments to plan sponsors' including guaranteed lifetime income options in their plans is potential liability under the Employee Retirement Income Security Act of 1974 ("ERISA"). Section 404 of ERISA imposes certain fiduciary duties (e.g., "prudent man standard of care") on plan sponsors with respect to their operation and maintenance of retirement plans on behalf of their participants and beneficiaries. A violation of ERISA's fiduciary duties potentially results in personal liability for plan sponsor fiduciaries. In order to assist plan sponsors in fulfilling their fiduciary obligations, the Department of Labor (the "DOL") has issued regulations, rulings, releases, interpretive guidance, and other pronouncements that help to clarify who is a fiduciary under ERISA and how to fulfill the duties attendant thereto. With respect to guaranteed lifetime income products, plan sponsors are concerned that the DOL's pronouncements are either vague or insufficiently clear. This lack of clarity in the application of certain DOL pronouncements to guaranteed lifetime income products has caused plan sponsors to be reluctant to include guaranteed lifetime income options in retirement plans. With respect to the guaranteed lifetime income options, there are four areas of DOL pronouncements that cause the most concern to plan sponsors: (1) Section 2509.96-1 -- Interpretive Bulletin Relating to Participant Investment Education; (2) Section 2550.404a-4 – Selection of Annuity Providers – Safe Harbor for Individual Account Plans; (3) Section 2550.404c-1 – ERISA section 404(c) Plans; and (4) Section 2550.404c-5 – Fiduciary Relief for Investments in Qualified Default Investment Alternatives. The issues raised by these pronouncements when applied to lifetime income options are further discussed below. Potential actions that the DOL could take to help resolve these issues are addressed in other relevant parts of this letter.

(A) Interpretive Bulletin 96-1 (Education versus Advice: Fiduciary Liability for Providing Investment Advice)

Plan sponsors may be reluctant to add guaranteed lifetime income products in retirement plans because of concerns that, due to the perceived complexity of such products, any attempt by plan sponsors to educate participants about these products and give relevant information could be deemed investment advice under ERISA or lead to breach of fiduciary duty for inadequate disclosure. Thus, this issue raises

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[4] Brookings Institution "Increasing Annuitization of 401(k) Plans with Automatic Trial Income, June 2008.

two potential liabilities for plan sponsors: (1) fiduciary liability for investment advice; and (2) fiduciary liability for inadequate disclosure and/or misrepresentation about a plan product or feature.

Interpretive Bulletin 96-1 creates a safe harbor for plan sponsors of participant-directed DC plans for providing "education." IB 96-1 is critical guidance for plan sponsors and has been tremendously helpful in the effort by plan sponsors to educate their plan participants and beneficiaries. The safe harbor provides for 4 categories of education that can be provided to plan participants without stepping over the line into ERISA investment advice: 1) plan information (such as information about plan's benefits, features, terms, and descriptions of the investment alternatives under the plan; 2) general financial and investment information (such as information about investment concepts, like risk and return, diversification, dollar cost averaging, the different asset classes, etc.); 3) asset allocation models (e.g., pie charts, graphs or case studies); and 4) interactive investment materials (such as questionnaires, worksheets, software, etc.).

While category 1 of Interpretive Bulletin 96-1 would *permit* a plan sponsor to provide plan participants and beneficiaries with information about a lifetime income product that is available as an investment alternative under the plan, other DOL pronouncements would *require* the plan sponsor to provide such information. Examples of such pronouncements include the safe harbor under Section 2550.404c-1 (ERISA section 404(c) Plans), Section 2550.404a-5 (Proposed Participant Fee Disclosure Regulation) and Section 2550.408g-1 (Proposed Investment Advice -- Participants and Beneficiaries -- Regulation). Currently, however, there is no specific guidance from the DOL regarding what types of information a plan sponsor can give to participants about a guaranteed lifetime income product available under the plan that would meet the requirements of the safe harbor under IB 96-1 as well as the other DOL pronouncements mentioned above. Without such specific guidance, plan sponsors are concerned that any information that they give to their participants and beneficiaries could be seen as inadequate and insufficient to inform their participants about this investment option, which in turn could lead to potential liability under ERISA.

Secondly, although category 2 of the Interpretive Bulletin 96-1 specifies that general financial and investment information includes "estimating future retirement income needs", none of the categories under the safe harbor really discuss guaranteed lifetime income products. Plan sponsors would like to be able to educate participants about the benefits and advantages of converting their retirement assets into a stream of income at retirement that will last for their lifetime, how this can be done (e.g., by purchasing an annuity, a lifetime income product that has guaranteed withdrawal rights, etc.), and what options are available to them, including in-plan and out-of-plan options. Such information could also include lifetime income illustrations and modeling of different payout options based on actual account balances. Since participants typically only have one lifetime income investment option available in their plan (if any), the safe harbor for providing education should include the ability to describe specific product features, including actions or events within the product that impact the level of available payments. Plan sponsors want assurance that providing this valuable information will not constitute providing investment advice such that they could become liable as a fiduciary.

(B) Section 2550.404a-4 (Plan Sponsors' Potential Liability for Selection and Monitoring of a Lifetime Income Product Provider)

Under ERISA, plan sponsors have a fiduciary duty to prudently select and monitor the investment options under the plan as well as the providers of such options. Plan sponsors are fairly familiar with the selection and monitoring rules with respect to traditional accumulation products such as mutual funds, but they may not fully understand what is required to fulfill their fiduciary duty when selecting annuity

contracts and other investment products with guaranteed lifetime income benefits, and the providers thereof. Because the long-term guarantees that may be provided by a guaranteed lifetime income product are dependent upon the solvency and claims-paying ability of the provider both now and into the future, plan sponsors are concerned that they may be assuming additional and unforeseeable fiduciary liability with respect to these products as compared to non-guaranteed traditional accumulation products. The DOL has issued regulatory guidance and a safe harbor to help address this issue in the context of defined benefit plans and defined contribution plans, respectively. Under Interpretive Bulletin 95-1, a defined benefit plan sponsor of a plan that unilaterally purchases annuity benefits for participants is protected if, at the time of the selection of the annuity provider, the plan sponsor chose the "safest available annuity." Recognizing that this standard does not work well in participant-directed DC plans, the DOL issued a separate safe harbor - Regulation section 404a-4 - for the selection of distribution annuities in such plans. Unfortunately, this safe harbor has not provided plan sponsors with adequate clarity regarding their fiduciary obligations in selecting distribution annuities. Additionally, the safe harbor is limited to distribution annuities and does not extend to new solutions such as guaranteed living benefits. Furthermore, the DOL has not yet provided rules or guidance to help plan sponsors understand how to satisfy their fiduciary duty in the selection of other kinds of guaranteed income products – such as in-plan annuities – as investment or accumulation options that can be redeemed like any other option.

(C) Section 2550.404c-1 (Plan Sponsors' Potential Liability for Participant's Election of a Lifetime Income Product)

Provided certain conditions regarding participant investment control, diversification, investment transfer opportunity and information disclosure are met, plan sponsors of participant-directed DC plans rely on ERISA section 404(c) for limited relief from fiduciary liability for any losses that might otherwise result from a participant's imprudent election of an investment option under the plan to invest his account. However, 404(c) does not make specific reference to a participant's election of a guaranteed lifetime income product that leads to a particular type of payout of his or her account. These products may have additional costs for the guarantees provided and frequently are illiquid, thus carrying an additional risk regarding the claims-paying ability of the provider in the distant future. Thus, a participant's election of an illiquid guaranteed lifetime income product is more than just an investment decision but also a permanent election of a form of payout benefit. Section 404(c) does not purport to relieve a plan sponsor of fiduciary liability for a participant's irrevocable election of a form of payout benefit that's contingent on the claims-paying ability of the provider.

The section 404(c) regulations require a plan sponsor to provide participants with "sufficient information to make informed decisions with regard to investment alternatives available under the plan." Plan sponsors are concerned as to what constitutes "sufficient information" with respect to lifetime income products given their special features. (See above discussion regarding the inadequacy of Interpretive Bulletin 96-1 with respect to lifetime income products.)

