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Request for Information Regarding Lifetime Income Options for Participants & Beneficiaries in Retirement Plans

Comment On: IRS-2010-0006-0001
Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

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General Comment

Response to Lifetime Income RFI.

Attachments

IRS-2010-0006-0075.1: Comment on FR Doc # 2010-02028

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May 3, 2010

Internal Revenue Service
US Department of the Treasury
Office of Regulations and Interpretations
Employee Benefits Security Administration (EBSA)
1111 Constitution Avenue, NW
Washington, DC 20224

Re: REG-148681-09

To Whom it May Concern:

On behalf of the millions of American workers and the hundreds of corporations, advisors and advisory firm clients who rely on BrightScope for accurate retirement plan data and information, BrightScope Inc. ("BrightScope") is pleased to submit these comments in response to the request for information (RFI) by the Employee Benefits Security Administration of the Department of Labor and the Internal Revenue Service of the Department of the Treasury. The Agencies are seeking comments regarding the rules under the Employee Retirement Income Security Act (ERISA) and the plan qualification rules under the Internal Revenue Code (Code) to determine whether, and, if so, how, the Agencies could or should enhance, by regulation or otherwise, the retirement security of participants in employer-sponsored retirement plans and in individual retirement arrangements (IRAs) by facilitating access to, and use of, lifetime income or other arrangements designed to provide a lifetime stream of income after retirement.

BrightScope Inc. was founded in 2007 to support the retirement income security of America's workforce by bringing data and transparency to the defined contribution plan marketplace. BrightScope supports efforts that lead to enhanced retirement income security and our comments will focus specifically on the aspects of the RFI which we are uniquely positioned to address.

Longevity Risk: The Critical Issue for U.S. Retirement Policy

The primary driving force behind the need for lifetime income is the increasing life expectancy of American workers. Life expectancy in the United States is now approaching 78 years, an all-time high; however, few retirees are fiscally prepared for a long retirement, or are aware of the costs.[i] Studies have shown that as many as two-thirds of Americans underestimate their own longevity risk.[ii]

While workers are living longer, they face decreased access to products that help them generate income in retirement. Companies are increasingly freezing their defined benefit (DB) plans in favor of defined contribution (DC) plans. Unfortunately, the same features that make DC plans popular among workers during their savings years – individual accounts, flexibility and portability – create issues during their retirement years. Without the ability to pool risks, DC plans do not adequately protect against longevity risk.

As we have learned over the past few decades in our individual account retirement system, strong defaults must be in place to encourage optimal behavior for those individuals who fail to make their own retirement decisions. With the advent of automatic enrollment and QDIA's, defined contribution plans now have strong defaults for the accumulation phase of retirement saving. We believe that it is vital to complete the default system by building a strong decumulation system that accomplishes the following objectives:

1. Fully protects against longevity risk.
2. Creates secure streams of income.

While there are other important objectives – fee transparency, flexibility, etc. – if the two objectives above are not met, American workers will not be adequately protected.

Two Approaches to Protect Against Longevity Risk: Self-Insurance and Risk Pooling

The primary way the defined contribution marketplace is currently dealing with longevity risk is to encourage workers to self-insure. Workers can self-insure through over-saving or by taking on other types of risk, such as market risk, for a longer period of time to make up for their savings gap. At BrightScope we call this second method "risk switching", or substituting one risk for another. The problem with risk switching using market risk is not only that workers may have to endure more volatility than they desire, but also that the market risk is only a partial protection against the longevity risk it was supposed to replace. Clearly, risk switching does not satisfy our objectives for a strong decumulation system.

Interestingly, current DOL and ERISA regulations support the use of risk switching under the PPA and QDIA rules. Under these rules, the optimal default path for a new entrant into the U.S. retirement system is automatic enrollment into a defined contribution plan and a default in to a target date fund, or other QDIA. Most target date funds have expressed their mandate as a glide path that gets participants "through" retirement, rather than in simply managing the assets "to" retirement. In other words, target date funds are attempting to *protect against* longevity risk by encouraging participants to take on more market risk even as they approach retirement. By failing to properly define the role of the target date fund as an accumulation vehicle, the DOL and Congress have encouraged the use of risk switching as the primary defense against increasing longevity. Unfortunately for American workers, this method of self-insurance not only fails to fully protect against longevity risk, it also does not generate a guaranteed income stream.

The alternative to self-insurance is pooling of longevity risk. Risk pooling occurs when a large number of people share potential benefits or potential costs by averaging them together. With a significantly large number of risks pooled together, high and low extremes cancel each other out and thereby provide cost stability, as long as risks are independent of one another. In our opinion risk pooling is the only way to fully protect against longevity risk.

Pooling longevity risk has two major advantages:

1. **Full Longevity Protection**: Because pooled assets aggregate longevity risk of a workforce, they avoid the "over saving" dilemma inherent in individual account plans. Vehicles that use pooling only need to accumulate enough funds to provide benefits for the average life expectancy of the group.

2. **Anti-Aging**: Pools of assets do not age, unlike the individuals in them. While some workers retire and begin tapping into their retirement income stream, younger workers replenish the assets. So, the average age of the pool of assets does not change over time.

In the defined contribution world, the best way to access the benefits of risk pooling is through the private insurance marketplace.

Managing the Concerns

For all the advantages of risk pooling, the private insurance marketplace and current crop of annuity products offered by private insurers have yet to obtain widespread adoption and have major issues that have yet to be addressed. The term "annuity" has earned itself a negative reputation amongst investors. There are a variety of factors that may explain this reputation, from the inflexibility of some of the contracts, to the manner in which they have been sold and the large fees and commissions earned by their salespeople. If a default system is to be developed and gain traction it is going to have to overcome the issues annuities have faced in the past – complex contracts, high fees, lack of flexibility – and tackle the negative PR problem. Firms like BrightScope that are actively engaged in protecting consumers will certainly follow the development of any future regulations with great interest. Although it will be an uphill battle, we have been impressed with several of the recent innovations by private insurers intent on tackling this issue, and are confident that with strong regulatory support and adequate investor protections a strong decumulation system can thrive as the final piece of the default retirement system.

Conclusion

Encouraging the creation of lifetime income from accumulated retirement savings is a noble goal and one worth pursuing. Longevity risk is a legitimate concern for the U.S. economy and one which cannot be solved through means other than risk pooling. We encourage the ongoing efforts to create a strong decumulation system and would be pleased to offer our support and resources if called upon.

Thank You.

Ryan Alfred, President, BrightScope Inc.

Brooks Herman, VP of Research, BrightScope Inc.

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[i] Heron, Melonie, et al. "Deaths: Final Data for 2006." National Vital Statistics Report. Vol. 57, No. 14. April 17, 2009.

[ii] "2005 Risks and Process of Retirement Survey, Report of Findings." Society of Actuaries. March 2006.