AMERICAN BENEFITS COUNCIL

May 3, 2010

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

Re: Request for Information – Lifetime Income (RIN 1210-AB33)

Dear Sir or Madam:

The American Benefits Council (Council) appreciates the opportunity to provide information and comment to the Department of Labor (DOL) and Department of Treasury (Treasury) on their Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans (RFI). The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

First and foremost we would like to thank Treasury and the DOL for initiating this project, which we understand will be the first phase of a new regulatory focus on the distribution phase of retirement planning. The Council agrees that the retirement security of millions of baby boomers and future generations depends not only on their ability to accumulate sufficient assets/resources for retirement but also on how those resources are utilized to provide retirement income.

In fact, the Council believes this issue is so important that we held a benefits briefing conference call attended by nearly 200 of our members and this letter represents the preliminary input from Council members during and after the briefing. We also plan to hold a roundtable discussion for plan sponsor members in the near future, but we were unable to schedule the roundtable in time to include resulting observations/insights in this letter. We will be happy to share the results with you following the roundtable.

<u>Background</u>

The increasing number of baby boomers approaching retirement, along with the recent turmoil in the financial markets, has understandably resulted in a sharpened focus on the need to ensure that retirement plan assets and other retirement resources last over the lifetime of the retiring employee. The decline in defined benefit plans and increase in defined contribution plans over the last 25 years means many baby boomers and future generations will face the decision on whether and how to create some form of lasting income (whether guaranteed or not) from accumulated retirement plan assets in order to supplement Social Security.

Although many lifetime income options are currently available – lifetime annuities, guaranteed minimum withdrawal products, systematic withdrawals, longevity insurance – employees generally do not select these options when retiring. Some policymakers appear to believe increased access to these options in plans will result in higher usage but the Council is not convinced this would be the case. When annuities are offered, for example, few elect them. This is especially telling in defined benefit plans with lump-sum options where the annuity form of payment is the default distribution option and the participant (and his/her spouse if married) must make a significant effort to elect another form of distribution but yet the vast majority do. Even if "you build it", they won't necessarily come.

Although the focus of this project is on defined contribution plans, the Council encourages the agencies to consider potential ramifications for defined benefit plans. Even though plan participants generally take the lump-sum payment when given a choice, all defined benefit plans offer life annuities and many defined benefit plans do not offer lump sums, at least with respect to the full benefit. They should be encouraged to continue or even extend that tradition. In particular, any incentives offered to participants to choose lifetime income should apply to people retiring under defined benefit plans as well as defined contribution plans. The Council firmly believes in the value of defined benefit plans and urges the agencies to make policy decisions that will provide helpful guidance and encouragement to defined benefit plan sponsors and resist decisions that will result in further decline of these plans (both within and outside this project).

While participants generally do not elect lifetime income options when taking distributions from employer-sponsored plans, Council members have noted that many roll over their distributions to IRAs. Thus, DOL and Treasury also need to focus on IRA distribution patterns and product availability.

One of the questions raised by the RFI is why employees who have annuities available to them fail to elect them. Council members and most other entities commenting for the RFI will only have anecdotal information from conversations with participants such as: the perceived high cost of annuities (due, in part, to adverse selection); perception of poor or negative returns (the insurance company gets to keep my money if I die tomorrow); unsupported belief in their own investment prowess (I can do better); wealth versus annual income deception (today I am a millionaire, tomorrow I have an annual income); fear of losing investment diversification (annuity backed by just one company although state insurance guarantees can partially mitigate this concern); the desire to bequeath assets to heirs; and the perception that a regular income in addition to Social Security checks will not be needed. In other words, participants want to retain access to their funds, they want the possibility of participating in asset growth, and they do not want to transfer all of their retirement assets to an insurance company.

The DOL and Treasury might find it helpful to conduct behavioral economic studies to provide insights beyond anecdotal information. Behavioral economics has been applied to health care and selective retirement plan issues (automatic enrollment). In fact, one limited study would seem to support the premise that how the choice is framed for the participant (consumption versus investment) strongly influences the outcome of their decision (perhaps indicating that appropriate educational material published by the agencies could have a significant effect).[1]

To put this in perspective, a 65-year-old who has accumulated $1 million and retires might be advised that the most he should withdraw from his account for the first year is 4 percent, and then adjust it for inflation in future years, in order to have a reasonable prospect of the money lasting for his lifetime. That would be $40,000 in the first year. By contrast, the same $1 million applied to an indexed-for-inflation (CPI-U) straight life annuity would currently produce an income of approximately $55,000 for a male and $50,000 for a female for the first year (according to quotes from one of our service provider members). Of course additional features such as a guaranteed payout in the event of premature death or a survivor annuity would reduce the annuity payment to some degree.