The section 404(c) regulations require specific disclosures and transferability provisions regarding the plan's "designated investment options", which are the core investment options that the section 404(c) regulations require a plan to have in order for the plan sponsor to qualify for the safe harbor. Plan sponsors are concerned that lifetime income products may not qualify as designated investment options under the section 404(c) regulations or, even if they do qualify, the disclosure provisions may not be adequate given the special features of these products. Clarification by the DOL would be helpful.

For reasons of cost and administrative complexity, it is unlikely that a defined contribution plan would offer more than one guaranteed lifetime income option to participants. It would be helpful for the Agencies to clarify that the mere fact that only one investment is offered in this category does not result in the exercise of improper influence by the employer, which is prohibited in a 404(c) covered investment by the terms of DOL Reg. Sect. 2550.404c-1(c)(2).

(D) Section 2550.404c-5 (Plan Sponsors' Potential Liability for Investing Participants' Accounts in a Default Investment without His or Her Prior Direction)

Many plan sponsors have now adopted automatic enrollment plans in which plan sponsors unilaterally enroll their employees into the plan if they do not act to enroll on their own. Automatic enrollment involves the employer's selection for the participant of his or her compensation deferral rate as well as the investment option (the "default investment") in which deferral amounts are to be invested. Even plans that are not automatic enrollment plans may have a default investment for participants who do not make an investment election. The Pension Protection Act created a strong public policy in favor of such arrangements. Without a safe harbor, plan sponsors who use automatic enrollment or default investments face fiduciary liability for their investment decisions on behalf of participants if they turn out to be imprudent. The DOL has issued a safe harbor that provides limited fiduciary relief for certain default investments. In order to qualify for the relief, the plan's default investment must be a qualified default investment alternative or QDIA. There is language in the regulation which states that funds that meet the qualification requirements of the regulations (such as retirement date funds) can have "ancillary" features such as "annuity purchase rights, investment guarantees, death benefit guarantees, or other features." Many plan sponsors are not fully comfortable that this language is also a reference to guaranteed lifetime income or withdrawal benefits that may accompany a default investment option. Plan sponsors need regulatory certainty that products that otherwise qualify as a QDIA do not become disqualified simply because they have guaranteed lifetime income or withdrawal rights. Plan sponsors also need regulatory certainty that a QDIA that has guaranteed lifetime income or withdrawal features does not become disqualified during the payout or drawdown phase.

Additionally, the QDIA regulations require the plan sponsor to issue an advance notice to the participant that, among other things, contains a description of the QDIA. Plan sponsors may want clarity as to what would constitute an adequate description of a lifetime income product beyond the information specified in the QDIA regulations.

[Section II] Other Impediments

(A) Lack of Portability during Vendor Changes or Product Removal

Lifetime income products contain special costs for their guaranteed features, and it is assumed that the product will remain in the plan until the participant can elect the guaranteed feature, thereby getting the benefit of what he or she paid for. However, if the plan sponsor changes plan service providers and moves the plan to another vendor, as their fiduciary duty often requires, the lifetime income product may not be portable to the new provider, and the participants will lose the benefit of the guarantees for which they already paid. Even if the new provider does offer its own lifetime income product, there may be different costs or features. Even if the prior provider has an out-of-plan version of the lifetime income product (such as through an IRA), the plan sponsor's change of provider does not qualify as a plan "distributable event" that would allow plan participants to preserve the guarantees by electing a distribution that could be used to purchase the out-of-plan product version or electing a rollover to an IRA that contains the lifetime income product.

The same issue may arise with respect to plan mergers that result from corporate transactions. Furthermore, a plan sponsor may find it prudent to remove a guaranteed lifetime income product from the plan without undergoing a vendor change. For this reason, employers who engage in periodic RFPs for their plans or frequent M&A activity, or who may want flexibility in adding or removing the plan's investment options, may be reluctant to offer guaranteed lifetime income products inside their plans. Other than a hardship withdrawal (which does not qualify as a rollover distribution), the earliest date that active (as opposed to terminated) participants in a 401(k) or 403(b) plan can access their retirement plan account (assuming plan provisions allow it) is age 59-1/2. In the case of a 457(b) plan, the earliest date is age 70-1/2. (Employer contributions, such as matching contributions, in qualified plans must be invested at least for a minimum fixed period before they can be distributed and are often subject to a vesting schedule.) The portability of guaranteed lifetime income products is a big concern for plan sponsors, and the IRA rollover rules do not currently offer a clear solution. These issues are of particular concern to small employers who do not have negotiating power to cause a new vendor to make system changes necessary to support lifetime income products. The Treasury Deparment may conclude that a solution would require a statutory change to various distribution provisions of the Internal Revenue Code affecting 401(k), 403(b), 457(b) and other plan types.

(B) <u>Qualified and Joint Survivor Annuity Rules Present Administrative Burdens</u>

The qualified joint and survivor annuity rules present administrative burdens and complexities when applied in the context of certain guaranteed lifetime income products, and changes to those rules would encourage the use of guaranteed lifetime income products without compromising spousal protections. The vast majority of 401(k) plans today take advantage of the option under IRC § 401(a)(11)(B)(iii) and Treas. Reg. § 1.401(a)-20, Q&A 3(a) to provide for a 100% spousal death benefit (unless waived) in lieu of offering QJSA or QPSA benefits. Many 401(k) plans are designed this way because many participants and beneficiaries waive the QJSA and QPSA benefits even when they're available, and implementing the survivor annuity rules creates additional costs and administrative burdens due to the notice, waiver, revocation, and spousal consent requirements. Under current IRS rules, if a participant selects payment in the form of a life annuity, the exception to the survivor annuity rules is no longer available, and plans must comply with the QJSA and QPSA rules. Election requirements with respect to a contemporaneous annuitization decision are relatively straightforward. They are less straightforward for certain living benefits and for irrevocably elected future payments of income. For example, it is not clear under the code and regulations, or under recently issued Private Letter Ruling 200951039, whether guaranteed lifetime income products like GLWBs that do not involve annuitization of participant accounts trigger application of the survivor annuity rules. This confusion is a barrier to adoption of these lifetime income products. We recommend that the Agencies clarify that guaranteed lifetime income products in which participants maintain control of an account balance supporting the lifetime income guarantee are not life annuities for purposes of the survivor annuity rules. The result should not vary due to the possibility that at some point during the payout phase (after the supporting account balance is depleted) the guaranteed lifetime income payments will be paid by the guarantor. The result should also not vary based on the fact that a single election has been made by 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?

In most cases, an individual portfolio is superior when it combines lifetime income products with other investment vehicles. Guaranteed lifetime income products can play a key role in providing a guaranteed base income that allows other investments to be more aggressive with a better rate of return. For example, a simple fixed income annuity combined with mutual funds is a balanced investment for many individuals.

The complexity of combining these products with the products mentioned in the question is an important consideration. For example, guaranteed lifetime income products generally do not require medical underwriting at the point of purchase; however, combining the product with long-term care would likely require medical underwriting for the application process. Products such as reverse mortgages are already very complex and combining them with annuities could prove too convoluted for individuals to understand. Suitability issues also need to be more closely reviewed when attempting to combine lifetime income options with products such as reverse mortgages.

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?

There appears to be significant differences across demographic groups with regards to retirement plans. A study by the Center for Retirement Research at Boston College showed a disparity among racial and ethnic groups regarding participation in and contributions to 401(k) plans. According to the study, white workers participate at a higher rate and contribute a higher percentage than African American or Hispanic workers.[5] Another study by the Employee Benefit Research Institute also found that there are statistically significant differences in participation and contribution rates based on gender, race, geographic differences, education level, income level, and marital status.[6] Furthermore, it is clear that life expectancy and earning capacity are different among men and women and that more females annuitize than males because of greater life expectancy. Efforts to improve educational materials provided to participants could help to address these disparities. The uncertainty surrounding the fiduciary liability of plan sponsors in providing education materials should be addressed to encourage additional educational efforts for plan participants.

