April 30, 2010

Kevin T. Hanney, CFA
12 Crosby Road
North Salem, NY 10560

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
Subject: Lifetime Income Option Request for Information, RIN 1210-AB33

To Whom It May Concern:

I write in response to your request for information with regard to lifetime income options for participants and beneficiaries in retirement plans and individual retirement accounts (the "RFI"). While I am employed as an investment professional and responsible for oversight of retirement plans both in the US and overseas, I wish to address you in my capacity as an individual. The views that I express here are my own and should not be construed to represent the views of my employer or any organization with which I am affiliated. However, I have the opportunity in my professional capacity to frequently interact with others in my field as we actively consider the issues that face individuals in the U.S. as they attempt to save for and fund retirement. As a consequence of these interactions, I believe that my views are not unique and much of what you read here may be echoed in other responses to your RFI. It is my hope in writing this response that I may share some reasonably well informed perspective on these issues from the various perspectives of plan sponsor, plan service provider and plan participant which is not slanted in any one particular direction.

I will attempt to answer many of the questions included in your request for information directly so that it may be clear as to which questions each point may address. However, with your indulgence, I would first like to present a summary of what I believe to be several of the most important aspects of the problem we face in establishing an environment in this country where it is possible for most people to avail themselves of solutions which construct and maintain a reliable stream of income throughout retirement.

Knowledge, Resources & Incentives

Most individuals do not independently possess the knowledge, resources and/or incentives that are necessary to construct and implement a savings and investment program in their working years and subsequently adhere to a drawdown/spending program during retirement which in combination are sufficient to attain and maintain an acceptable standard of living in retirement. Left to do this on their own, many individuals grossly underestimate their needs in retirement and the level of assets which are necessary to fund them. Additionally, in spite of efforts to educate and disclose material information to individuals, few people understand the level of risk inherent in the investment vehicles available to them through their employer sponsored retirement plans or individual retirement accounts, often taking excessive risks in the investment of their limited savings and failing to manage these risks as they approach and enter retirement. Others may excessively save during their working years only to amass their savings in investments with such low return expectations that they run a very real risk of shortfall in spite of their excessive deferrals. These individuals often suffer the dual misfortune of reducing their standard of living while employed as well as failing to maintain the purchasing power of their assets through retirement and seeing that standard of living decline further.

The failure to accumulate a sufficient level of assets and convert them into a flexible and robust stream of retirement income can itself lead to consumption or deferral decisions which may impact not only one's standard of living, but an individual's own chances for mortality.

Some argue that the solution to this dilemma is to focus on educating people on the risks of failing to save and invest for retirement and introducing basic concepts of finance and investments such as the time value of money and the benefits of diversification. Unfortunately, even professionals in these areas fail to follow their own good advice and many end up in much the same situation as the general populace. Others who are well informed and actively engaged in the effort to manage their retirement savings are often exposed to factors beyond their control which can devastate a skillfully constructed strategy simply as a consequence of being in the wrong place of their life cycle at the wrong time in the market cycle. ("See Returns on 401(k) Assets by Cohort" by Munnell and Aubry, March 2010)

While I fervently support the notion that our population as a whole must improve its level of economic and financial literacy, I fear the behavioral and logistical obstacles to achieving the required level of sophistication and ubiquity necessary to achieve an adequate level of retirement security in this country purely through educational efforts are insurmountable. These efforts must be underpinned by the development and application of flexible, reliable & cost effective lifetime income defaults by fiduciaries of the nation's retirement system.

Clear & Flexible Guidance

Most of the components required to build appropriate lifetime income defaults exist in the market today and current regulations provide a framework within which they may be applied. However, the effort required to piece together product components, integrate them and acquire knowledge of the regulatory standards governing them in sufficient detail to enable a fiduciary to implement a solution without fear of undue legal exposure is substantial. The Agencies are in the unique position today to provide much needed clarity and guidance which will likely increase the level and speed at which fiduciaries adopt these solutions.

I would emphasize here that clear and flexible guidance will be most effective at promoting the development and adoption of suitable solutions. Overly prescriptive standards will stymie innovation, reduce competition and most certainly fail to meet the needs of a broad range of plans and participants, each with their own unique set of circumstances. While this RFI is clearly a very strong step in the right direction, the Agencies must continue to solicit and consider feedback from the many stakeholders impacted by their activities. Draft guidance and meaningful comment periods will be critical to successfully addressing the many issues we face.

One approach to immediately improve clarity for plan sponsors and plan services providers is to update language in existing guidance to reflect recent product developments and innovations so that fiduciaries and advisors may understand to which products it applies. Knowledge and understanding of current guidance is sufficiently mottled as a consequence of dated and narrow terminology so as to lead many key stakeholders to believe some of the most promising lifetime income solutions under development today are not covered by existing guidance and safe harbor provisions.

Additionally, it is critical for the Agencies to promote a standard of care to which all fiduciaries will be held. While many in this field will endeavor to develop best-in-class practices as it relates to the design, evaluation, selection and oversight of lifetime income solutions, few will devote valuable resources to the effort in the absence of a clear and reasonable standard of care. This is not to say that fiduciaries should bear no responsibility for performing adequate due diligence and applying prudence that a reasonable expert would apply given the facts and circumstances prevailing at the time of making decisions. However, there exists a very real risk of being judged, criticized and perhaps censured at some point in the future in the event that unforeseen, unfortunate and unavoidable conditions should arise. The Agencies are in the position to provide the level of confidence to fiduciaries necessary to explore this area by issuing and periodically updating clear and consistent communication of the required standard of care for the evaluation, selection and monitoring of lifetime income solutions.

Access to Information on Key Features & Pricing

While many professionals involved with retirement plans maintain expertise in various fields such as actuarial science, behavioral finance and investment theory, employee benefits administration, information technology, insurance and options pricing, few organizations and fewer individuals possess sufficient depth of knowledge in all of these areas to understand and assess many lifetime income solutions in full. The Agencies should recognize that, in the current environment, it typically requires a cross functional team of professionals versed in all of these disciplines to fully evaluate a lifetime income solution and determine whether or not it is appropriate for the population of participants in a particular retirement plan. It is perhaps even more difficult today for an advisor of individuals to properly perform an adequate level of due diligence in the selection of a solution for their client. I would argue that it is nearly impossible for an unaided individual to gather and understand a sufficient degree of information to completely vet the myriad alternatives available through the retail market at the present time.

I do not suggest that the Agencies can entirely solve this dilemma, as a lifetime income solution is an inherently complex and long-lived instrument and there will always be a fair degree of uncertainty involved with the selection of such products. However, the Agencies are in the unique position to establish and maintain a repository of unbiased research and information regarding key features and pricing of such instruments. The information collected here may serve as a launching point for the due diligence efforts of institutions and individuals, providing the basis for critical assessment by fiduciaries and communications between service providers, sponsors, advisors and participants.

Preserving the Most Effective Features of Defined Benefit & Defined Contribution Plans

Many authors assert that the defined contribution system in the U.S. has failed to meet the objective of providing retirement security for the majority of our population. I do not argue for or against this contention here. However, I assert that defined contribution plans and individual retirement accounts in this country enjoy several important advantages over defined benefit plans which should be preserved in order to make the most of lifetime income solutions as they develop for the market.

