PSCA.org PROFIT SHARING/401k COUNCIL OF AMERICA

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Office of Regulations and Interpretations
Employee Benefits Security Administration
United States Department of Labor
submitted via electronic delivery

RE: RIN 1210-AB33, Lifetime Income RFI

Ladies and Gentlemen:

The Profit Sharing / 401k Council of America (PSCA) is pleased to respond to the Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans (the RFI) issued by the Departments of Labor and the Treasury (the agencies). PSCA is a 63-year old non-profit association representing companies that sponsor profit sharing, 401(k), and similar plans. PSCA speaks for over 1,200 companies who employ approximately 5 million plan participants throughout the United States. PSCA's members range in size from very small firms to conglomerates with hundreds of thousands of employees. All regard their defined contribution plans as vital factors in their business success.

Overview

The looming retirement of the baby boom generation has resulted in the employer provider retirement plan community's increased focus on the "distribution phase" of the 401(k) system. In our latest survey of 2008 plan year experience, 21 percent of plans offered an annuity distribution option. However, an exceedingly low number of participants, well below one percent, select an annuity distribution option from a defined contribution plan when it is offered. For the one-half of defined benefit plans that offer a lump sum payment, over 90 percent of participants endure the cumbersome spousal waiver procedures to avoid the required default joint annuity distribution. This behavior is very likely to be repeated by defined contribution plan participants if a default annuity payout mandate is implemented for their plans. The lack of participant interest, combined with the increased complexity and fiduciary responsibilities involved in offering an annuity, results in a low level of interest among PSCA members in either offering a traditional annuity product or seeking regulatory relief to facilitate offering this product.

Notwithstanding the above, lifetime income products can play a key role in the management of retirement assets. The provider community is well aware of the situation in employer provided plans and has responded by developing and marketing many new lifetime income products. Some are "in-plan" products that permit investment during the accumulation phase. Others are distribution-stage products with much more flexibility than the traditional products. A significant portion of the industry is marketing these products on an IRA platform rather than as a direct plan distribution option. Some products have an insured or annuity feature, and others are pure managed payout funds. Longevity insurance that begins payments at an advanced age provides an interesting complement to the managed payout funds and some other insured products. These products are in their infancy, and questions about them have resulted in a very low adoption rate by plan sponsors. PSCA believes that the market should be permitted to refine and improve these products without government interference that could hamper this important process. When products are developed that meet the needs of participants and plan sponsors, they will be included in employer provided plans.

The state of the defined contribution system
The RFI discusses a 2007 GAO report that analyzed 2004 Survey of Consumer Finances data on defined contribution plan savings rates. According to the RFI, the report states that "only 36 percent of workers participated in a current defined contribution plan in 2004, with the total median account balance of only $22,800. This report is relevant to this RFI because the need for lifetime income may be most acute among workers who have small but significant retirement savings balances." The GAO report disregards coverage in a defined benefit plan.

This outdated and flawed report should be ignored. It ignores the effects of the new default rollover treatment of amounts greater than $1,000 that became effective in 2005 and key provisions of Pension Protection Act of 2006 – enhancement of automatic enrollment, promotion of target date funds, and permanency of the 2001 EGTRRA pension provisions, including the Saver's Credit. According to the Bureau of Labor Statistics, in March 2009 sixty-seven percent of all private sector workers had access to an employer provided retirement plan (defined benefit or defined contribution or both) and 51 percent participated. Seventy-six percent of full time private sector workers are covered and 61 percent participate. Even the lowest-decile income workers benefit – 35 percent have access to a retirement plan at work and 15 percent participate[1].

While some workers have enjoyed a full working career under a defined contribution plan such as a profit sharing plan, 401(k)-type plans in which the employee decides how much to save have been widely available for less than twenty years, and most participants have participated in them for a much shorter period of time. Policymakers must be wary of statistics citing average 401(k) balances and balances of those approaching retirement because they have not saved over their full working career and some balances belong to brand new participants. According to the Employee Benefit Research Institute, for consistent 401(k) plan participants for the five year period ending December 31, 2008, the average 401(k) account balance was $86,500 and the median balance was $43,700 (down from $114,337 and $57,933, respectively, at the end of 2007). Individuals in their sixties with thirty years of tenure with their current employer had an average balance of $179,573 ($231,880 in 2007).[2] These balances will be considerably higher for year-end 2009, reflecting the improved markets.