Additional studies that should be considered:

- Prudential Supplement to Six Workplace Report on Retirement Planning, "*Women Indicate Strong Need for Guidance and Support with Respect to Workplace Retirement Plans"* (February 2010).[7]

- Prudential, "*Hispanic Americans on the Road to Retirement"*, (March 2008).[8]

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[5] Center for Retirement Research at Boston College, Alicia Munnell and Christopher Sullivan, "*401(k) Plans and Race*", 9-24, November 2009.
[6] Employee Benefit Research Institute, Craig Copeland, "*Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2008*", Issue Brief No. 336, November 2009.
[7] http://www.prudential.com/media/managed/WP6GenderSupplement.pdf
[8] http://www.prudential.com/media/managed/Hispanic_Retirement_FINAL_3-19-08.pdf

- MetLife Mature Market Institute Study, "*Study of Boomers and Retirement Income Decisions Study: The Silent Generation Speaks*" (June 2005) - Women from the Silent Generation (born between 1930–1945) are *more* likely than men to own an annuity.
- Marti Barletta, *Marketing to Women*, 2006 – Women make 53% of investment decisions.
- Annuity 2000 Basic Table (Experience Mortality) – Women generally have longer life expectancies than men. A 65-year-old female is expected to live to age 86.7 while a 65-year-old male is expected to live to age 84.

Participant Education

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?

One of the most basic objectives of a defined contribution plan or IRA is to provide sufficient income in retirement, either on a standalone basis or as a supplement to other benefits such as DB plans or payments from Social Security. A recent survey of financial advisors by Mainstay Investments found that "there is still a need for additional client education on the amount of supplemental income they will need to maintain their current lifestyle in retirement". The survey also reported that financial advisors said that "less than half of clients know how much money they will need to supplement Social Security."[9]

In order for participants to make informed planning decisions regarding the application of their retirement savings to meet their income needs in retirement, they need to understand a range of issues, one of which is the important risk of outliving their assets. Illustrations of a strategy consisting solely of non-guaranteed withdrawals should be accompanied by disclosures of the potential risk that the assets may be depleted during the participant's lifetime. Such disclosure should also include a discussion of the general availability of in-plan and out-of-plan guaranteed lifetime income alternatives. A basic understanding of guaranteed income for life should be a critical element in any such education materials provided to participants. Participants should be made aware that, depending on their specific income needs, guaranteed lifetime income products, either inside of a retirement plan or IRA or in addition to them, can be an important component of their retirement income planning and that it will take a combination of savings vehicles to ensure they have a secure retirement strategy.

Specifically, within an employer-sponsored plan, participant education materials should clearly and concisely explain the benefits of guaranteed lifetime income products and how they compare to other options that are offered by their plan. This would include information such as the historic return patterns of each of the options, the specific risk ratios associated with each of the plan choices, the expense ratios or fees associated with each option, and an explanation of differences between and

[9] MainStay Investments, "*Financial Advisors Study"*, April 6, 2010.

among different options. Similar educational information is already provided in the accumulation stage under the plans.

Regardless of the plan options participants choose, they should receive education materials about guaranteed lifetime income options and the benefits at the distribution stage, and if they are a younger participant, the benefits of electing a guaranteed lifetime income option later in their professional career. Such education might also include the potential benefits to them of allocations to deferred annuities during their career, either to purchase a specified amount of future annuity income, or to lock in current mortality guarantees (as a hedge against future improvements in population mortality which may be reflected in the guaranteed annuity rates provided in contract issued in the future). Such education could also address additional alternatives where available in the plan, such as guaranteed living benefits which provide a benefit floor for withdrawals without requiring the participant to turn over a block of plan assets to the annuity issuer.

Some examples of the basic information that participants need to make informed decisions about guaranteed lifetime income include:

- Participants' need for guaranteed lifetime income
- Guaranteed payment periods
- Anticipated life expectancy
- Costs and fees
- Withdrawal options and limitations
- Impact of withdrawals on future guaranteed payments
- Investment objectives
- How contributions are invested
- Importance of diversification
- Information about underlying investment options
- Potential loss/gain from investment options and market risks
- Guaranty protections
- Survivor benefits
- Risks associated with purchasing guaranteed income (e.g. inflation, interest rate, mortality and credit risk)
- Tax implications
- Surrender charges

Moreover, while it is clear that, at a minimum, participants should receive educational materials on lifetime income options as they near retirement and the distribution stage, it would also be prudent to provide extensive information earlier in a participant's career with the employer. This would ensure that participants will be able to properly formulate a long term retirement plan.

The employer should be able to provide the information in an electronic, layered format that includes a clear explanation of the options offered by the plan, including a discussion of the relevant benefits and risks, costs, and other considerations. Ideally, participants should receive educational materials from a variety of sources. Plan sponsors should also be encouraged to incorporate opportunities for support and counseling, including individual meetings, group seminars, and online workshops, to address the important needs of employees who are not self-starters or who simply want or need one-on-one support. Such communications should be tailored to the specific individuals receiving the information and delivered in a clear and concise manner.

Although the amount and types of information provided to participants varies from plan to plan and provider to provider, because of 404(c), it is fairly standard—even for non-ERISA plans—for providers to develop investment education materials and basic investment information to help participants to make informed decisions. However, much of the emphasis is on the accumulation phase of saving, and little attention has been paid to the decumulation phase. We believe that participants need increased information on the decumulation phase. Guidance is needed in this area, especially if plan sponsors and providers are being asked to increase their education efforts about distribution, including lifetime income options.

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?

We believe that current law and guidance under Title I of ERISA supports the use of plan assets to pay for participant education with respect to their accounts in the plan, and we do not believe that providing information about out-of-plan options is prohibited. In fact, rollover notice rules for employer-sponsored plans generally require it. Nevertheless, ERISA guidance that provides additional comfort to plan fiduciaries with regard to such educational information could further encourage informed decisions by plan participants. While such guidance would not affect non-ERISA plans, it could still provide indirect encouragement to those plans as well. Moreover, rollover notice requirements might be revised to incorporate information regarding such important decisions as well.

19. What specific legal concerns do plan sponsors have about educating participants as to the advantages and disadvantages of lifetime income or other arrangements designed to provide a steam of income after retirement? What actions, regulatory or otherwise, could the Agencies take to address such concerns?

Our response to question 14 includes a detailed discussion of the specific legal concerns plan sponsors have about educating participants about lifetime income options. In general, plan sponsors are concerned that any attempt to educate participants about these products and provide relevant information could create potential fiduciary liability, either because the information might be deemed "investment advice" under ERISA, or because any deficiency in such information could constitute inadequate disclosure and/or misrepresentation about a plan product or feature. The DOL could address these concerns by amending its existing regulatory materials on this subject (including Interpretive Bulletin 96-1, Field Assistance Bulletin 2007-1) or issuing new guidance to clarify that plan sponsors can provide information about lifetime income products to assist their participants in evaluating available alternatives, whether inside or outside of the plan, and that providing such information will not give rise to any potential fiduciary liability.

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?

Plan sponsors should be encouraged to provide education about the advantages and disadvantages of guaranteed lifetime income options. The DOL could help plan sponsors by clarifying that they will not face fiduciary liability for providing educational materials to their plan participants. The DOL should develop and distribute a model disclosure that would accompany an illustration of the product and therefore mitigate the fiduciary responsibility of the plan sponsor.

Participants should be provided with appropriate education on the mechanics, benefits, risks and considerations. Guaranteed lifetime income can provide "income insurance" to help protect against the risks investors are likely to face in retirement, such as longevity risk and market risk. Outside of Social Security, many investors will be retiring without other forms of guaranteed income.

Participants should also be provided with guidance on how to decide if guaranteed lifetime income makes sense given their unique situation and income needs. Participants should be urged to discuss guaranteed lifetime income options with a financial advisor. The advisor can help the participant consider whether and how much to annuitize based on the participant's expenses, sources of income, risk tolerance, health condition, and other factors.