As highlighted in the GAO report of July 2009 Government Accountability Office (GAO) published Report GAO–09–642 entitled, ''Private Pensions: Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs," individuals are faced with many risks, including but not limited to longevity risk, investment risk and inflation risk. Traditional defined benefit plans managed these risks through a number of channels including the pooling of longevity and investment risk and, in some cases, inflation risks, the hiring of professional management and the implementation of complex liability driven strategies designed to align assets and liabilities as each fluctuated with market and economic conditions. Organizations often devoted a fair amount of internal resources to the management of these risks, and when necessary provided additional funding to meet benefit obligations as they arose. However, with changes in accounting and investor perception over time, the maintenance of such benefit plans is no longer tenable for most businesses and many have moved to freeze and eliminate such benefits preferring instead to focus on defined contribution arrangements where cost and impact on the enterprise are easier to project and manage.

However, some third party entities remain capable of bearing such risks and providing lifetime income benefits through defined contribution plans and retirement accounts. In order for these solutions to provide maximum utility and potentially garner the broadest degree of adoption, they should preserve key features of the most common products used in these plans and accounts today; such as liquidity, portability, price certainty and competitive cost. Areas which should be improved might include transparency and disclosure. Each feature is subject to a cost/benefit that may be valued according to the unique needs and constrains of its user, whether it be at the level of a large retirement plan or an individual's retirement account. Hence, it should be expected that a wide range of costs and benefits will develop as products are introduced to this market.

It should also be noted that defined contribution plans and individual retirement accounts enjoy a material advantage over traditional defined benefit plans in that they provide most participants with a considerable degree of influence over how much retirement income they may enjoy in the presence of appropriate lifetime income solutions. The ability to increase the size of deferrals of one's current income to an account with access to lifetime income products has a two-fold effect: it improves the probability of reaching one's desired level of income through the accumulation of a larger asset base and most likely reduces the targeted standard of living in retirement. While some may have unreasonable expectations of life in retirement, most people would consider maintaining the standard of living they enjoyed before retirement as success. Those which save more while working and establish a reasonable reduction in their standard of living will have an easier time maintaining that standard in retirement.

Financial Stability of Counterparties

Several entities are ideally positioned to stand as counterparties to various forms of lifetime income arrangements or the financial instruments which underlie them as long as: there are sufficient reserves in place to back up their obligations at the time they come due, the benefits promised are properly priced and an appropriate safety net exists to support the system in times of stress. It is critical to evaluate and communicate current standards for financial stability of these entities and establish new standards where necessary. Entities such as state insurance guaranty associations and clearing houses provide an extremely valuable backstop at this time. (See Gallanis, The Life and Health Insurance Guaranty System, and the Financial Crisis of 2008–2009, June 2009 and Chicago Mercantile Exchange Web site, http://www.cme.com/edu/intro/specs/clrhouse9706.html) However, they are often poorly understood and do not receive sufficient attention in the evaluation of lifetime income solutions and the support they may provide. I encourage the Agencies to develop a centralized venue where fiduciaries and individuals may access information on these entities and the backstops they provide as they evaluate lifetime income solutions which may be appropriate for their needs.

However, it is possible that current systemic protections may not be sufficient to provide stability in times of extreme stress. The Agencies must consider the impact on not only retirement security, but the nation's financial stability from widespread adoption of lifetime income products. With retirement assets in this country on the order of multiple trillions of dollars, deploying even a moderate portion of those assets to lifetime income solutions could stretch our institutions' capacity to manage and support the system in times of crisis.

Suggestions for the Development of New Instruments

It is beyond the scope of this letter to provide a detailed description of the mechanics underneath various arrangements, but it is possible to establish contracts with insurance companies or use various products backed by clearing houses which maintain the requisite degree of financial stability and flexibility to provide a competitive value proposition for the individuals seeking to construct a secure stream of income based on an underlying base of assets. The U.S. government is also in a position to provide access to reliable income through the issuance of Treasuries and TIPS which may be used directly by individuals through conduits such as TreasuryDIRECT or indirectly by the counterparties as hedging instruments underlying the benefits they offer. The Treasury may further develop instruments that would have direct application in the development of lifetime income solutions, such as the issuance of amortizing nominal and inflation-linked securities. This idea, promoted by Ralph Goldsticker of Mellon Capital Management , has tremendous potential to alleviate both the problems of securing reliable and adequate income for retiring Americans and providing access to a substantial source of funding for the large debt burden carried by the U.S. I would strongly encourage the Agencies to explore this idea and consider the advantages of creating such instruments for use in this country.

Thank you for the opportunity to shares some of my views on lifetime income options and the issues around their use in retirement plans and individual retirement accounts. I attach below answers to several of the questions included in the RFI for your further considerations.

Sincerely,

Kevin T. Hanney, CFA

RFI Responses

General

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

Advantages:

- Provides protection against longevity risk.
- Enables financial planning and budgeting in retirement.
- Purchasing deferred products in advance of retirement assists participants with critical retirement savings decisions in the working years leading up to retirement.
- Removes burden of appropriately managing and effectively drawing down your own assets which is complicated, subject to a high degree of uncertainty and exposed to a wide range of risks that even professionals struggle to manage. Most individuals are simply unable to do this effectively without some form of insurance or risk sharing.

Disadvantages:

- Inflation may erode purchasing power in some product designs.
- Some product designs limit or eliminate the opportunity for growth in assets and/or income.
- Many traditional annuity designs are irrevocable and may pose risks to individuals who experience unexpected financial needs.
- Some product designs limit or eliminate the ability of a participant to bequeath balance.
- Portability may be very limited in comparison to common investment alternatives.
- Product expenses may include additional layers of fees in comparison to common investment alternatives which may erode purchasing power.

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?

- Poor positioning or lack of in-plan options in DC plans.
- Herding behavior tends to prevent many participants from considering a lifetime income option. Individuals who do not know others who have utilized a lifetime income option are less apt to utilize one themselves in part because they lack the powerful influence in their decision making process of perceived familiarity. Similar factors impact organizations sponsoring plans which defer the introduction of such options in part because peers do not offer similar options.
- Misunderstanding of associated costs.
- Lack of control and the concern that most traditional options, such as immediate or deferred annuities, typically require that participants make an irrevocable decision to relinquish control. While broad statistics may suggest that people can afford to relinquish some degree of control on average, individuals live in a “fat

tailed world". In other words, anyone may experience some extreme personal event with far reaching financial ramifications at any time. The conditions that enable institutions such as insurance companies to bear such risks are primarily due to the presence of large populations of clients whose pooling of premiums and individual circumstances improve the odds that insurers will only see a subset of their clients experience these events on a relatively infrequent basis.

- Lack of transparency and knowledge of the factors which drive cost and benefits.
- A lack of education around lifetime income options. Most individuals and organizations do not understand these products and even with sufficiently available education, most participants do not have the time or inclination to develop a practical understanding of the costs and benefits of these options in the absence of salient incentives,
- Very limited experience with large scale insurance company failures and the risk they pose to policyholders.
- Few individuals and organizations understand the operation of the "Safety Net" provided by state guaranty associations or how it varies from state to state.
- People tend to overestimate the amount of income which may be reliably generated by their wealth.
- People tend to underestimate the length of retirement and their financial needs.
- People tend to suffer from status quo bias. They become familiar with tracking their "balance" during their working years and consider that to be their end goal rather than the income it should generate in retirement.
-

Is it the result of a market failure or other factors (e.g., cost, complexity of products, adverse selection, poor decision-making by consumers, desire for flexibility to respond to unexpected financial needs, counterparty risk of seller insolvency, etc.)?

- Virtually all of the examples listed in the question contribute to current low utilization rates. However, some specific root causes may contribute more than others:
  - Low levels of financial literacy
  - Most current plan designs implicitly default to forego lifetime income because it is not offered as an option, or it is an opt-in feature in the few cases where it is available. Research on participant behavior shows that most participants accept a default in the absence of incentives to do otherwise.
  - The benefits and risks of various lifetime income options are often less obvious than the perceived benefits and risks of maintaining a large balance in an investment-only account.
  - It's virtually impossible for most people to equate the present value of a stream of future payments to a single lump sum particularly when the collection of the stream of future payments is subject to the uncertainty represented by the examples given above. The inability to make this distinction typically leads to inaction.
  - Lack of unbiased reference points to judge the relative merits of a product. Decision makers (both participants and plan sponsors) would benefit from evaluating products in comparison with well designed and broadly available benchmarks. Few, if any, of these exist today.

