American Federation of Labor and Congress of Industrial Organizations

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May 3, 2010

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

Re: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans Docket ID: EBSA-2010-0007; RIN 1210-AB33

Ladies and Gentlemen:

The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) submits this response to the Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans issued by the Employee Benefits Security Administration and the Internal Revenue Service.[1] 75 Fed. Reg. 5253 (February 2, 2010)

The AFL-CIO, its 57 affiliated unions and its community affiliate, Working America, represent more than 11 million workers. For more than 60 years, the American labor movement has championed the provision of real retirement security to working families across all sectors of our economy.

We face a retirement security crisis today. The current economic downturn, combined with the erosion of secure, defined benefit pension plans and the explosion of cheaper, less secure defined contribution plans, has exposed severe deficiencies in the current retirement system. And, the decline in asset markets imperils the savings of workers and the funding of

[1] Our responses note the question numbers from the Request for Information (RFI) where appropriate. As we are not responding to all of the questions posed, the numbers are not consecutive. We also note that while we do not have empirical data for plans covering represented workers, the responses reflect discussion with various affiliates.

pension plans. Without systemic reform, it will take years for depleted retirement accounts and pension funds to turn around.

Today, only 16 percent of workers are very confident about having enough money for a comfortable retirement—the lowest level in 20 years, according to the 2010 Retirement Confidence Survey.[2] This lack of confidence is justified as the majority of America's workers will face retirement with far less security than previous generations.

Ensuring that working families have sufficient retirement assets and savings to support a comfortable retirement is an important national policy objective. Everyone should have adequate retirement income after a lifetime of work to maintain a reasonable standard of living in retirement. And, the data shows that 401(k) savings plans are not up to the task. As of June 2009, the median account balance in a workplace plan was around $27,000 and for those near retirement (ages 55 to 64), the median was only $69,127.[3]

We should recognize the preference for lump sum payments is directly related to the inadequacy of 401(k) savings plan account balances. Workers and retirees will continue to choose lump sum payments as long as the typical balance does not provide meaningful retirement income when it is annuitized. A $70,000 account balance is a very large amount of money in relationship to workers' current financial needs but provides only a trivial amount of monthly lifetime income.[4]

In our view, defined benefit pension plans remain the soundest and most cost-effective vehicles for building and safeguarding retirement income security, with professional asset managers, lower investment fees and better returns. We are fully committed to strengthening and improving existing defined benefit plans and 401(k) savings plans through legislative and regulatory action. But, we cannot ignore the reality that the current system is inaccessible, inadequate or insecure for the millions of workers without pensions.

We welcome the agencies' attention to retirement security, but we are concerned that the RFI focuses on only one small aspect of the crisis we face. More than just tinkering with existing savings plans, offering automatic enrollment in Individual Retirement Accounts and encouraging lifetime income options must be done. We need a new private sector retirement system for future

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2 Ruth Helman, Craig Copeland and Jack VanDerhei, *The 2010 Retirement Confidence Survey*, Employee Benefit Research Institute (March 2010) available at http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-2010_No340_RCS.pdf.

3 Craig Copeland, *Individual Account Retirement Plans: An Analysis of the 2007 Survey of Consumer Finances, With Market Adjustments to June 2009*, Employee Benefit Research Institute (August 2009) available at http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=4326.

4 For a 60-year old worker and his 60-year old wife, a balance of $70,000 provides monthly payments of less than $400 on a joint and 100% survivor annuity using the federal Thrift Savings Plan calculator or ImmediateAnnuities.com, Instant Annuity Calculator, (assuming Pennsylvania residency).

generations, one that combines the best features of both defined benefit and defined contribution plans in order to achieve more comprehensive coverage and adequate benefits for all workers.

Lifetime Benefit Payments Availability and Advantages (Questions 1-8)

The most significant advantage of lifetime benefit payments is the security of a steady, guaranteed monthly income stream. In defined benefit plans, this payment stream generally also provides continued payments to a spouse or other designated beneficiary.

As a result of the guaranteed payment stream, participants do not face longevity or investment risk. In addition, the plan bears the responsibility for the ongoing investment of plan assets and its larger pool of assets and use of professional investment managers can provide better returns at a lower cost.[5]

The potential disadvantages include the inability to access funds in the event of a financial emergency, and for those without an option to elect an annuity with continued payments to a beneficiary who die shortly after retirement, there is a perceived loss.