Assuming there is fiduciary relief, a financial advisor could start this discussion by answering a questionnaire with the investor, which can include the questions listed below. The investor's responses can help the financial advisor determine if guaranteed lifetime income is "not likely recommended," "may be recommended", or "likely recommended."

i. Along with outside sources, how much of your overall expenses are covered by a modest portfolio withdrawal rate (i.e. 4%)?

ii. Rate your flexibility to reduce spending and expenses should the market underperform. *If you can cut back when the market isn't performing well or have cash reserves to cover unexpected expenses, you may not need guaranteed lifetime income payments.*

iii. How much of your necessary expenses are covered by outside sources such as Social Security and/or a pension? *If you have enough income from Social Security and a pension to cover your critical expenses, you may not need guaranteed lifetime income..*

iv. Given your current health and family history, rate your estimated life expectancy relative to average. *If you live longer than you expected, you could outlive your money. Guaranteed lifetime income payments can help guard against this.*

v. Are you unwilling to pay a fee and have less access to principal in exchange for a stream of guaranteed lifetime income? Generally features that add flexibility, such as guaranteed minimum income benefits and guaranteed lifetime withdrawal benefits, come with an additional fee. *Is one of your top priorities to leave a financial legacy to your heirs? With certain forms of guaranteed lifetime income, such as immediate annuities, you no longer own or have access to the principal, as you have exchanged this for lifetime payments. This money would no longer be available to your heirs when you pass away. Alternatively, guaranteed living benefits, such as guaranteed lifetime withdrawal benefits, can allow an individual to pass on the market value to beneficiaries.*

Disclosing the Income Stream that Can be Provided from an 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?

An individual benefit statement should include an estimate of the accrued benefits as a guaranteed lifetime income stream of payments or "annuity equivalent". Many plan participants see the lump sums that are in their retirement accounts as sufficient to cover their expenses during retirement. However, many participants do not realize how much they need to save in order to have an adequate monthly benefit. The educational value of estimated monthly payments based on the account value could spur the participants to begin saving more. Raising awareness of plan participants about lifetime income options could also encourage plan sponsors to begin to offer lifetime income as an option in their plans. We support the Lifetime Income Disclosure Act, S. 2832, and we think it provides a good template for discussion of these questions. Similar provisions were included in HR 4742, the SAVE Act of 2009. The Department of Labor should use these bills for guidance in developing policy on these issues.

22. If the answer to 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?

As a minimum requirement, on an annual basis, defined contribution plans subject to ERISA should include annuity equivalents on benefit statements provided to plan participants. An annuity equivalent should be the amount of monthly payments the participant or beneficiary would receive at the plan's normal retirement age if the total accrued benefits of such participant or beneficiary were used on the date of the lifetime income disclosure to purchase guaranteed lifetime income, with payments under such annuities commencing at the plan's normal retirement age. The statement should show the monthly payments under both a single life and qualified joint and survivor annuity (an annuity with survivor benefits payable for life to the employee's spouse). The annuity equivalents should only be required to be provided once a year, even when quarterly statements are otherwise required. The DOL should permit plans that currently offer annuity or guaranteed lifetime income products to use the underlying assumptions and purchase rates under the products for illustrative purposes.

While the DOL should not require the annuity equivalent shown on the statement to be based on the assumption of continued contributions by the plan participant, plan sponsors should have the option of directing participants to a website where participants can generate an annuity equivalent that assumes continued contributions to the plan. Such information may be meaningful to a participant who, for example, may wish to compare their plan benefit illustration on the website to the estimated benefits provided on their Social Security Statement, which does assume that their earnings will continue in the future.

23. <u>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 on as safe harbors?</u>

The DOL should provide extensive guidance to ensure illustrations of accrued benefits in the form of lifetime income are uniform and do not impose undue cost burdens on plan sponsors or create potential liability. The DOL should issue assumptions that employers may use in converting a lump sum amount into an annuity equivalent. Employers should be able to base their annuity equivalents on clear assumptions prescribed by the DOL. These assumptions will make it unnecessary for the plan sponsor to hire an actuary which would add substantial costs to providing the statements. Plans that currently offer annuity or guaranteed lifetime income products should be permitted to satisfy any illustration requirement by using the underlying assumptions and purchase rates under the products for illustrative purposes. The DOL should also develop additional tools that can be accessed by the participants in order to make calculations that are more specific to their individual financial situations.

Furthermore, the DOL should issue a model disclosure that employers can use to explain the statements to employees in simple terms that can be understood by the average plan participant. The model should make it clear that the annuity equivalent is merely provided as an illustration to help them plan for their retirement years. It should also describe the assumptions that were used to determine the annuity equivalent. The model should explain that the actual annuity payments that may be purchased with the total accrued benefits will depend on a number of factors and may vary significantly from the estimate provided in the statement. The model disclosure will encourage uniformity in the statements that participants receive even when they change employers and plans.

Plan sponsors should be provided with a clear course they can follow to ensure that these statements do not cause them to be subject to additional liability. ERISA should provide that plan sponsors should not be liable for payments in the amount illustrated under the rules. This protection should apply to any disclosure of an annuity equivalent that incorporates the explanation from the model disclosure that is prepared in accordance with DOL rules.

Plan sponsors should have the option of including language in the model disclosure or the statement that directs participants to the provider's website where calculators are available to model different income illustrations based on different assumptions inputted by the participant.

Plan sponsors should also have the option of providing disclosures in paper or electronic format in addition to the standard disclosure discussed above that may be more tailored to a specific employee population. These disclosures should also be covered by the fiduciary safe harbor as long as reasonable assumptions are used and appropriate disclosures and explanations are provided. Extending the fiduciary protection to these additional disclosures will encourage plan sponsors who use a specific lifetime income product in their plan, who also offer a defined benefit plan, or who have a unique

employee population in terms of age or other factors, to provide information that is more relevant and helpful to participants than the standard disclosure.

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?

The statement should not include an income replacement ratio. Every individual's situation is different and determining whether income after retirement is satisfactory to an individual is beyond the scope of these statements. Retirement providers do not have enough information about their participants to make this type of determination. Attempting to make such a determination could create potential liability.

401(k) and Other Plan Qualification Rules

25. How do the 401(k) or other plan qualification rules affect defined contribution plan sponsors' and participants' interest in 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?

The required minimum distribution (RMD) rules for annuity contracts under Code Section 401(a)(9) apply to both tax-qualified retirement plans (including 401(k) and other defined contribution plans) as well as Individual Retirement Accounts (IRAs) (other than Roth IRAs). The RMD rules provide very mechanical tests for determining whether a stream of annuity payments complies with these rules.

Retirees today are particularly concerned about (i) outliving their assets, (ii) financial market variability and uncertainty (particularly inflation), and (iii) material unexpected expenses (particularly health care expenses) that cause liquidity problems. Immediate lifetime income annuities are uniquely well suited to address many, but not all, of these concerns. The current RMD rules inhibit offering annuity features that could address more of these concerns. In that regard, the rules could be modified to allow insurers to offer lifetime income annuity contracts that more effectively and flexibly satisfy consumer risks and concerns during retirement.

In particular, current RMD rules should be adjusted to allow annuities to be designed in a way that most effectively addresses: (i) longevity risk, (ii) retirees' anticipated inflation risk, and (iii) material unanticipated changes in a retiree's cash-flow needs during retirement.

Today, the RMD rules generally require that annuity payments be made at least annually over the taxpayer's life or the lives of the taxpayer and his or her designated beneficiary. In addition, annuity payments must not increase (with certain limited exceptions) and the interval between payments must be uniform throughout the distribution period. Although these rules permit insurers to offer some flexibility in lifetime income annuity design, they are not sufficient to permit insurers to adequately address various consumer needs and risks that often change materially during retirement.

In general, one of the benefits of funding an immediate lifetime income annuity from a tax-qualified source is that annuity payments, if properly structured, automatically satisfy the complex RMD rules with respect to the funds used to purchase the annuity. A retiree has no need to calculate annually the RMD amount for the annuity and does not have to remember to annually request distributions to satisfy the RMD rules applicable to the annuity. Thus, an annuity that complies with the RMD rules relieves a retiree of considerable administrative burdens. If these burdens are not otherwise properly handled, the retiree can be subject to significant tax penalties.

In order to satisfy the annuity RMD rules, all annuity payments must be non-increasing or increase only in accordance with specific exceptions enumerated in the RMD regulations under Code Section 401(a)(9). These specific exceptions allow annuities to be designed in a way that addresses many of the risks and concerns described above; however, there are a number of annuity features in the marketplace designed to address some of these risks and concerns but that cannot satisfy applicable RMD requirements. For example, annuity payments designed to increase by certain fixed amounts each year (to keep pace with the consumer's anticipated inflation expectations) cannot satisfy these requirements in certain cases.