The decision to choose a Lifetime Income option is very complicated and unstructured. Individuals are generally unable to accurately gauge the risks or relative merits of such

products without clear and simple guidance. There are few sources of such guidance available to participants or plan sponsors.
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?

- Create salient incentives for lifetime income over other forms of distributions, such as tax advantages in retirement or during an individual's working years or perhaps tax advantages for couples electing to utilize a lifetime income option over systematic or ad hoc distributions from an unprotected balance.
- Provide clear and robust guidance for plan sponsors with regard to the extent and nature of Safe Harbor provisions governing the selection of providers as well as the description and presentation of lifetime income options in retirement plans.
- Establish a central repository of unbiased and reliable educational material on which plan sponsors may rely for plan design decisions and which may be used to develop communications for or distribute directly to plan participants.

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

- Some DC plans offer annuities or other guaranteed products, but the vast majority of these are offered as out-of-plan options and are designed as opt-in choices. Consequently, they tend to see very low usage among participants.
- Some DC plans offer systematic distribution programs which draw down assets based on a formula, fixed percentage of assets or fixed dollar amount. However, these programs do not guarantee that distributions will extend for the life of the participant and will end when assets are depleted from the account.

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

- Some plans offer annuity purchase platforms which function something like an "annuity supermarket", enabling a participant to compare the costs and features of institutionally priced annuities as they approach and enter retirement.
- Several lifetime income designs being considered by the large plan market focus on establishing a floor on retirement income through the incremental or large scale purchase of deferred payout products during a participant's working years. The form of contract used in most of these designs under consideration are known as guaranteed minimum withdrawal benefits ("GMWB") or guaranteed lifetime withdrawal benefits ("GLWB")
- Most of these designs establish an annual amount of income which a participant may withdraw from their assets in retirement and guarantee that participants will continue to collect a minimum amount of income even after their assets are depleted. Like traditional annuities, payouts of GMWB/GLWB products may be adjusted for joint survivor arrangements and for early or deferred withdrawals for those wishing to retire before or after a pre-defined normal retirement age.
- Various designs differentiate themselves in several respects, most importantly, the manner in which the amount of guaranteed income is determined, the manner in which the amount of guaranteed income may increase over the life of

the participant, the level of fees paid by the participant leading up to and in retirement, and the structure of the guarantee itself.
- At least two broadly discussed designs further differentiate themselves from single insurer products by offering variations on a multi-insurer approach.
- At least one proposed design has a feature that may allow for some form of cost of living adjustment. However, this is done one a flat percentage basis as opposed to explicit inflation linking. Inflation protection is typically a very expense feature to include in lifetime income options, partly due to the relative lack of securities available which may be used to hedge against inflation risk.

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?
- At least one well publicized product design focuses on employer contributions as the funding source for the purchase of deferred Lifetime Income. However, this product has not been adopted by any plans as of this date.
- Virtually all of the existing products and designs currently under development in the large plan market may be adapted to use employer contributions as the primary source of funding and most behavioral finance researchers would suggest that designing default actions to include such contributions would lead to wider adoption among plan participants.

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?
- Several annuity and variable annuity products are in wide use through individual retirement accounts.
- Features of these products vary widely along with their attendant costs.
- Some products currently being designed for use in dc plans are being design with companion IRA products which will enable dc participants to roll over their assets and preserve the benefits they accumulated while in plan. These IRA products will likely have higher expenses associated with them in comparison to their in-plan counterparts.

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?
- Most product features a priced in the manner of financial options and as such the price of each option is generally driven by the following factors:
  - Market conditions, especially volatility
  - The level and term structure of interest rates across the entire yield curve, but 10-year nominal Treasuries in particular

    - Riskiness of underlying investments' asset allocation and the availability of liquid hedging instruments to offset the risk of the underlying investment allocation (e.g., equity futures contracts and interest rate swaps)
- The most expensive features of a guaranteed product may change depending on the nature of other features included. For example, products which provide participants with the ability to withdraw all or a portion of their principal without penalty will increase the cost of the longevity option embedded in the product when compared to products that do not offer such "liquidity" features. This is primarily due to the lack of forfeitures which exist in illiquid or irrevocable products like traditional fixed annuities. Forfeitures describe annuitants who die earlier than average mortality assumptions would project and consequently do not collect the full value of their expected benefits based on that mortality assumption. Insurance companies can increase the payout (i.e., reduce the cost) of traditional annuities based on estimates of the level of forfeitures they expect to experience across their customer base. Therefore, liquidity features tend to increase the cost of some lifetime income products in comparison to irrevocable products like traditional fixed annuities.
- One feature that was commonly offered prior to the financial crisis of 2007-2009, but subsequently withdrawn from virtually all products is known as a "roll up". Roll ups guarantee the participants that the asset base used to calculate their income benefits will increase by a minimum percentage each year. For example, a product may offer to recalculate the income benefits for a person each year in retirement on their birthday using a previously established rate multiplied by the "greater" of their account balance at that time or a previous account balance "rolled up" by a minimum percentage, say 5% or 6%. This form of guarantee became problematic during the Financial Crisis when some account values fell by 20-50% and insurers were still obligated to increase the notional account basis by a minimum percentage.
- Another feature which is sometimes confused with a roll up, but is far less expensive is known as a "ratchet". This feature continues to be offered in many products today. A ratchet provides the opportunity for income to increase, but only if certain values, such as the participant's current account balance, are higher than at a previous measurement date. This is sometimes referred to as a "High Watermark". Ratchets are far less expensive to hedge than are roll ups for several reasons. One important consideration is that account balances tend to plateau early in retirement due to withdrawals from the account (participant distributions and fees) outpacing the investment growth of the underlying assets. Most value from a ratchet feature accrues before participants retire and begin taking withdrawals from their accounts. Consequently, the presence of a ratchet tends not to increase the cost of providing such features in these products. See Milliman's discussion of Actuarial Guideline 43 for helpful case studies which compare the reserve and capital requirements for various combinations of roll up and ratchet features.
- As mentioned above, inflation-linking features are extremely expensive and difficult to evaluate from a cost-benefit perspective. Consequently, few products are offered with these features today.

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

In Plan Option:

Advantages:

- Institutional pricing
- Fiduciary oversight by qualified professionals with proper incentives to maintain a sufficient standard of care
- Ease of use through payroll deduction
- Default status may avert behavioral biases of participants such as herding behavior and status quo bias
- Opt out defaults which include lifetime income will result in broader adoption specifically because of behavioral biases.

Disadvantages:

- Individuals with unique financial needs may not be as well served by an in plan option as they would by a bespoke solution.
- Opt in design which include lifetime income will result in lower adoption, in the absence of other incentives, specifically because of behavioral biases.

Outside of Plan, After Distribution or Rollover:

Advantages:

Broad array of choices

Disadvantages:

- Potentially more expensive due to retail pricing, surrender charges and commissions.
- Requires a proactive selection process which entails a considerable amount of time and effort on the part of the individual.
- Individual is responsible for seeking information and advice on their own.
- Lack of reliable benchmarks or reference points for comparison

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

In Plan Option:

Advantages:

- Provides the ability to continue to offer competitive retirement benefits in the absence of a defined benefit plan.