Notwithstanding the strengths of a secure, lifetime benefit stream, most workers elect lump sum distributions if they have the choice of doing so under a defined benefit pension plan. (Question 2) In the case of 401(k) savings plans negotiated by AFL-CIO affiliate unions, most plans were designed to supplement defined benefit pension plans and the lump sum distribution is the only payment form.[6]

The most typical reasons participants elected the lump sum option noted by AFL-CIO affiliate unions included:

- The fear that the employer and the plan might not be there in the future and, in some instances, the potential loss of benefits given the limits of the guarantees provided by the Pension Benefit Guaranty Corporation (PBGC).

- The size of the potential payment since the present value of an annuity offered by the defined benefit plan could be the largest sum workers would ever have available and for some, it could be used to meet immediate financial needs.

- The preference to manage their own money and the belief they could achieve better results.

- The desire to provide a legacy to their heirs.

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5 Beth Almeida and William B. Fornia, *A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans*, National Institute on Retirement Security (August 2008) available at http://www.nirsonline.org/storage/nirs/documents/Bang%20for%20the%20Buck%20Report.pdf

6 Because the lump sum distribution is the only option, none of our affiliate unions are aware of any negotiated 401(k) savings plans using employer contributions to fund lifetime income. (Question 5)

The traditional defined benefit plans negotiated by AFL-CIO affiliate unions offer a range of lifetime income options in addition to the statutorily mandated qualified joint and survivor annuity, including term certain benefits (for example10, 15 or 20 years certain and life), joint and survivor annuities with differing percentages of continued benefits (ranging from 66 2/3% to 100%), and Social Security leveling options.

The primary advantage to participants in defined benefit plans of selecting payments through the plan are its simplicity and easy availability, the absence of any additional fees (both ongoing investment management fees or any fees associated with an annuity purchase) and the benefits of pooling risk. One disadvantage may be the limited options that the typical plan offers compared to the array of alternatives available in the market.[7]

Lifetime Income Options Should Be Required (Question 13)

In our view, all defined contribution plans should be required to offer some form of lifetime income option although we recognize that today's relatively modest balances will not provide significant retirement income.[8] However, including this requirement would make it easier for participants to consider choosing lifetime income as opposed to confronting the market on their own following the receipt of lump sum distributions. But, in order to have meaningful lifetime annuity options available through defined contribution plans, significant changes in the current annuity market to address the high cost of these products are needed.

In addition, if plans are required to offer lifetime income options, agency guidance must be provided to plan sponsors on how to evaluate the varying annuity options available to assure that only those options appropriate for providing retirement income are included. While the Pension Protection Act required the Department to issue its regulation exempting the selection of a provider for optional lifetime distributions from the safest available annuity standard, this approach should be revisited if plans are required to offer a lifetime income option.

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7 It is worth noting, however, that offering too many choices often leads to inaction and that choosing among the various lifetime income options available in the market may require a level of financial sophistication and understanding that many Americans do not have. *See*, e.g., John Turner, *Designing 402(k) Plans That Encourage Retirement Savings: Lessons from Behavioral Finance*, AARP Public Policy Institute (2006) available at http://assets.aarp.org/rgcenter/econ/ib80_pension.pdf; Sheena S. Iyengar, Wei Jiang, Gur Huberman, *How Much Choice is Too Much?: Contributions to 401(k) Retirement Plans*, PRC WP 2003-10, Pension Research Council (2003) available at http://www.archetype-advisors.com/Images/Archetype/Participation/how%20much%20is%20too%20much.pdf; Annamaria Lusardi and Olivia S. Mitchell, *Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education* WP 2006-144, University of Michigan Retirement Research Center (2006) available at http://www.mrrc.isr.umich.edu/publications/papers/pdf/wp144.pdf; ERISA Advisory Council, Report of the Working Group on Financial Literacy and the Role of the Employer (2007) available at http://www.dol.gov/ebsa/publications/AC-1107a.html

8 Making a partial annuity option available in 401(k) savings plans would benefit participants by offering a middle ground rather than an "all or nothing" approach to taking a distribution. (Question 10)

For those 401(k) savings plans that do not supplement defined benefit pension plans, it may be appropriate to make the lifetime income option the default option. However, participants must be afforded a reasonable time and appropriate disclosures in order to decide whether to opt out of the default.