The Treasury Department should consider providing more exceptions to the non-increasing payment rule as well as other changes to the RMD rules that facilitate the provision of annuity products and features that most effectively and flexibly address consumer financial risks during retirement, without imposing undue tax recordkeeping burdens on the taxpayer and annuity providers.

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?

Changes should be made to the spousal survivor annuity rules to clarify when payments under a lifetime income product are received in the form of an annuity, thereby identifying when the QJSA/QPSA rules are triggered and when they are not. The clarification would encourage availability of guaranteed lifetime income by eliminating the disincentive for plan fiduciaries.

Rules should clarify when participants are deemed to have made an "election" under certain lifetime income products for purposes of the QJSA/QPSA rule, thereby triggering rules such as notice, waiver, revocation and spousal consent.

It should be noted that most of these newer forms of guaranteed lifetime income products are available to participants well in advance of retirement in order to accrue the greatest possible future benefit and provide pre-retirement downside income protection. The products are fully revocable by the plan participant prior to the date on which income begins and are administered by recordkeepers in a manner similar to other investment options of the plan (i.e. with a daily valuation or similar calculation). Death of the plan participant prior to the date the income begins would cause the guaranteed lifetime income option's remaining account value or cash-out amount (for options that have no account value but do have a defined means or method of daily valuation of the cash-amount) to be administered in the same manner as other plan investment account values belonging to the participant. To encourage greater adoption of guaranteed lifetime income products, a plan participant's election of guaranteed living benefits (or automatic enrollment into such a structure) should not trigger QJSA/QPSA rules until such time that income has been deemed irrevocably annuitized and the income start date has been determined. However, normal QJSA/QPSA rules should apply in cases where the lifetime income

structure is not revocable before the income start date and where there is no explicit calculation of a residual value that might revert to the participant upon revocation.

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?

Plan sponsors may continue to be reluctant to add guaranteed lifetime income options because of the absence of certainty surrounding these rules. Plan sponsors will take the most conservative approach to avoid potential plan disqualification. The lack of guidance for in-plan “accumulation” guaranteed lifetime income products, under which participants can make ongoing contributions and reallocations, serves as a real impediment to employers offering these products.

The rules should be clarified that the QJSA rules only apply to in-plan accumulation guaranteed lifetime income at the time that the participant’s “investment” in the contract is irrevocably annuitized, and only if the payout form is over the participant’s lifetime. That is, the QJSA only applies when the guaranteed lifetime income is converted or committed to lifetime-based periodic payments. As long as the participant has an account balance over which they maintain some elements of control (such as the right to make withdrawals in excess of predetermined lifetime income payments), and any account balance is available to the heirs of the participant, the QJSA rules should not apply. The result should not change based on the fact that at some point in time the participant’s account may be depleted in order to fund withdrawals.

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 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?

All lifetime income products should be on a "level playing field" with respect to required minimum distribution rules. However, currently, the IRS has two separate sets of rules for determining the amount required to be distributed from a qualified retirement plan to a participant after he or she attains age 70-1/2 or, if later, retires. The set of rules that applies depends on whether the participant’s accrued benefit is in the form of an individual account under a DC plan or is annuitized. Plan sponsors will want clarity as to which set of rules apply to the different payout phases of a guaranteed lifetime income product.

Specifically, we believe that the following changes should be made:

- A participant in a DC plan who has a distribution/payout annuity (subject to the "annuitized benefit” RMD rule) and investments with an account balance (subject to the” account balance RMD rule) should be permitted to aggregate the two sets of benefits for RMD purposes under the account balance rule, using the fair market value of the payout annuity.
- Pure longevity annuities (i.e., lifetime payout starting at an advanced age at/near life expectancy) should be carved out of the RMD rule. This would incentivize people to provide for a means to avoid outliving their assets. There should not be a policy issue, because this would

not result in hoarding retirement assets for one's heirs instead of using them for retirement needs. Rather, it is a means by which participants can better use their retirement assets in their retirement planning. In fact, the longevity annuity (with its late start date) addresses what many consider their biggest retirement risk - outliving their assets and income sources.

- Both of the above changes should also apply to IRAs.

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?

IRI believes that other commentators are better positioned to respond to this question.

Selection of Annuity Providers

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?

Currently, a limited number of ERISA plan sponsors are using the safe harbor as reflected by the fact that they generally are not offering the products in their plans. Please see the discussion in the answer to question 14 regarding the plan sponsor's potential fiduciary liability with respect to the selection and monitoring of guaranteed lifetime income providers. The unique features of guaranteed lifetime income products and the application of safe harbors should be addressed in order to promote the usage of these products.

Due to the complexity of the safe harbor, currently, many plan sponsors are not willing to confront the annuity selection process. The lack of clarity of the requirements might discourage a plan sponsor from making an annuity or guaranteed lifetime income option available because they are concerned about their own personal liability risk. The DOL imposed 12 separate conditions that must be considered and addressed in making a determination under the safe harbor on the selection of an annuity. One of the requirements is to obtain guidance from an independent expert, which would add additional costs that many employers are not willing to incur.

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 usage without compromising important participant protections? What are those changes and why should they be made?

We believe the safe harbor has not been widely utilized because of plan sponsors' concerns about provider selection elements. Specifically, plan sponsors are troubled by the safe harbor's requirement that they "assess the ability of the annuity provider to make all future payments under the annuity contract" and conclude that "the annuity provider is financially able to make all future payments under the annuity contract." The DOL should revise the safe harbor to modify or eliminate the requirement that fiduciaries make the determination of whether an annuity provider is able to make all future

payments under an annuity contract. However, the safe harbor still should require that the fiduciary give consideration to the financial strength and other factors that ensure the reliability of the provider.

We would also suggest that the safe harbor be clarified to relieve the fiduciary of liability for changes in circumstances with respect to the provider's future financial stability if the fiduciary fulfills the requirements under the revised safe harbor at the time of the selection. The safe harbor should continue to require that fiduciaries: engage in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities; appropriately consider and conclude, at the time of the selection, that the cost (including fees and commissions) of the annuity contract is reasonable in relation to the benefits and administrative services to be provided under such a contract; and, if necessary, consult an appropriate expert or experts for the purposes of compliance with the safe harbor provisions.

We would also request that the DOL consider as a factor in its deliberations on this issue that insurance companies are subject to a comprehensive state insurance regulatory system. This system includes numerous mechanisms designed to protect consumers from the risk that a particular insurer may be unable to satisfy its financial obligations.[10]

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?

We believe that the safe harbor protections are just as appropriate for other guaranteed lifetime income products as they are for distribution annuities. As we mentioned in our response to questions 30 and 31, the lack of clarity of the safe harbor might discourage plan sponsors from making a guaranteed lifetime income option available because they are concerned about the risk of liability. Plan sponsors need a clear explanation of their duties when selecting guaranteed lifetime income solutions for their plans, and the safe harbor should be modified to provide fiduciaries with an unambiguous way forward.

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[10] Each state has its own set of laws, rules, and regulations over insurance companies that are domiciled in the state as well as extensive oversight of insurance companies domiciled in another state that also seek licensure in the state. The state insurance departments have applied conservative requirements on insurance entities, which have bolstered life insurers to remain solvent in even the most difficult of times. First, state insurance regulators apply more conservative accounting requirements by not allowing certain assets (non-admitted) to be included in capital and surplus. Second, many states have implemented investment limitations to reduce exposure to a single insurer as well as to specific asset classes such as bonds and equities. Additionally, many other risky types of transactions are either limited or prevented. Third, many states have incorporated derivative restrictions whereby insurers who write derivative contracts must cover these transactions with assets set aside for that risk. Fourth, state regulators have set minimum capital requirements in Risked Based Capital (RBC). Most life insurance entities have RBC levels of several times their solvency capital. Finally, in addition to regulatory reviews, insurers must also undergo annual independent audits. State regulators monitor the solvency of insurers at least quarterly and more frequently for at-risk insurers. These protections should be taken into account when determining the reliability of the provider among other factors that will be developed by the DOL. Our members stand ready to assist the DOL as the process moves forward.

ERISA Section 404(c)

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 investment 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 ERISA 404(c) regulation be amended to encourage use of these products?