Disadvantages:

- Lack of adoption among peer companies poses material headline risk, employee relations issues and exposure to legal action in the event of unforeseen negative results.
- Products continue to develop at a rapid pace and design improvements continue to emerge.
- A lack of understanding with regard to current safe harbor guidance.
- Current safe harbor guidance must be improved to explicitly recognize more lifetime income designs.
- Lack of broad consensus among plan sponsors and product providers on standards. While most products should continue to provide choice among features to remain suitable and meet the unique characteristics of each plan, some degree of standardization for a basic feature set will enable plan sponsors to evaluate lifetime income products on a relative basis. In the absence of some consensus, most plan sponsors will continue to wait for others to take first steps.

Out of Plan Option:

Advantages:

- Reduced fiduciary requirements.

Disadvantages:

- Less control and transparency.

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?

- Partial annuitization may be suitable for some plan participants primarily due to the benefits it provides for budgeting in retirement, the form of diversification provided by income from the partial annuity and the potential for a participant's remaining assets to provide a buffer against future inflation.
- However, participants will continue to be faced with many of the same obstacles to utilization, albeit to a somewhat lesser degree.
- Some providers of irrevocable annuity products support the idea of partial annuitization over full annuitization due to the uncertainties that surround retirement income adequacy. However, it should be noted that some annuity providers argue it is not appropriate for most individuals to annuitize all of their retirement assets due to the reduced ability to meet unforeseen expenses in the future.
- It is very important to note that participant-directed DC plan participants enjoy a valuable design benefit in the freedom they have to make choices and

subsequently change their minds at any point in the future. Some would argue that this design feature should extend into lifetime income options as well. There is most certainly a cost to maintaining this flexibility. However, the risk profile of each individual in a plan is different than that of a hypothetical average of a plan's participants. Real people far more often subject to extreme outcomes in their personal financial circumstances than conventional risk measurements would imply. Therefore, the benefits of maintaining the freedom to make changes at any point in the future may be worth the cost of maintaining that freedom.

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

- Establishing lifetime income solutions as default options within retirement plans will lead to wider adoption
- Clarification of acceptable behavioral design standards will increase the confidence of plan sponsors who might be aware of their potential benefits, but would otherwise forego implementing them in their plan designs for fear of censure and/or legal exposure.

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

- Flexibility must be preserved in order to meet the needs of all participants.
- Individuals must be aware of any limitations on the liquidity or revocability of their decision before making the choice to annuitize. Most traditional designs have severely limited or no liquidity.
- Irrevocable products should only be used for basic living expenses and care should be taken to estimate what those might be both at the time of annuitization as well as how those may change in the future.

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

- Each DC plan and its population of participants are subject to unique circumstances. It would be imprudent to assume that all DC plans are appropriate vehicles to offer lifetime income to participants. Therefore, it would be ill advised to force the introduction or use of lifetime income options through regulation.

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

- All of the above plus:
- While work is currently underway to assess various designs to offer lifetime income through DC plans, many products that do exist continue to evolve and have only limited operating history
- Current safe harbor provisions are imprecise as they apply to various products currently under consideration, specifically guaranteed lifetime/minimum

withdrawals benefits (GLWB or GMWB). More clarity and revised guidelines that specifically apply to those products in all phases of their life cycle (not just in the insurer payout phase) will enable plan sponsors to select products without fear of undue liability

- State insurance laws differ and some product designs may be approved in some states, but not others. Standard design features should be agreed and available for plans with participants in all states.
- State insurance guaranty associations provide little clarity on how GLWB/GMWB products would be valued in the event of insurer insolvency prior to the point where an insurer is paying benefits to a participant. While there is clearly some value to the obligation as evidenced by insurer capital requirements and reserves they are required to maintain in relation to the obligations, state guaranty associations may not have a prescribed method for calculating a present value for these contracts prior to insurer payout. The Agencies would provide invaluable assistance to plan sponsors by working with various GA's and the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) to develop and communicate a clear policy as it relates to valuing such instruments in all phases of their life cycle. There should also be an explicit recognition on the part of state guarantee associations that GLWB/GMWB contracts represent obligations of any insurance company from the point of purchase and fees are collected and that these obligations must be preserved under any remedies coordinated by a state guarantee association for a troubled insurer, such as an assumption reinsurance or extended payout arrangement.
-

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?

- Few, if any, combined solutions are currently being promoted in the institutional marketplace which touch on these various aspects of a retiree's potential needs.
- A combined product may overcome behavioral biases which would otherwise prevent an individual from securing potentially useful products like long-term care insurance.
- The products currently available as standalone options in these areas need more development to be appropriate for the institutional marketplace.
- Transparency and disclosure needs to be improved for fiduciaries to consider introducing these options.
- Such products would appear to involve an even higher degree of complexity and risk to the individual by potentially concentrating their exposure to a single insurer or group of related companies.

Participant Education

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

17. What information (e.g., fees, risks, etc.) do plan participants need to make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement?

- How an accumulated asset base may be converted into income, for example, systematic withdrawal programs, purchase of individual annuities, the purchase of a laddered government bond portfolio and various forms of other lifetime income solutions. Description of timing risk as it applies to the sequence of returns one may experience in the years leading up to and after retirement. Few people understand how the sequence of returns will impact the value of an account in the presence of cash flows and a clear explanation of how different investors may have very different experiences depending on their need to access their retirement assets at different times.
- Education about longevity risk, investment risk and inflation risk and approaches to mitigating it
- Modeling tools and advice resources.
- An example of output from a tool which uses historical market returns and bond yields to simulate hypothetical guaranteed income levels and the value of such guarantees for participants retiring between 1969 and 2009 is included with this response. Access to the tool may be provided at the Agencies’ request.

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?

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

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?

- Questions 18, 19 & 20 may be partially addressed by updating existing guidance to modernize terminology so that it reflects many of the product innovations developed over the last several years and provides a clear and reasonable standard of care in the evaluation, selection and oversight of lifetime income solutions.

- The establishment and maintenance of a repository of information and research on lifetime income options would be extremely helpful to fiduciaries in developing their understanding of these products and such material may serve as a basis for communications with participants and clients.
- The collection and sharing of best-in-class practices may provide models for fiduciaries to emulate in the establishment and maintenance of their own programs.

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

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

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

- Accrued benefits may be helpful to participants, but this information should be supplemented with meaningful projections which illustrate various scenarios under which a participant may improve the probability of reaching a desired level of income and/or purchasing power in retirement.

22. If the answer to question 21 is yes, how should a lifetime stream of income payments be expressed on the benefit statement? For example, should payments be expressed as if they are to begin immediately or at specified retirement ages?

- Income illustrations should be age-appropriate. The information needs of a young saver differ dramatically from someone nearing retirement.
- Younger savers will need to understand how the level of income they may secure for retirement will change under various savings patterns as well as under various market environments.

People nearing retirement should see illustrations of how their assets would create income and be subject to risk under different scenarios such as a laddered government bond portfolio, traditional annuities, GLWB/GMWB solutions and systematic withdrawal programs.

Should benefit amounts be projected to a future retirement age based on the assumption of continued contributions?

- Yes; Underlying assumptions should be clearly specified

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?

- Payments should be illustrated in whatever periodicity is available through products offered in the market. Monthly & annual would be helpful along with weekly so as to enable people to compare these amounts to the take home pay they enjoy during their working year.
- Income illustrations could be in the form of a "retirement paycheck", as per the concept promoted by Financial Engines of Palo Alto, CA.
- Income illustrations should include inflation scenarios which highlight the damage inflation may cause to purchasing power over time. Inflation scenarios should

take into account extreme scenarios, such as the inflation experienced during the 1970s as well as more typical levels experienced since then.