The Council commends DOL and Treasury for beginning this process through the publication of the RFI and collecting comments. There is significant work to be done by the agencies to encourage increased access to (and use by) retirees of annuity and other forms of lifetime income during their retirement years. An educational effort, backed by behavioral economic studies, would appear to be a good next step.

Our recent experience indicates that inertia can be a powerful tool such that automatic enrollment and automatic increases can be very useful in expanding employee

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[1] "Why Don't People Insure Late Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle," by J.R. Brown, J.R. Kling, S. Mullianathan, and M.V. Wrobel, American Economic Review Papers and Proceedings 98:2 (2008).

participation in retirement plans. However, the Council does not believe an attempt to mandate annuities as the default option (or a partial default option) for defined contribution plans will share a similar success pattern. Where lump-sum payments are available (as clearly illustrated in defined benefit plans that default to annuity payments but offer lump-sum payments) plan participants tend to use whatever process is required in order to obtain the lump sum. In addition, it would be impossible to design a default option to account for the spectrum of financial situations of individual plan participants. The better focus should be education.

The Council is aware of new products addressing some of these participant concerns and we would urge the agencies to avoid inhibiting product innovation in crafting any new guidance, clarifications or educational materials that are generated. For example, some products now allow participants to purchase future streams of income ("pieces" of an annuity) with each investment under an in-plan retirement income accumulation plan. In addition, Mutual fund offerings now include funds that provide for appropriate investment diversification to support distributions through an individual's retirement years or for a specified period of years.

As another example, several insurance companies are currently offering products called Guaranteed Minimum Withdrawal Benefits (GMWB). The products differ, but basically the insurance company issues a guarantee, in exchange for a fee, that so long as the participant meets certain conditions, the insurance company will make payments to the participant at a specified rate even if the participant exhausts his/her entire retirement plan balance. The guaranteed payments are based on a "benefit base" that may be the highest balance in the participant's account during his/her working years or, in some products, the highest covered balance during his/her working or retirement years.

<u>Fiduciary and Other Concerns</u>

The RFI appears to assume most defined contribution plans do not offer periodic distributions and asks why. The Council understands that some of these plans do offer types of periodic payments, some of which are intended to stretch over the life of the participant and his or her beneficiary. Nevertheless, few defined contribution plans offer distributions in the form of an annuity. Council members indicate plan sponsor disinterest boils down to three issues: (1) fiduciary liability, (2) administrative challenges, and (3) lack of participant demand.

To rectify this, plan sponsors need clear, simple fiduciary guidance allowing them to provide lifetime income options to plan participants without risking a significant increase in potential fiduciary liability. Under current law, the selection of an annuity provider is fraught with potential missteps that could result in continued liability for the plan sponsor well into the future. As you know, the DOL issued guidance (in response to a directive in the Pension Protection Act) that the "safest available annuity" standard in Interpretive Bulletin 95-1 does not apply to the selection of an annuity contract provider for distributions from a defined contribution plan. The same guidance, however, indicated significant due diligence is necessary. This includes an assessment of the provider's continued ability to fulfill its contractual obligations, such that a clear "safe harbor" has not been established. Plan sponsors are understandably concerned that courts will make this assessment in hindsight, resulting in potential litigation liability years later.

In addition, recent lifetime income products allow plan participants to roll over their plan benefits into an IRA with an annuity platform which allows them to obtain multiple bids from different insurance companies selling annuity products. The plan sponsor may want to inform participants about the availability of the annuity platform to rollover IRAs, but would want to avoid any endorsement that could imply fiduciary responsibility. Clear guidance indicating due diligence steps (including what types of information should be provided to plan participants) that could be taken by plan sponsors to avoid future liability would be very helpful. For example, plan sponsors should be encouraged to make such "referrals" without becoming subject to fiduciary liability.