These products would not appear to be eligible to be considered as a core investment option under 404(c). This is to be distinguished from investment options under a traditional deferred annuity, which pursuant to the referenced regulation can be used as a core option if they otherwise satisfy the requirements of those rules. Moreover, some practitioners have questioned whether purchased deferred income products are eligible at all under a plan seeking the protection of ERISA Section 404(c), due to certain restrictions in terms of flexibility and fee disclosures. Plan sponsors are not using these products to meet the 404(c) fund diversification requirement. The fact that plans are unable to include these products under 404(c) is a deterrent to the utilization of these products. The 404(c) regulations require a plan sponsor to provide participants with "sufficient information to make informed decisions with regard to investment alternatives available under the plan." Plan sponsors are concerned as to what constitutes "sufficient information" with respect to lifetime income products given their special features. An objective of 404(c) is that plan sponsors should make an array of investment elections available that allow participants to be successful in preparing for retirement. These products are a mechanism for achieving this goal.

Even for non-core investment options, 404(c) still requires sponsors to provide "sufficient information" about the products. As we discussed, plan sponsors are concerned about the uncertainty regarding the "sufficient information" standard because they are unsure about what needs to be provided. Uncertainties surrounding the fiduciary liability for education also contribute to the uncertainty surrounding this issue.

Another typical guaranteed lifetime income product combines a product, which includes several underlying funds, some of which may qualify as core funds, with a guaranteed lifetime withdrawal benefit (GLWB product). In addition to ensuring that a participant does not outlive their retirement assets (even if the account balance goes to zero), a GLWB product has the following advantages: (1) The ability of the participant to make additional contributions during the initial payout phase and make withdrawals that exceed the guaranteed payout benefit (e.g., liquidity); (2) the participant's continued participation in the underlying investment performance with downside protection, which provides potential income growth and inflation protection; and (3) an investment strategy that is based on the participant's target retirement date. Potential disadvantages include (1) voluminous disclosure material that may overwhelm the participant (hence, why the DOL should issue guidance on a simplified disclosure approach for these products that is meaningful for plan participants); and (2) the inability of these products to qualify as designated investment options under section 404(c) to assure participants that these plan options have been appropriately selected by a plan fiduciary based on applicable DOL standards.

Currently the information provided to participants varies depending on the product. For traditional annuities, a certificate from the insurance company is provided when they decide to annuitize their account balance. That certificate is required under state insurance law, and it contains information about the amount of each monthly payment as well as additional relevant information. In the case of SEC registered products, such as a variable annuity, participants receive a prospectus that outlines the details of the product.

404(c) may be a vehicle for provide fiduciary relief for these types of products in terms of when a participant makes a payout election. It could be clarified that if certain standards are met, the plan sponsor could be relieved from fiduciary liability from the participant's election of a certain distribution option. 404(c) does not currently extend to this issue. It currently provides fiduciary relief for the participant's investment election. However, these products are not only investment options. They are also offered as distribution options. Therefore, relief should be extended to payout options. Changes to the regulations regarding disclosure and fees could encourage plan sponsors to use these products as core options. The 404(c) safe harbor would address a concern of plan sponsors that is distinct from the concern that would be addressed by the 404a-4 safe harbor. 404a-4 would provide a safe harbor for the selection and monitoring of guaranteed lifetime income providers in retirement plans, whereas, a 404(c) safe harbor would provide relief for the participant's election of a lifetime income payout option offered by a guaranteed lifetime income provider. Both safe harbors would encourage plan sponsors to include guaranteed lifetime income products in their retirement plans.

The DOL should provide guidance as to the proper information participants should receive. There should be a uniform standard established by the DOL to outline what constitutes "sufficient information".

34. <u>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 the use of these products?</u>

A small, but growing number of ERISA 404(c) plans provide guaranteed lifetime income through variable annuity contracts or similar guaranteed lifetime income products. The advantages of such products include protection from longevity and investment and inflation risks for both participants and their beneficiaries. Benefits of the products include providing participants the ability to retain investment control and avoid any requirement to liquidate investments in order to receive the benefit of distribution guarantees as well as flexibility to liquidate or reduce investments by transferring money out of the investment funds.

Plans provide participants with information about these investment alternatives in accordance with section 404(c) and applicable securities law requirements, and information about guaranteed lifetime-income products is delivered in prospectuses for registered products and in documents that resemble prospectuses for non-registered products. These documents include descriptions of the underlying investment funds and substantial information about operation of the guarantees, including calculations of guaranteed-withdrawal amounts, explanations about the effect of transfers in and out of the underlying investment funds, fee disclosures, and discussions about the actions of participants or sponsors that could result in the loss of guarantees.

ERISA 404(c) regulations should be amended to require that the description of any investment alternative include a description of any annuity purchase rights, investment guarantees, death benefit guarantees, or other features ancillary to an investment fund.

Qualified Default Investment Alternatives

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 target maturity fund product that 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 should take to encourage use of these lifetime income features in connection with qualified default investment alternatives?

Many plan sponsors have now adopted automatic enrollment plans in which plan sponsors unilaterally enroll their employees into the plan if they do not act to enroll on their own. Automatic enrollment involves the employer's selection for the participant of his or her compensation deferral rate as well as the investment option (the "default fund") in which deferral amounts are to be invested. Even plans that are not automatic enrollment plans may have a default fund for participants who do not make an investment election. The Pension Protection Act created a strong public policy in favor of such arrangements. Without a safe harbor, plan sponsors who use automatic enrollment or default funds face fiduciary liability for their decisions if they turn out to be imprudent. The DOL has issued a safe harbor that provides limited fiduciary relief for certain default funds. In order to qualify for the relief, the plan's default investment must be a qualified default investment alternative or QDIA. There is language in the regulation which states that funds that meet the qualification requirements of the regulations (such as retirement date funds) can have "ancillary" features such as "annuity purchase rights, investment guarantees, death benefit guarantees or other features." The QDIA regulations require the plan sponsor to issue an advance notice to the participant that, among other things, includes a description of the QDIA. Plan sponsors may want clarity as to what would constitute an adequate description of a lifetime income product beyond the information specified in the QDIA regulations

When promulgating the QDIA regulations, some in the industry asked the DOL to include stable value products (such as fixed products that include guaranteed annuity purchase rates) as one of the options that could be used as the QDIA, and the DOL declined to do so. This issue should be revisited because QDIAs are important safe harbors that plan sponsors rely on. The fact that there is a guaranteed feature should not disqualify these products from being QDIAs. It may require some additional disclosure to participants to ensure they understand the fee structures associated with these products.

Comments Regarding Economic Analysis, Regulatory Flexibility Act and Paperwork Reduction Act

36. What are the costs and benefits to a plan sponsor of offering lifetime annuities or similar lifetime income products as an in-plan option? Please quantify if possible.

IRI believes that other commentators are better positioned to respond to this question.

37. Are there unique costs to small plans that impede their ability to offer lifetime annuities or similar lifetime products as an in-plan option to their participants? What special consideration, if any, is needed for these small entities?

IRI believes that other commentators are better positioned to respond to this question.

38. Would making a lifetime annuity or other lifetime income product the default form of benefit payment have an impact on employee contribution rates? If so, in which direction and why?

Contribution rates are based on the specific needs and financial status of the individual. It is unlikely that making a lifetime income product the default form of benefit payment would have a major impact on contribution rates. Younger participants are unlikely to focus on the distribution method and would be unlikely to increase their contribution rate. However, if it were coupled with an illustration of potential future lifetime income payments, contribution rates might be positively impacted. If individuals are aware that their current rate of savings will not result in a rate of payments that will sustain them in retirement, they could act to increase their contribution rate. These comments are based on the assumption that the default option would revocable and there would not be any penalties for shifting the funds into another investment option.

39. For plans that offer lifetime annuities or similar lifetime income products, what percentage of eligible workers elect to annuitize at least some of their retirement assets and what percentage elect to annuitize all of their assets?

IRI believes that other commentators are better positioned to respond to this question.

GLOSSARY OF TERMS

ACCUMULATION PERIOD—The period during which the owner of a deferred annuity contract makes payments into the contract and accumulates assets. Also known as accumulation or savings phase.

ACCUMULATION VALUE—The sum of premiums and earnings in an annuity contract, minus contract charges and withdrawals (and losses, if a variable vehicle). Also known as the contract or account value.