- Both single life and J&S forms could be shown as well as the impact of taking early and deferred retirements due to the material reduction and increase in benefits which may result from such actions.

23. If the answer to question 21 is yes, what actuarial or other assumptions (e.g., mortality, interest, etc.) would be needed in order to state accrued benefits as a lifetime stream of payments?

If benefit payments are to commence at some date in the future, what interest rates (e.g., deferred insurance annuity rates) and other assumptions should be applied? Should an expense load be reflected?

- The same assumptions as the underlying lifetime income option is using to project benefit payments and hedge market exposures

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?

- Some tools are currently promoted in the market for the evaluation of metrics such as income replacement ratios.
- These tools can be used to evaluate retirement plans in aggregate or sub-sets of the population based on various participant-level data tracked by record keepers.
- It's possible these would be useful for communicating such information to participants.
- Most plan service providers would likely develop services for projecting income illustrations and including them on participant statements similar to those available today. At least two large record keepers are currently offering this service to plans.

Should caveats be required so that participants understand that lifetime income payments are merely estimates for illustrative purposes? Should the assumptions underlying the presentation of accrued benefits as a lifetime income stream of payments be disclosed to participants?

Should the assumptions used to convert accounts into a lifetime stream of income payments be dictated by regulation, or should the Department issue assumptions that plan sponsors could rely upon as safe harbors?

- Yes, assumptions should be disclosed and caveats for the uncertainty should be included, particularly as it relates to the various levels of confidence one may attach to obtaining income from various channels. In other words, caveats should distinguish between the risks of relying on a systematic withdrawal program from a balanced portfolio versus the risk of collecting income from an insurance company of from a laddered portfolio of U.S. government bonds.

It would be helpful to issue clear and concise guidance on assumptions, but this should not be prescriptive or forced by any form of regulation.

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?

- Income replacement ratios are helpful to some participants, but may be confusing to others. If included, replacement ratios should be supplemented with cash income illustrations as described above.
- Inflation estimates should be explained clearly.
- Inflation scenarios should be included in income illustrations as described above.

401(k) and Other Plan Qualification Rules

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

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

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?

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?

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?

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?

Selection of Annuity Providers

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

30. To what extent do fiduciaries currently use the safe harbor under 29 CFR 2550.404a-4 when selecting annuity providers for the purpose of making benefit distributions?
Some DC plans offer annuity options as out-of-plan options for distributions. Fiduciaries generally rely on the protections afforded under 404a-4 when selecting the annuity providers for this option
31. To what extent could or should the Department of Labor make changes to the safe harbor under 29 CFR 2550.404a-4 to increase its usage without compromising important participant protections? What are those changes and why should they be made?

- It is very important that the Agencies clearly communicate this guidance and clarify how it applies to various forms of lifetime income solutions. Terminology and product designs in this area may be confusing and difficult to compare. Plan sponsors and participants would benefit from updated guidance.

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?

- I believe the safe harbor applies to products which are considered annuities at some point in their lifecycle (generally in payout and potentially before that time). The Agencies should provide clarification to plan sponsors that safe harbor would apply to products which represent annuities when a contingent event occurs, such as the issuance of certificates, whether notional or physical, by an insurance company or at the point of purchase for a contract which includes annuity provisions at some point in the future.

ERISA Section 404(c)

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

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

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

Qualified Default Investment Alternatives

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

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

- At least 150 plans in the U.S. currently use lifetime income options with GLWB/GMWB features embedded in the product.
- Several large plan sponsors are currently evaluating existing products and others under development.
- Features in these products include:
  - Longevity protection, payments extend for the life of the participant and joint recipient
  - Underlying assets are fully liquid and accessible at any time by participants and beneficiaries without surrender charges or other fees for liquidity
  - Most include a benefit base "ratchet" which creates the opportunity for income levels to increase in the event that the market value of a participant's assets should exceed a previous "high watermark" set by the account value at an earlier date.
  - Fees & benefits are set for the life of the product and cannot change in the future.
  - Benefit levels for protection purchased in the future may vary based on changes in economic conditions, but benefits purchased are not subject to change.

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

Executive Order 12866 (EO 12866) requires an assessment of the anticipated costs and benefits of a significant rulemaking action and the alternatives considered, using the guidance provided by the Office of Management and Budget. In addition, the Regulatory Flexibility Act (RFA) may require the preparation of an analysis of the economic impact on small entities of proposed rules and regulatory alternatives. For this purpose, the Agencies consider a small entity to be an employee benefit plan with fewer than 100 participants. The Paperwork Reduction Act (PRA) requires an estimate of how many "respondents" will be required to comply with any "collection of information" requirements contained in regulations and how much time and cost will be incurred as a result. The Agencies in this section of the RFI are requesting comments that may contribute to any analyses that may eventually need to be performed under EO 12866, RFA, and PRA, both generally and with respect to specific areas identified in questions 36 through 39.

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.

- Plan sponsors are faced with additional communications costs and the selection and oversight of such options requires additional resources. However, these vary considerably from plan to plan. It is extremely difficult to quantify them.

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

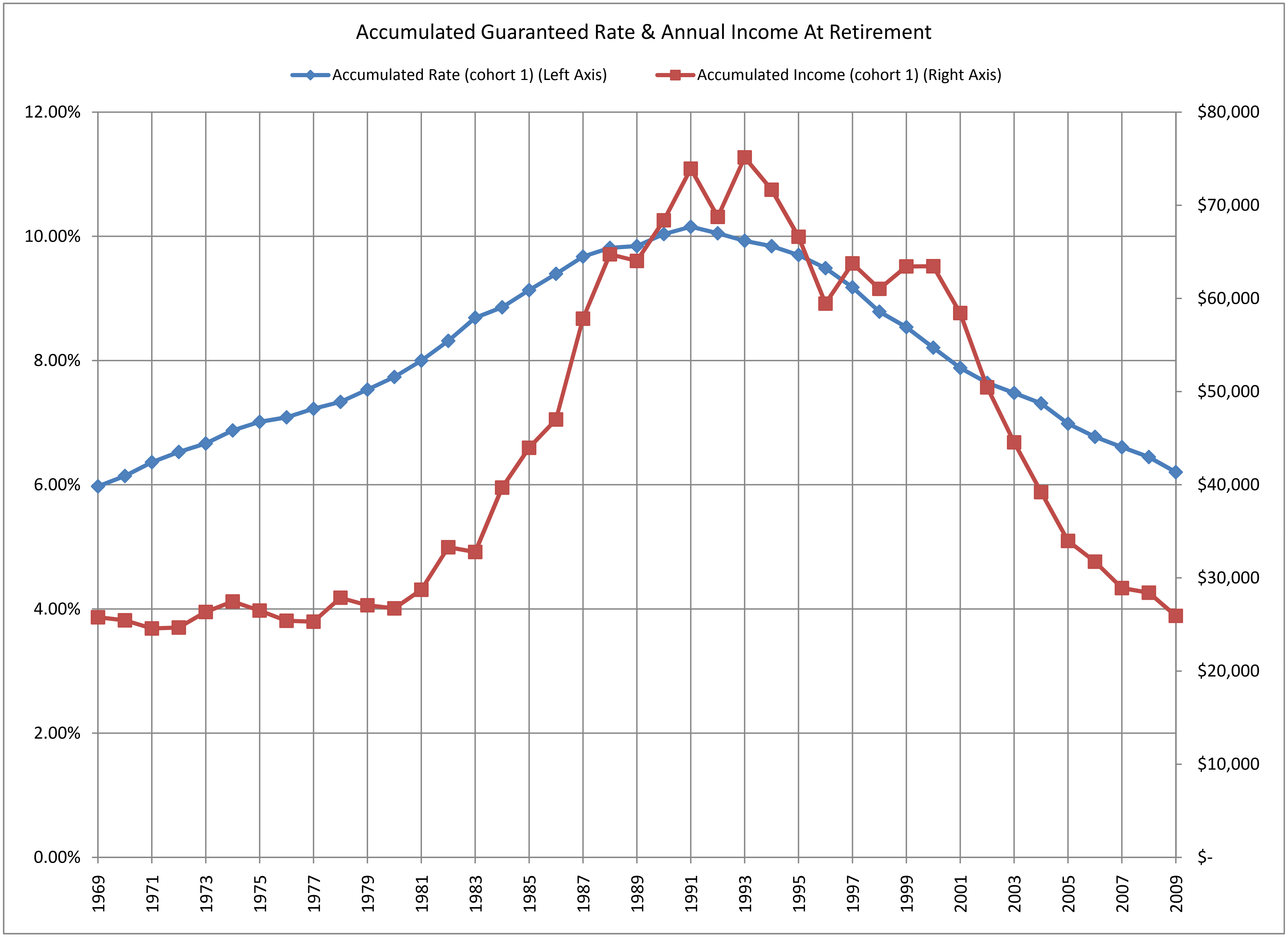
- Small plans have limited access to internal knowledge and/or unbiased external advice regarding the intricacies of these products.
- Small plans typically do not have sufficient resources to fully assess the costs and benefits of the wide range of product options available in the marketplace.
- Small plans typically do not have sufficient negotiating power to secure sufficiently equitable pricing to make Lifetime Income products practical for most plan participants
- It would be beneficial to most small plan sponsors if the Agencies were to issue and update from time to time clear and practical guidance on:
    - Which product features tend to drive costs, impact liquidity/flexibility of the participants, and impact portability,
    - How they might best communicate the features and benefits of such products to participants in their plans, and
    - Disclosure requirements for such products