The Congressional Research Service estimates that a married household that contributes 10 percent of earnings to a retirement plan for 30 years will be able to replace 53 percent of pre-retirement income. If they save for forty years, they will replace 92 percent of income.[3] A 10 percent savings rate is realistic given average contribution rates of 7 percent and average employer contributions of 3 percent. These estimates do not consider Social Security payments

The lesson is clear – long-term participation in a 401(k)-type plan will result in the accumulation of assets adequate to provide a secure retirement.

Flexible plan design is imperative to the success of the employer provided retirement system.
Employer provided defined contribution plans, to a larger degree than defined benefit plans, have benefited tremendously from their ability to innovate and adapt to design plans that meet the needs of

[1] Employee Benefits in the United States, March 2009, Bureau of Labor Statistics, United States Department of Labor, July 28, 2009.
[2] 401(k) Plan Asset, Allocation, Account Balances, and Loan Activity in 2008, EBRI Issue Brief No. 335, October 2009.
[3] *Retirement Savings: How Much Will Workers Have When They Retire*?, CRS Report For Congress, January 29, 2007.

employers and employees. This flexibility has created a cauldron of innovation because service providers are able to design and market new ideas and products and test them in an open market. Some of the best ideas, such as automatic enrollment and target date funds, exist today because employers are free to alter their plan designs. Some ideas failed in this market place - credit card loans were proposed and soundly rejected by plan sponsors. PSCA firmly believes that this freedom to innovate must be preserved. The development of new lifetime income and managed payout products would not have occurred if defined contribution plans were required to offer a traditional annuity default distribution.

The agencies should not mandate that a lifetime income product, or any other plan investment, be included in a defined contribution plan.

There are no compelling reasons to mandate that annuities, and especially specific annuity products, be offered as a distribution option from a defined contribution plan; and doing so will likely harm these plans.

PSCA believes that the best course of action is to let the current competition of ideas continue so that viable products, which still need to evolve, can be available to participants. A major factor in the limited utilization of annuities in defined contribution plans is that average wage workers already are provided with a substantial annuity when they retire. According to the 2009 Social Security Trustees Report, the average 65 year old retiring in 2009 will receive a Social Security benefit that replaces 40 percent of pre-retirement income. These annuity payments are subsequently adjusted for inflation. Married couples can each elect to receive their own benefit or 150 percent of one spouse's benefit. Social Security provides a 100 percent survivor's benefit. In two-earner families, the surviving spouse can switch from their own benefit to the spousal benefit if it is higher. If an average retiree seeks to replace 80 percent of their working income in retirement, Social Security will provide half that amount, indexed for inflation.

Second, the evidence that those taking lump sum distributions from their retirement plan are not purchasing annuities is inconclusive. It is true that for the approximately 20 percent of defined contribution plans that offer annuities, nearly all retirees take a lump sum/IRA rollover or leave their assets in the plan. However, some or all of an IRA balance may subsequently be used to purchase an annuity. When it makes sense to purchase an annuity, retirees may be doing so.

Third, there is no evidence that participants who choose not to purchase annuities through their plan when they retire are harming themselves. For how many participants does it make sense to make the irrevocable decision to purchase an annuity at age 62 or age 65, especially if the annuity options available are not indexed for inflation? Does it make sense to convert a lump sum to an annuity when the prices are high and account balances are depressed, as in the recent recession?

A December 2002 report by the TIAA-CREF Institute provides some insight on participant's preferences for various distribution options at the time of retirement. Prior to 1989, an annuity product was the only distribution available under the plan. Non-annuity options were added in 1989, 1991, and 1996. By 2001, only 45 percent of new retirees selected an annuity payout. These participants were furnished with illustrations of the income levels of various options at the time of retirement. According to the report, "The choices individuals are making therefore do appear to be made willingly and voluntarily, reflecting consideration of the available options."[4]

[4] John Ameriks, , Recent Trends in the Selection of Retirement Income Streams Among TIAA-CREF Participants, Issue Number 74, TIAA-CREF Institute, December 2002.