Another challenge for plan sponsors interested in providing access to lifetime income products prior to distribution (in-plan products) is ERISA Section 404(c). The regulations issued by the DOL under 404(c) provide the conditions necessary to relieve plan fiduciaries from liability for plan participant investment decisions. Among the requirements for core options are rules relating to transferability and liquidity. The 404(c) regulations do not currently address the plan sponsor's fiduciary obligations when offering an in-plan lifetime income options (including the GMWB described above). The Council encourages the agencies to provide clarifying solutions to the portability concerns that may deter plan sponsor interest in innovative lifetime income solutions because of the potential loss of a plan participant's guarantee should the plan sponsor change service providers.

Also, the current rules make it very difficult for plan sponsors to offer electronic elections and annuity options within the same defined contribution plan. With the development of electronic technology, plan sponsors face complaints from participants forced to obtain a distribution using paper forms. As you know, generally plan participants in plans that provide for annuity distributions must obtain spousal consent for any distribution method other than a joint and survivor annuity distribution. Although Treasury guidance allows an electronic signature from the spouse, the spouse must be in the presence of a notary or plan representative. The Council understands that plan service providers have been unable to devise a system accommodating electronic spousal consent. Guidance allowing other safeguards (such as a separate PIN for the spouse) could facilitate use of electronic technology in distributions from defined contribution plans that include annuity options and thus eliminate this administrative roadblock. Guidance is also needed to clarify whether GMWBs and in-plan options (including a GMWB) discussed above are considered lifetime periodic payments or annuities for purposes of these rules.

In addition, current rules make it difficult if not impossible for plan sponsors to offer another recent market innovation commonly called "longevity insurance". Longevity insurance involves purchase, generally at retirement, of a deferred fixed annuity which does not begin to make payments until a later time, typically around the average life expectancy. A 65-year-old retiree, for example, could purchase a deferred annuity that begins payment at age 85. The longevity insurance allows the retiree to budget the remainder of the retirement plan assets to last over a specified period (20 years in this example), thus eliminating the worry of outliving his or her income.

In this product, the time value of money and mortality premium (participants dying prior to the average life expectancy subsidize the payments to those living beyond average life expectancy) results in significant annuity benefits at lower cost than an immediate annuity may provide. Current minimum required distribution rules that require minimum distributions to begin by age 70-1/2 do not contemplate this type of arrangement. The participant would be forced to include the value of the annuity in the calculation of the minimum distribution resulting in larger required distributions. In extreme cases, the required distribution could be more than the remaining benefit. Until this is addressed, few plan sponsors will add longevity insurance to their plans. The Council recommends that assets used to purchase longevity insurance (without a death benefit) be excluded from the minimum distribution calculation.

As you can see in these issues, the key to any guidance relating to lifetime income will be flexibility. New product innovations may generate more support for lifetime income by participants and should be encouraged, not discouraged.

Disclosure and Education

The Council strongly believes disclosure and education are the first steps toward increasing the availability and use of lifetime income products. The agencies should encourage but not require plan sponsors to provide illustrations of lifetime payments at age 65. In fact, the Council would encourage the DOL to provide these examples in their guidance. Similar to the fee examples provided in the prospectus of a registered security, the DOL disclosure could illustrate that a lump sum of X could create an income stream of Y at age 65 and provide the relevant interest rate and mortality assumptions (and perhaps show the variance based on different interest rates).

Requiring plan sponsors to provide illustrations based on actual account balances could backfire. The Council is aware of one large member who currently provides such illustrations and is faced with employee relations problems whenever interest rates decline and future illustrations show lower payments.

Plan sponsors who want to educate employees on the benefits of lifetime income may be deterred by the lack of guidance on appropriate education in this area. The Council recommends that the DOL expand Interpretive Bulletin 96-1 and the DOL Advisory Opinion commonly known as "SunAmerica" to address allocation of assets in retirement.

It is also important that any educational efforts include information on the risks of lifetime income products – references to inflation adjustments, claims paying ability of the provider, disbursing risks, and state guarantees are all information of use to plan participants. Additionally, education about the risks associated with not electing any type of lifetime income product would also assist participants.

Finally, the Council would note that lifetime income products alone will not lead to a healthy retirement income. It would be difficult to live off the proceeds of an annuity purchased with, for example, $5,000. The DOL and Treasury should continue efforts to support increases in plan participation and rates of contribution among plan participants.

Again, we appreciate the opportunity to provide information and comment on the subject of lifetime income during retirement. We will follow up with you after we hold our plan sponsor roundtable. In the meantime, if you have any questions or would like to discuss these comments further, please contact me at 202-289-6700.

Sincerely,

Jan Jacobson

Jan Jacobson
Senior Counsel, Retirement Policy