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?

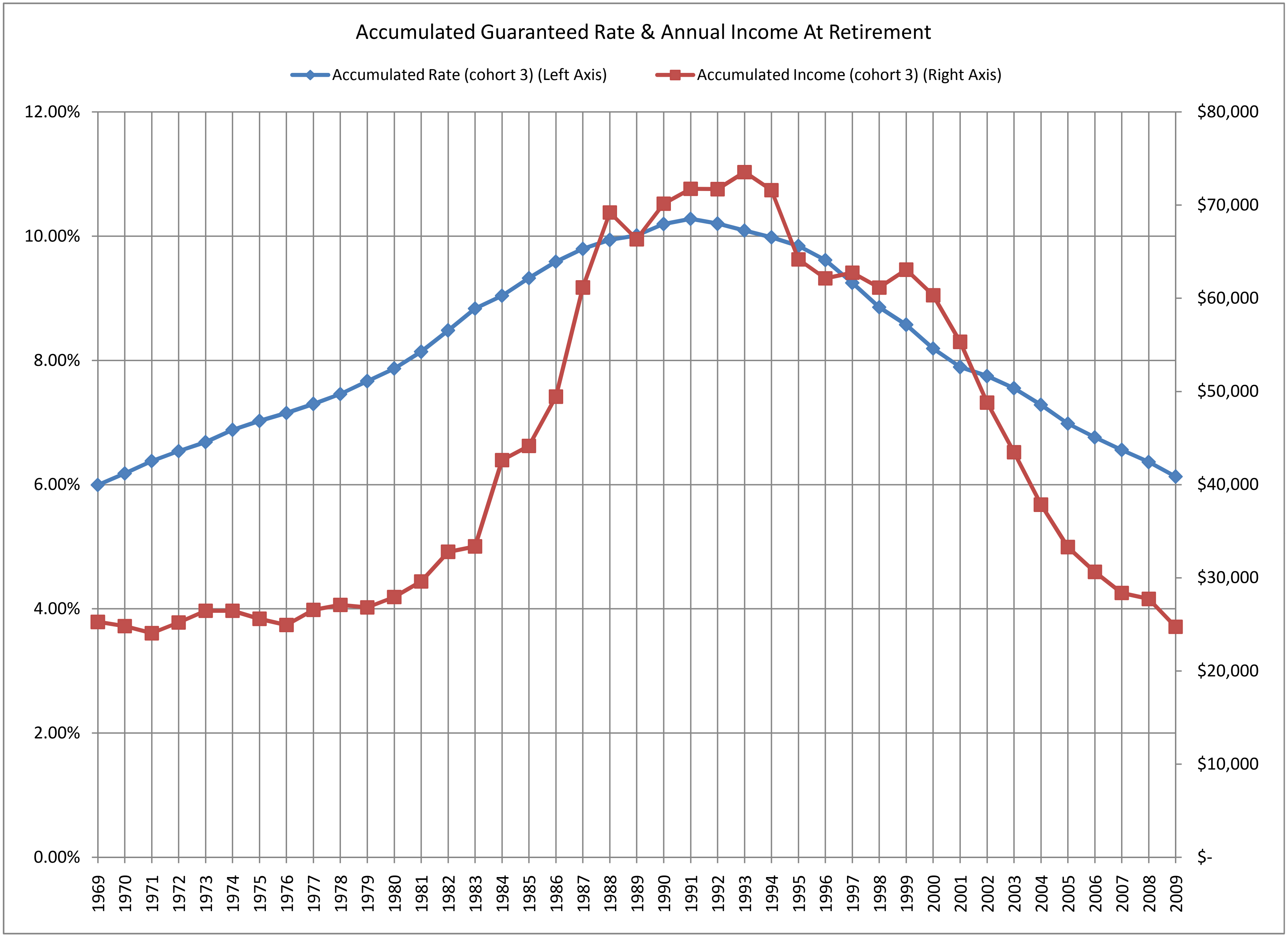
- The designation of a Lifetime Income option as a default form of benefit payment from a DC plan would likely have a measurable impact on individual employee contribution rates. However, it is entirely possible that the magnitude of this impact would be difficult to discern at the plan level, because participants would interpret the information available to them regarding the amount of income they could expect in retirement in different ways.
- Some would potentially increase their contribution rates if they believed their current contribution levels (and/or investment returns) are insufficient to fund an acceptable standard of living in comparison to that which they enjoy during their working years.
- Others, however, might conclude that they have saved enough (and/or their investment returns have supplemented their savings sufficiently) to establish an acceptable standard of living in retirement thereby freeing them to redirect some of their savings to other consumption decisions during their working years. I.e., the purchase of a new home or repairs to an existing one, funding education for themselves or others, travel, charitable pursuits, etc.

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?