Fourth, mandating that defined contribution plan sponsors offer specific annuity approaches will likely stifle innovation. As we have noted, financial institutions have developed and marketed many new products, with and without a guaranteed feature, to help near retirees manage their assets in retirement.

Fifth, plan sponsors do not provide annuities as a plan option for good reason. Any defined contribution plan sponsor offering an annuity option must manage attendant administrative and compliance requirements. For example, a waiver of the qualified and joint survivor annuity cannot be done electronically. Sponsors offering a plan annuity option assume fiduciary responsibly for selecting and monitoring the annuity vendor. Sponsors know that when annuity options are offered they are not utilized, and there often is no participant pressure to add an annuity option to the plan. Finally, sponsors know that if a retiring or retired participant wants to annuitize some or all of their lump sum they can do so in an IRA (some employers offer a feature to facilitate this process). To keep the defined contribution system healthy and growing, especially among smaller employers, it is important to avoid new regulations that imposes additional administrative responsibilities, compliance obligations and fiduciary liabilities that would accompany a mandate to offer an annuity.

Rather than be an advocate for a particular type of plan investment or plan design, we urge the agencies to maintain a regulatory environment that promotes a large and even playing field. Under this approach, plan sponsors will continue to innovate as they work to accommodate the different needs of their varied workforces and not just those of the "average" participant.

Selected questions:

Q-1 asks what are the advantages and disadvantage to participants of receiving some or all of their benefits in the form of lifetime payments.

The advantage is that a retiring participant receives a predictable, steady stream of income for as long as the participant lives.

On the other hand, there is risk that the participant will die early and the investment in the annuity will be lost to heirs. The standard annuity payment is eroded by inflation. Annuities have numerous features to address these concerns, such as a survivor feature, guaranteed payout periods regardless of death, and inflation indexing. All of these features lower an annuity's payment amount. Annuities are subject to credit risk – the chance that the issuer will not remain in business. Most states offer a guarantee pool, but the covered amount is inconsistent and may be less than the value of the annuity.

Most participants are not equipped to make the analysis comparing an annuity to other investment alternatives. For example, annuity pricing is very opaque – purchasers only know the payment stream for an initial investment amount. Hopefully, pending Department of Labor fee disclosure regulations currently under review at the Office of Management and Budget will provide needed transparency. Finally, an annuity income stream is generally constant, while retirement expenses vary and are often unpredictable, such as the costs of a health care crisis.

Q-5 We believe that the use of employer matching contributions or non-elective contributions to fund lifetime income products is negligible. Very few plans currently offer these products.

Q-9 Plan sponsors are not yet embracing in-plan lifetime income products, but there is significant interest in them. PSCA recently surveyed its plan sponsor members and found that 91 percent of respondents are aware of these products and 22 percent are considering adding them to their plans. In the group considering the products, 37 percent indicated they "wanted their employees to have this option" and 63 percent reported that they wished to assist participants in "having a secure retirement."

It is currently difficult to include an in-plan lifetime income product with the other investment options in a defined contribution plan that allows transfers between investment choices because of surrender charges and fees. It is also difficult to help participants understand how accumulation annuities work in relation to other investment options and hard to find an advice model that would meet the needs of the general population of participants. Compliance with the required minimum distribution rules can be difficult with some products. Portability issues arise when a participant severs employment. As we have noted, we expect that market forces will result in improved products that address or ameliorate these issues.

From the sponsor's perspective, installment distribution options have advantages over in-plan lifetime income products. They don't require another investment option within the plan or a contract with an outside party that may impose fiduciary liability on the sponsor.

Q-13 As we have stated and explained above, PSCA strongly opposes any mandates to offer a lifetime income product or for them to be a default distribution option. Traditional annuitization of a variable account balance in a defined contribution plan is different than a formula-driven lifetime payout from a defined benefit plan. It is a complex purchasing decision. For example, purchasing an annuity from temporarily diminished assets at the bottom of the recent market downturn when interest rates were at historic lows would have resulted in a lifetime of significantly reduced retirement income for participants and their spouses. The "endorsement effect" of an annuity default distribution could influence the purchasing decision, leading to sub-optimal outcomes for participants and putting plan sponsors at risk of lawsuits.