Participant Education (Questions 17-20)

In order for participants to make informed decisions about their benefit payment options, appropriate information should be provided and that disclosure should, at a minimum, show the monthly payment stream payable under any lifetime income option or other arrangement. Defined benefit pension plans make such disclosures today as part of processing a retirement application.

Because participants typically have access to their account balances in 401(k) savings plans for events occurring before retirement, the information must be available as part of the distribution process regardless of the triggering event. Providing the information at this time could be the last opportunity to educate individuals about the differences between single sum distributions and lifetime income.

The information given to participants in 401(k) savings plans should also include an explanation of the risks related to taking a single sum distribution, such as longevity and investment risk, as well as relevant factors to consider in evaluating whether the ability of the provider of lifetime income options to make future payments and the reasonableness of the costs of providing the benefit.

The Department should encourage plans to educate participants about the advantages and disadvantages of lifetime income options as compared to single sum distributions. Doing so is clearly one way to begin changing the discussion and the focus to what can be provided by the funds workers save rather than just on accumulation. As suggested by the ERISA Advisory Council Working Group reports cited in the RFI, one approach to encouraging participant education is the expansion of Interpretative Bulletin 96-1, an approach we support.

Disclosing the Income Stream That Can Be Provided From an Account Balance (Questions 21-24)

We think it would be valuable for benefit statements provided to participants in 401(k) savings plans to show the lifetime income stream as well as the accrued account balance.[9] Doing so could help educate participants about the value of the account balance and its ultimate purpose—the provision of income during retirement. Moreover, showing the income stream is one way to help change the emphasis from the total amount saved to the income that the account balance can provide. Too often, workers do not know the monthly retirement income that would result from their accrued savings.

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[9] While ERISA Section 105(a)(1)(A), 29 USC §1025(a)(1)(A), requires quarterly statements for the typical 401(k) savings plan, the lifetime income stream should only be required on an annual basis.

To make the benefit statement most meaningful, we suggest that the monthly payments shown be based on the accrued balance with payments beginning at normal retirement age. For those participants who are married, it would be helpful to include both single-life and joint and survivor-type annuities, as well as any other option available under the plan.

We believe using the accrued balance (with projected interest at a reasonable rate) is the most appropriate amount to use in showing potential lifetime income because it reflects what is currently available to the participant, assuming the balance remains invested until retirement. Including projected contributions to retirement age has the potential to mislead participants into believing they will have more funds available at retirement.

The assumptions used to convert the account balance to monthly lifetime payments must be described in the benefit statement, particularly because they are likely to change from statement to statement. Without that description, participants may wonder about the differing amounts shown over time. And, including caveats in the statement would also be appropriate.

The Department should consider specifying the assumptions to be used by plans to insure uniformity across plans and avoid unreasonable or inappropriate assumptions. In addition, it would be helpful for the Department to issue a standardized table of conversion factors on a periodic basis to make it easier for both participants and plan sponsors to determine monthly payments.

Transfer of Defined Contribution Distributions to Defined Benefit Plan

Before considering any action to facilitate the "purchase" of lifetime income from defined benefit pension plans, we recommend the PBGC be consulted about the treatment of such "annuities" in the event of plan termination. Based on affiliate experience,[10] PBGC will continue payments in the event of a distress termination if the defined contribution balance has been converted to a monthly stream of payments, but, in their view, these payments are not guaranteed under Title IV of ERISA and the associated assets are outside the statutory allocation categories in Section 4044 of ERISA.

We hope these comments are helpful to EBSA in promoting retirement security, an issue of vital importance to all working families. Should there be any questions about our comments or if additional information from the AFL-CIO would be helpful, please do not hesitate to contact me at (202) 637-3953.

Sincerely,

Damon A. Silvers
Director of Policy & Special Counsel

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10 The issue arose in the context of a floor-offset arrangement where defined contribution balances were merged into a defined benefit plan before its termination.