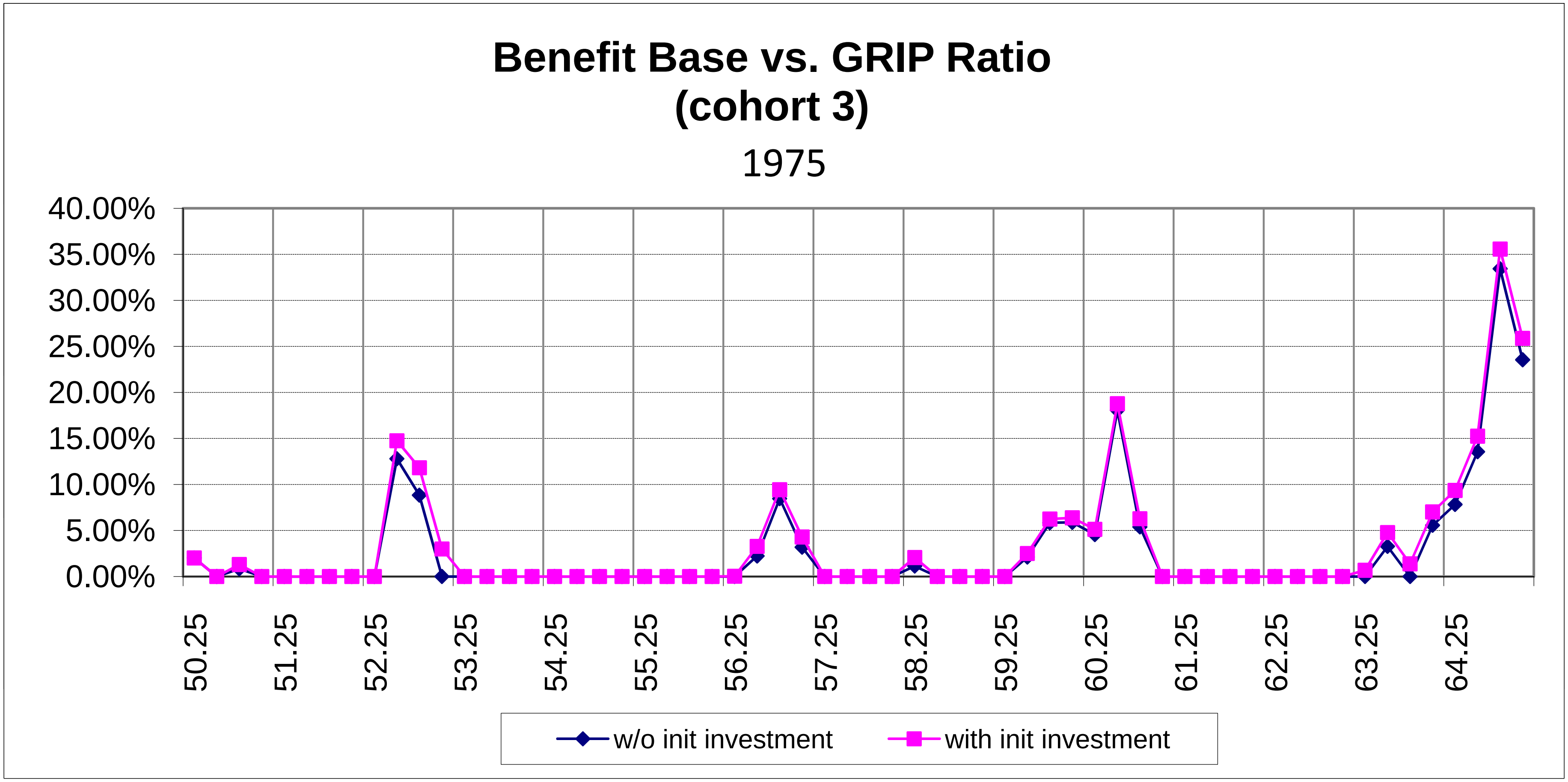
- Anecdotally, a very low percentage of participants choose to annuitize their assets in DC plans. Similarly, a large percentage of DB plan participants take lump sums rollovers when provided the option. This is true in other countries as well. For example, pension members in the UK will often take lump sum distributions at retirement in spite of the fact that many pensions use punitive commutation factors in the calculation of the lump sum values. In other words, participants take lump sums even though they know the present value of their pension payments is larger than the lump sums.



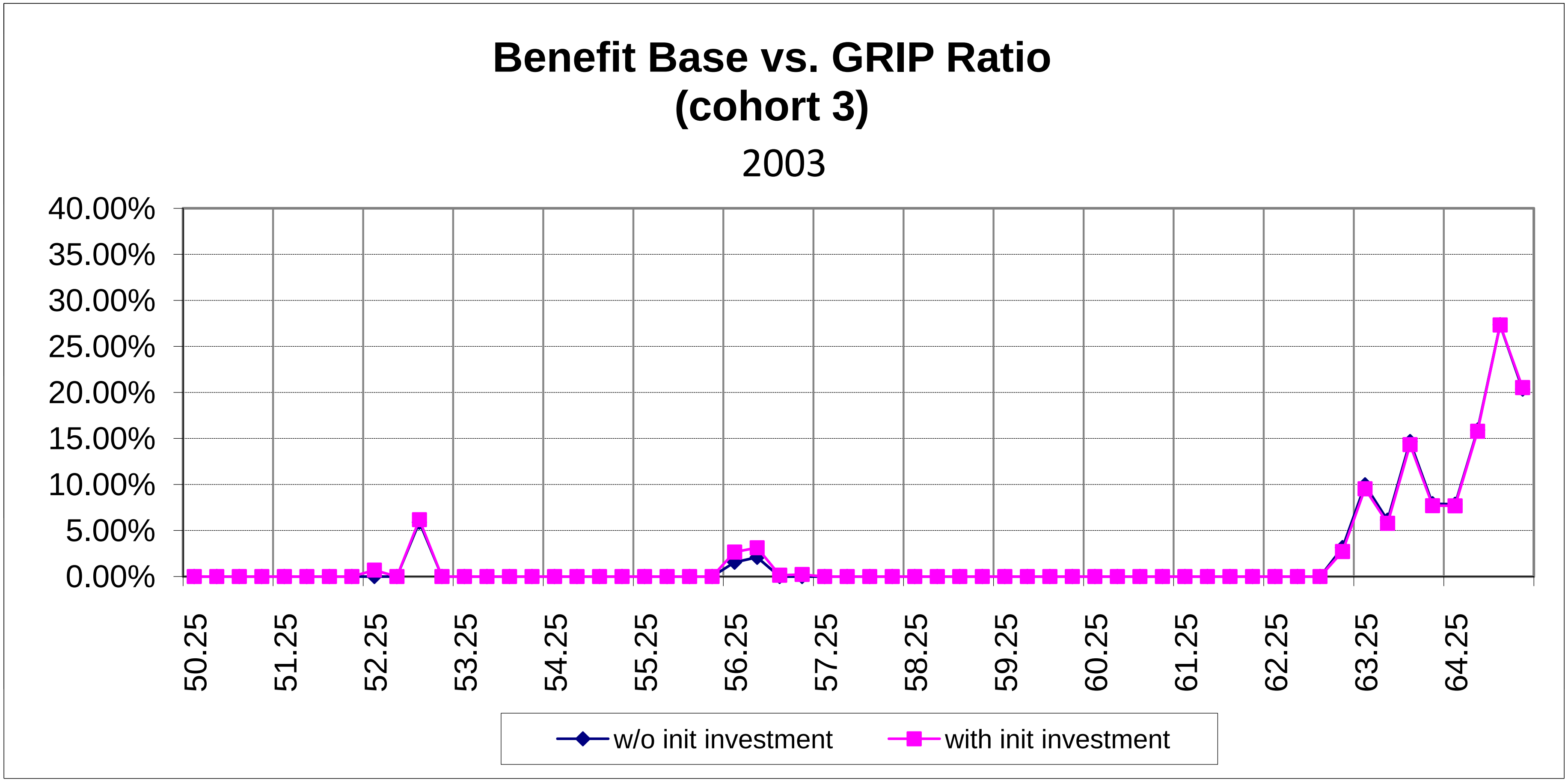
Source: AllianceBernstein & Kevin T. Hanney, CFA