Participant education and disclosing the income stream that can be provided from an account balance

While virtually all sponsors provide some type of education to plan participants, practices vary widely. In our 52nd Annual Survey, reflecting 2008 plan year experience, 35.5 percent of responding sponsors provide education specifically relating to the retirement distribution. In some cases plan sponsors offer extensive pre-retirement education that addresses not only the employer's plan but Social Security and Medicare, and even estate planning. Other sponsors feel that education should be limited to the plan and its investment options.

PSCA believes that current guidance regarding the provision of education or advice about distribution-related issues, including the ability to use plan assets to educate participants about lifetime income or other arrangements, is sufficient. However, retirement decisions regarding plan assets are not made in a vacuum. Guidance clarifying the use of plan assets for broad pre-retirement education that goes beyond issues related to the plan or investing of plan assets, such as Social Security, Medicare, general estate planning, eldercare, long-term care, etc., will encourage more plan sponsors to provide this type of education to plan participants.

PSCA does not support a regulatory or Congressional effort to require individual benefit statements to present an account balance as a stream of future lifetime income payments. That said, some plan sponsors and service providers voluntarily offer this feature today. Once again, PSCA believes that plan design decisions such as these are best handled by individual plan sponsors.

Section 105 of ERISA requires that benefit statements provided to participants and beneficiaries in self-directed individual account plans include a notice directing the participant or beneficiary to an Internet website at the Department of Labor for sources of information on individual investing and diversification (http://www.dol.gov/ebsa/investing.html). The website includes a rich array of resources for participants. The Department should consider adding an income stream calculator to the site that participants could use if they want to make this calculation. If the Department agrees to this suggestion, the calculator should accommodate both insured products and non-insured structured payment products.

Plan Qualification Rules

Question 28 discusses the operation of the required minimum distribution (RMD) rules in relation to "longevity insurance" that is purchased with a single premium and held as a plan or IRA investment, but only pays benefits at a later date, such as at age 85, to the owner or the joint life of the owner and the owner's beneficiary. One factor in the product's cost is the age of the purchaser – a younger purchaser will have a lower premium. PSCA believes this product may be an attractive investment for plan participants, but the RMD rules discourage its use. Under current rules, the RMD rules apply to an investment in longevity insurance held in a qualified plan or an IRA when the owner turns age 70 1/2, even though the owner is not receiving a benefit (and may never receive a benefit).

HR 2784, sponsored by Representatives Earl Pomeroy and Ginny Brown-Waite, includes a provision that amends the RMD rules to exclude the investment in the longevity insurance premium from the RMD requirements. Longevity insurance has been defined in legislation as an annuity that: (a) is payable no later than a year after the individual reached age 85 (or would have attained age 85), (b) is paid out in substantially equal periodic payments (not less frequently than annually) over the life of the employee or the joint lives of the employee and the employee's designated beneficiary, (c) does not allow pre-death commutation benefits or have cash surrender value, and (d) has a limited pre-commencement death benefit (return of premiums paid, plus a reasonable interest rate). PSCA urges the agencies to support this important legislation.

At the same time, it has long been PSCA's position that the minimum distribution requirement should be repealed. It is anathema to sound retirement policy. Forcing individuals to lose the advantage of tax deferred earnings accumulation and divert principle to pay income tax can seriously erode retirement security, especially since people who reach the age of 70 can reasonably be expected to live to age 90 and beyond. The minimum distribution rules are complex and some participants, fearing onerous penalties, withdraw even more than is required under the rules. They can force inappropriately timed conversion of investments to cash, a reality recognized by the Congress when it recently suspended the requirement because of the 2008 market meltdown.

Thank you for this opportunity to share PSCA's views. If you have any questions, or if I can be of any assistance, please contact me at 202-863-7272 or ferrigno@401k.org.

Respectfully,

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