ADMINISTRATIVE CHARGES—Expenses that cover all of the services involved with maintaining a variable annuity contract, such as transfers among subaccounts, preparation of contract statements and mailings, and other customer services.

ANNUAL CONTRACT FEE—An annual fee paid to the insurance company for administering the contract. The fee is often waived for contracts with high account values.

ANNUITANT—The person(s) upon whose life annuity payments are based. Often, but not always, the annuitant and the owner are the same person.

ANNUITIZATION—The conversion of the accumulated value of an annuity into a stream of income, either for one or more lifetimes or a specific period of time (or some combination).

ANNUITY—A series of periodic payments.

ANNUITY COMMENCEMENT DATE—The date income payments begin. Also known as the annuity starting date.

ANNUITY CONTRACT—A legal agreement between the contract owner and the insurance company, which may be either a deferred or immediate annuity and may be in the form of either a group or an individual contract.

ANNUITY INCOME PAYMENTS OR PAYOUTS—A series of payments made over a specified period of time with the duration guaranteed by the life insurance company at the beginning of the period.

ANNUITY PURCHASE RATE—The cost of an annuity based on insurance company tables, which take into account various factors such as age and gender.

ANNUITY UNIT VALUE—The measurement used to determine the amount of variable annuity payments. The amount of the payment is determined by the number of annuity units times the annuity unit value at the time of the payment.

A-SHARE VARIABLE ANNUITIES—Variable annuity contracts that have up-front sales charges instead of surrender charges, and are often accompanied by lower mortality and expense (M&E) charges. Sales charges are calculated as a percentage of each purchase payment.

ASSET ALLOCATION PROGRAMS—A system of assigning variable annuity purchase payments to subaccounts based on a contract owner's financial goals and risk tolerance. Portfolio rebalancing programs redistribute the amount of money allocated to each subaccount when the target percentages move out of alignment over time as the value of some subaccounts changes faster than others.

ASSET-BASED EXPENSES—Variable annuity expenses, such as investment management fees and annual insurance charges, that are based on the value of the assets held in the insurance company's separate account.

ASSUMED INTEREST RATE (AIR)—The rate of interest an annuity provider uses to determine the amount of each variable annuity income payment. If the actual performance of the contract holder's underlying investment portfolio is higher than the
AIR, payments will go up; if it is lower, payments will go down. Also known as the benchmark rate.

BENEFICIARY—The person designated under the contract to receive any payments that may be due upon the death of the owner or the annuitant.

BREAKPOINT PRICING—A system whereby the cost of up-front sales charges decreases depending on the cumulative amount of purchase payments that have been made.

B-SHARE VARIABLE ANNUITIES—Variable annuity contracts characterized by deferred sales charges, which typically range from 5-7% in the first year, and subsequently decline to zero after five to seven years. B-shares are the most common form of variable annuity contracts sold.

CASH SURRENDER VALUE—The amount that can be withdrawn from the contract after the deduction of any surrender charge. It is equal to the contract value minus the surrender charge. (The contract value is the sum of premiums and earnings minus contract charges and withdrawals, and losses, if a variable vehicle). Also known as cash value.

CHARITABLE GIFT ANNUITY—An annuity that involves the transfer of cash or property (including appreciated property) to a charitable organization in exchange for income payments for life or joint lives, with no period certain. The charity can fund its payment obligations using its own assets, or it can fund them by purchasing a commercial annuity.

COMMUTATION—A process provided under some annuities that allows annuity payments to be terminated and the remaining value to be withdrawn from the contract.

CONTINGENT DEFERRED SALES CHARGE—Back-end loads, charged on the liquidation of a variable annuity, which typically range from 5-7% in the first year, and subsequently decline to zero.

CONTRACT DATE—The date an annuity contract becomes effective.

CONTRACT OWNER—The person(s) who pays the premiums and has certain rights under the contract, such as making withdrawals, determining investment decisions, surrendering the contract, and changing the beneficiary or other terms of the contract.

C-SHARE VARIABLE ANNUITIES—Variable annuity contracts with no up-front or contingent deferred sales charges, which offer full liquidity to contract holders at any time. Also known as no-surrender-charge annuities.

DEATH BENEFIT—The payment made to the beneficiary upon the death of the contract owner or annuitant.

DEFERRED ANNUITY—An annuity contract that is purchased either with a single premium or with periodic payments to help save for retirement. The contract owner determines the point at which accumulated principal and earnings are converted into
a stream of income.

DEFINED BENEFIT PLAN—An employer-administered pension plan that qualifies for special tax treatment under the Internal Revenue Code. With a deferred benefit plan, the retired employee receives lifetime payments based on salary, years of service, and age at retirement. The employer bears the investment risk.

DEFINED CONTRIBUTION PLAN—An employer-administered retirement plan in which contributions with respect to an employee's compensation are made to the plan. The employee bears the investment risk.

DOLLAR COST AVERAGING—A program for investing a fixed amount of money at set intervals with the goal of purchasing more shares at low values and fewer shares at high values. Variable annuity dollar cost averaging programs involve allocating a certain amount of money to one investment subaccount, such as a money market fund, and then having portions of that payment periodically transferred to other subaccounts.

ENHANCED DEATH BENEFIT—A death benefit that goes beyond the guaranteed minimum death benefit by locking in investment gains every few years or every year, or paying a minimum stated interest rate on purchase payments.

ENHANCED EARNINGS BENEFIT—A feature of some variable annuity contracts that provides beneficiaries with an additional death benefit amount, usually equal to a percentage of earnings.

EXCLUSION RATIO—The formula that determines which portion of an annuity payment is considered taxable and which is a tax-free return of principal.

FIXED ACCOUNT—Part of the insurance company's general account to which a variable annuity contract owner may allocate all or part of premium payments. A minimum rate of interest is guaranteed, usually for a period of one year. Also known as a fixed investment option.

FIXED ANNUITIZATION—A stream of income payments that is fixed and guaranteed.

FIXED ANNUITY—An annuity contract that guarantees that the contract owner will earn a stated rate of interest during the accumulation phase of a deferred annuity, and receive a defined amount of income on a regular schedule when the contract is annuitized.

FLEXIBLE PREMIUM CONTRACT—A contract that allows payments to be made at any time after the initial purchase payment.

FREE-LOOK PERIOD—A specified number of days (e.g. 10 days) during which an annuity contract owner may revoke the purchase of the contract.

GENERAL ACCOUNT—All the assets of the insurance company not allocated to separate accounts.

GUARANTEED LIFETIME WITHDRAWAL BENEFIT (GLWB)—A guarantee that promises that a certain percentage (usually 4-5%) of a guaranteed benefit base (often paid premiums) can be withdrawn each year for the life of the contract holder,
regardless of market performance or the actual account balance.

GUARANTEED MINIMUM ACCUMULATION BENEFIT (GMAB)—A guarantee that ensures that the contract value of a variable annuity will be, at least, equal to a certain minimum amount after a specified number of years.

GUARANTEED MINIMUM DEATH BENEFIT (GMDB)—The basic death benefit offered under variable annuity contracts which specifies that if the owner, or in some contracts the annuitant, dies before annuity income payments begin, the beneficiary will receive a payment equal to (a) the greater of the contract value or (b) purchase payments less withdrawals.

GUARANTEED MINIMUM INCOME BENEFIT (GMIB)—A guarantee that ensures, under certain conditions, that the owner may annuitize the contract based on the greater of (a) the actual account value or (b) a payout base equal to premiums credited with a defined interest rate or the maximum anniversary value of the account prior to annuitization.

GUARANTEED MINIMUM LIVING BENEFIT (GMLB)—A benefit that protects against investment risks by guaranteeing the level of account values or annuity payments. There are three types—guaranteed minimum income benefits, guaranteed minimum accumulation benefits, and guaranteed minimum withdrawal benefits.

GUARANTEED MINIMUM WITHDRAWAL BENEFIT (GMWB)—A guarantee that promises that a certain percentage (usually 5-7%) of a guaranteed benefit base (often paid premiums) can be withdrawn annually until the base is completely recovered, regardless of market performance or the actual account balance, or for the lifetime of the contract owner or both spouses, depending on the type of product selected.

GUARANTEE PERIOD—The period during which the level of interest credited under a fixed annuity is guaranteed.