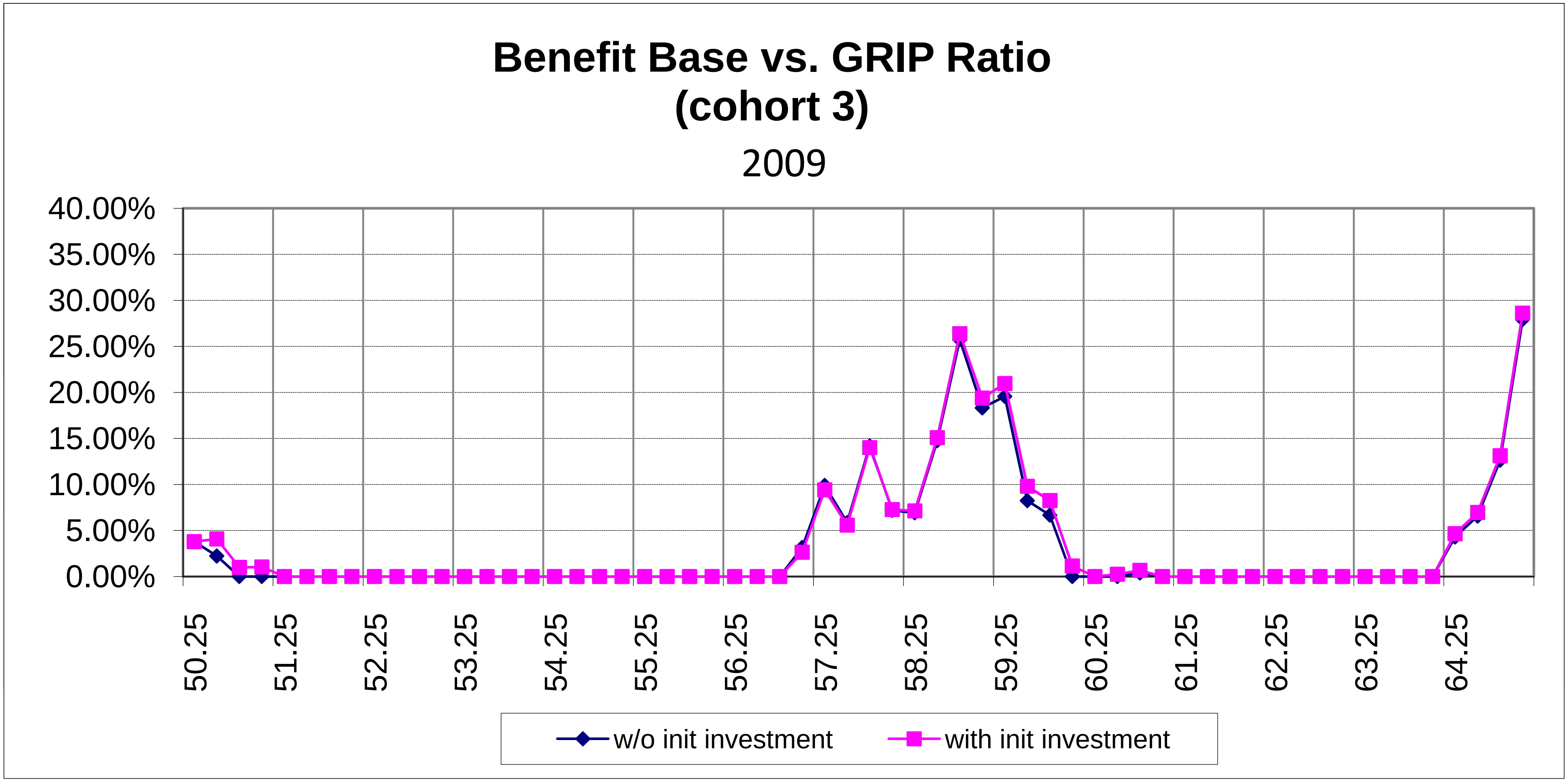
Source: AllianceBernstein & Kevin T. Hanney, CFA



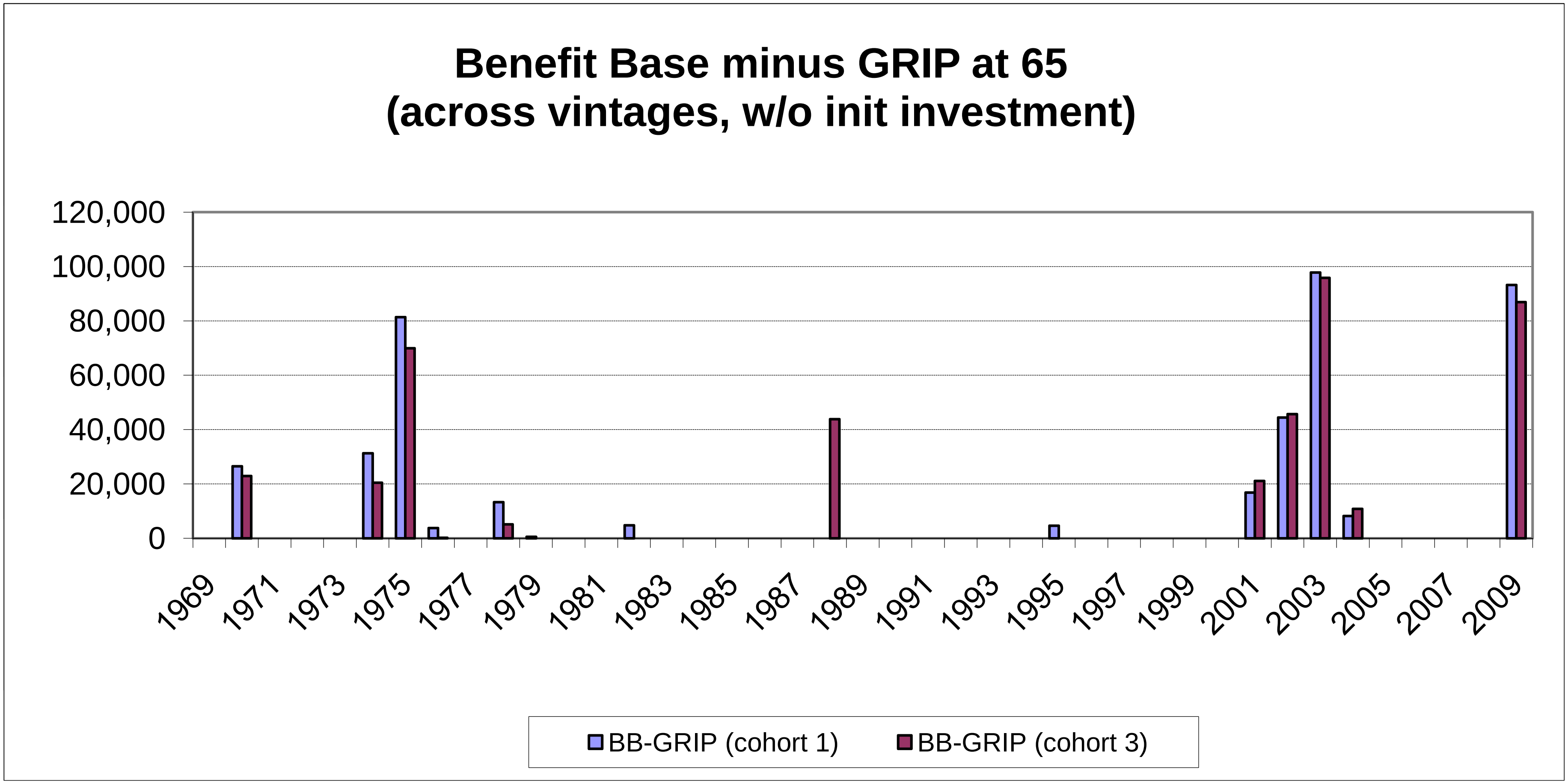
Source: AllianceBernstein & Kevin T. Hanney, CFA



Source: AllianceBernstein & Kevin T. Hanney, CFA



Source: AllianceBernstein & Kevin T. Hanney, CFA



Source: AllianceBernstein & Kevin T. Hanney, CFA