IMMEDIATE ANNUITY—An annuity that is purchased with a single lump sum. Income payments begin within a short period—less than 13 months. Immediate annuities can be either fixed or variable.

INCOME FLOOR GUARANTEES—Annuity payments supported by a floor which guarantees that subsequent payments will never be less than a given percentage of the original payment, such as 80%, regardless of the performance of the underlying investments.

INCOME OR PAYOUT OPTIONS—Different ways by which a contract owner can receive income from an annuity. These include a lump sum payment, systematic withdrawals, and annuitization.

INDEXED ANNUITY (IA)—An annuity that allows limited participation in gains tied to an index, usually the S&P 500, and that also provides a floor guarantee against downside market risk.

INSURANCE CHARGES—Charges that cover administrative expenses and the cost of the mortality and expense (M&E) risk.

INVESTMENT MANAGEMENT FEE—The fee paid in connection with the professional management of the assets of the investment funds underlying variable annuities.

ISSUER—The insurance company that issues the annuity contract.

JOINT AND SURVIVOR ANNUITY—A life annuity in which there are two annuitants, usually spouses, known as joint annuitants. Annuity payments continue as long as either annuitant is alive.

LEVEL ANNUITY PAYMENTS—Payments under a variable annuity contract that remain the same for a period of time, such as 12 months, and then change to reflect investment performance. Once changed, the payments remain the same for the next
12 months.

LIFE ANNUITY—Annuity payments that are guaranteed to continue for the life of the annuitant.

LONGEVITY RISK—The risk of outliving one's assets.

L-SHARE VARIABLE ANNUITIES—Variable annuity contracts that typically have shorter surrender periods, such as three or four years, but may have higher mortality and expense (M&E) charges.

LUMP SUM OPTION—A withdrawal option in which the annuity is surrendered and all assets are withdrawn in a single payment.

MARKET RISK—The risk of losing portfolio value due to the volatility of the stock market. Also known as financial market risk.

MARKET VALUE ADJUSTMENT (MVA)—A feature included in some annuity contracts that imposes an adjustment or fee upon the surrender of a fixed annuity or the fixed account of a variable annuity. The adjustment is based on the relationship of market interest rates at the time of surrender and the interest rate guaranteed in the annuity.

MINIMUM CREDITED INTEREST RATE—The minimum rate of interest that is guaranteed on a fixed annuity.

MONTE CARLO SIMULATION—A computerized analytical model which considers thousands of scenarios, using multiple data points such as inflation, interest rates, and market returns, and presents a range of probabilities that various outcomes might actually occur.

MORTALITY AND EXPENSE (M&E) RISK CHARGE—A fee that pays for the insurance guarantees, including the death benefit and the ability to choose a payout option that can provide lifetime income, at rates set in the contract at the time of purchase.

NET SALES OR NET FLOWS—Total variable annuity sales minus surrenders, withdrawals, inter- and intra-company exchanges, and benefit payments.

NON-QUALIFIED ANNUITY—An annuity that is not purchased as part of a retirement program that receives special tax treatment.

PARTIAL WITHDRAWAL—The withdrawal of an amount less than the entire cash surrender value of an annuity contract. Many contracts permit annual withdrawals of a certain amount that is free of a surrender charge.

PAYOUT PERIOD—The period during which the money accumulated in a deferred annuity contract, or the purchase payment for an immediate annuity, is paid out as income payments. Also known as payout phase.

PERIOD CERTAIN—A type of refund annuity that guarantees that if the annuitant dies before payments have been made for some minimum number of years, payments to the beneficiary will continue until the end of the guarantee period.

PORTFOLIO REBALANCING—A type of asset allocation program that periodically reallocates contract assets, in specified proportion, among fixed and variable investment options within a variable annuity contract.

PREMIUMS—The amounts of money paid into an annuity contract. Also known as purchase payments.

PRIVATE ANNUITY—An annuity that involves the transfer of property (such as real estate) from an individual or a revocable living trust in exchange for an unsecured promise by the transferee (an individual or a non-insurance entity, such as a trust) to make a periodic stream of fixed payments.

PURE LIFE ANNUITY—An annuity with payments that stop when the annuitant dies. Also known as a straight life annuity.

QUALIFIED ANNUITY—An annuity purchased with pre-tax dollars as part of a retirement program, such as a 401(k) plan, that receives special tax treatment.

RATCHET GUARANTEED MINIMUM DEATH BENEFIT—A type of enhanced death benefit that is equal to the greater of (a) the contract value, (b) premium payments less prior withdrawals, or (c) the contract value on a specified prior date.

REFUND ANNUITY—A type of annuity that guarantees that if the annuitant dies before the return of a specified amount of annuity income, some or all of the premiums will be refunded to the beneficiary.

RETIREMENT INCOME PERIOD—The period during which the money accumulated in a deferred annuity contract, or the purchase payment for an immediate annuity, is paid out as income payments.

RISING FLOOR GUARANTEED MINIMUM DEATH BENEFIT—A type of enhanced death benefit that is equal to the greater of (1) the contract value or (2) premium payments less prior withdrawals increased annually at a specified rate of interest.

RISK POOLING—The spreading (in the case of annuities) of longevity risk among a large group of individuals, some of whom die sooner than expected, some of whom will live longer than expected.

SAVINGS PERIOD—The period in which the owner of a deferred annuity makes payments and accumulates assets.

SEPARATE ACCOUNT—An account that is set apart from an insurer's general account and is legally insulated from the insurer's general creditors. Variable annuities are issued through separate accounts.

SINGLE PREMIUM ANNUITY—An annuity contract that is purchased with a single payment. All immediate annuities and some deferred non-qualified annuities are in this category.

STEPPED-UP DEATH BENEFIT—A death benefit that is increased regularly to protect investment gains.

SUBACCOUNT—The investment funds offered in variable annuity contracts are often called subaccounts. The term refers to their position as accounts held within the separate account of the insurance company offering the variable annuity.

SURRENDER CHARGE—The cost to a contract owner for withdrawals from the contract before the end of the surrender charge period. The surrender charge period typically is five to seven years.

SYSTEMATIC WITHDRAWAL PLAN—A distribution method that allows a variable annuity contract owner or other designated person to periodically receive a specified amount as a partial withdrawal from the annuity contract value prior to the annuity starting date. Unlike lifetime annuity payments, systematic withdrawals can continue only until the contract cash value is exhausted. The tax treatment of systematic withdrawals differs from that of annuity payments.

TAX-QUALIFIED RETIREMENT PLAN—A retirement plan, such as an IRA, 401(k), or 403(b), that meets specific requirements of the Internal Revenue Code as well as stipulations in various laws, such as the Employee Retirement Income Security Act (ERISA) of 1974, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, and the Pension Protection Act (PPA) of 2006.

TOTAL SALES OR TOTAL PREMIUM FLOWS—The sum of new sales (all first-time buyers of a contract, including inter- and intra-company exchanges) and additional premiums from existing contract owners.

TRANSFER—The movement of assets from one subaccount to another.

TRANSFER FEE—The charge for transferring assets from one subaccount to another.

UNBUNDLED CONTRACTS—Annuity contracts that permit purchasers to choose and pay for certain optional features they want in their contracts.

UNIT VALUE—A measurement of the performance of the underlying funds in a variable annuity, similar to the share value of a stock. Each investment subaccount has a separate unit value. The unit value increases with positive investment performance in the subaccount, and decreases with negative investment performance and with asset management and insurance charges.

VARIABLE ANNUITIZATION—A stream of income payments that vary based on the investment performance of underlying subaccounts.

VARIABLE ANNUITY—An annuity whose contract value or income payments vary based on the investment performance of underlying subaccounts.

VARIABLE ANNUITY PAYMENT FLOOR—A guaranteed minimum amount or floor for each annuity payment.

VARIABLE INVESTMENT OPTIONS—The investment choices available to a variable annuity contract owner. These choices typically include stock, bond, and money market funds.

WITHDRAWAL FEE—An administrative fee charged on withdrawals.

WITHDRAWALS—Distributions from an annuity other than scheduled annuity payments.

X-SHARE VARIABLE ANNUITIES—Variable annuity contracts that credit an additional amount to the contract value.