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On behalf of the
Financial Services Roundtable

Submitted to the
Employee Benefits Security Administration
U.S. Department of Labor
Internal Revenue Service,
Department of the Treasury
Hearing on
Certain Issues Relating to Lifetime Income Options
For Participants and Beneficiaries
In Retirement Plans

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Introduction

My name is Greg Burrows. I am the senior vice president of retirement and investor services at the Principal Financial Group®. We are a diversified financial services company with retirement being the largest operating segment.

For more than 65 years we have helped millions of people save for retirement. We currently provide retirement and investment services for nearly 35,000 plan sponsors and more than 3.6 million participants[1]. We continue to support them as they enter retirement, providing monthly income annuity payments to nearly 250,000 retirees.

A member of the Fortune 500, The Principal® has $284.7 billion in assets under management[2] and serves some 18.9 million customers worldwide.

I am here today on behalf of the Financial Services Roundtable. The Roundtable represents 100 of the nation's largest integrated financial services firms. Roundtable members provide banking, insurance, and investment products and services to American consumers and businesses. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

Thank you for the opportunity to share our views on the critically important subject of helping Americans secure lifetime income at retirement.

My comments are based around three core beliefs:

- First: we believe plan sponsors are in the best position—and have a strong desire—to play a leading role in helping participants with this complex task at the worksite with a systematic process of financial literacy leading to access to a broad spectrum of products.
- Second: while we believe there is not one single product that is a one-size-fits-all solution to help all retirees produce retirement income, we do believe income annuities, purchased at the time of retirement, can play an important role in many retirement portfolios.
- Third: we believe the right time to make decisions about guaranteeing retirement income is not during the savings phase but at retirement—the point of distribution when participants have the best understanding of their retirement income needs.

We will recommend the following actions for the DOL to consider:

- Remove barriers that prevent plan sponsors from providing the crucial retirement income assistance participants need.

[1] As of June 30, 2010

[2] Ibid.

- Encourage use of retirement income illustrations to drive home how long savings will last in retirement.
- Provide guidance on the right information at the right time for participants to make lifetime income decisions.
- Support incentives, not mandates to encourage plan sponsors to address retirement income issues on a voluntary basis.

Why we need to act now

There is a sense of urgency. We are on the verge of another baby boomer revolution as the first wave of 76 million begins to retire in 2011. Of all the challenges facing this generation and the next, few are as daunting as the risk of outliving their savings.

Given increased life expectancies and dwindling sources of lifetime retirement income from pensions and Social Security —not to mention the impact of recent market volatility—the challenge is immense.

According to our research being unveiled today, most Americans are worried but unprepared.

The Principal Financial Well Being Index[SM], a quarterly survey of American workers conducted for the past decade, finds 75 percent of American workers say they are very concerned about their long term financial future—the highest level since 2005. One of their top one concerns about retirement is being able to afford the basic necessities.

Despite those concerns, another recent survey of participants[3] found only 14 percent of those nearing retirement have actually created a plan for how they will transition their savings into a steady stream of income for life.

As concerning, participants do not have a realistic idea of how much they can spend without running out of money in retirement—a retirement that could span three to four decades.

Fifty-six percent of pre-retirees estimated they could spend 6 percent or more each year without depleting their savings and more than a third of respondents believed an 8 percent or higher rate is sustainable[4] – that is twice the 4 percent level that most financial experts suggest.

Clearly, there is a need to expand the financial literacy of American workers and the generations to come. That effort really needs to begin long before an individual enters the workforce—in elementary, middle and high school. The Principal® is pleased to join with the Financial Services Roundtable and other member companies in providing high tech financial literacy courses to over 430 high schools across the nation.

However, we believe the workplace is an excellent venue to promote financial literacy among adults: from learning how to save for retirement in their employer-sponsored plans to managing that savings as an income in retirement.

Barriers to retirement income education at the worksite

Plan sponsors agree that they play a key role. In a recent study, 83 percent of plan sponsors said they are worried their participants will make poor decisions with their savings at retirement and 72 percent[5] feel it is their responsibility to help by offering education, guidance and access to solutions including guaranteed income options. Plan sponsors also understand they benefit from addressing retirement income because it makes their benefit program more attractive to current and prospective employees.

However, concerns about fiduciary liability prevent many from providing retirement income education. Only 40 percent[6] of plan sponsors offer education targeted to participants nearing retirement. Plan sponsors are frequently worried that education about guaranteed lifetime income options would be construed as “advice” and would increase their fiduciary liability.

[3] Pre-retiree Participant Survey, Principal Financial Group, June 2010

[4] Principal Financial Well Being Index, First Quarter 2010

[5] Retiree Income Solutions Survey from the Principal Financial Group, March 2009

[6] Ibid.

We are pleased that the Treasury is focusing on a National Strategy for Financial Literacy and we salute the DOL for the excellent educational materials you have produced to promote financial literacy and we encourage you to do more, especially around retirement income education.

We urge regulatory guidance that would provide fiduciary protection and safe harbors to plan sponsors who provide education about lifetime income options.

Specifically we recommend that ERISA Section 404(c) type safe harbors—which currently cover participant selection of investment options in the plan—be developed to apply to participant selection of guaranteed lifetime income options and education about those options.

The plan fiduciary would remain responsible for the prudent selection and monitoring of the lifetime income options. We ask however that it be made clear that the plan fiduciary is insulated from liability for the results of the participant's choice.

Strong legal protection would go a long way toward encouraging plan sponsors to provide the resources necessary for participants to make crucial retirement income decisions.

But what kind of information do participants need and when do they need it?

We've learned four key principles from studying participants:

- Retirement income education needs to come early and often.
- Education should come before product discussions.
- Decisions about lifetime income products should come later, at the point of retirement.
- Participants need information about a range of products to meet unique needs.

I'd like to briefly discuss each of these and how the DOL can help.

First: retirement income education needs to begin long before retirement is on the horizon. Retirees repeatedly tell us they wish they would have learned more about the realities of managing money in retirement 10 to 15 years before retirement[7]. That information would have spurred them to save more.

One way to drive home the need to save early and often is to illustrate on benefit statements how an account balance translates into expected monthly income in retirement. Learning that a $50,000 balance at age 65 would amount to only about $275 a month[8] for life can be a real wake-up call.

While legislation has been introduced, we ask the DOL to take administrative action to encourage the use of retirement income illustrations more broadly. Regulatory guidance, that includes fiduciary protection for plan sponsors, could promote these illustrations as a best practice and help change how participants think about saving for retirement.

Second: Participants we've studied have made it clear they want education and guidance first before learning about specific products. They say focusing on products first breeds skepticism.

Participants need basic education about the risks and costs in retirement that include:

- Longevity – retirement could span 30 or more years
- Inflation – income needs could more than double over the course of retirement
- Healthcare – costs could increase at a faster pace than inflation. The typical 65 year old couple will need about $200,000 to cover all healthcare costs in retirement[9]

[7] Principal Financial Well Being Index

[8] Principal Financial Group Income Annuity Quote for a 65 year old, unisex pricing, with installment refund, August 30, 2010.

[9] Center for Retirement, Boston College, *What is the Distribution of Lifetime Health Care Costs from Age 65?* by Anthony Webb and Natalia Zhivan, February 2010. Estimate includes insurance premiums, out-of-pocket costs and home health costs and excludes nursing home care

Participants want to understand their personal circumstances and then receive guidance to develop a personalized plan that takes into account their unique needs.

Third: We believe decisions about selecting lifetime income products are best made at retirement, the point at which participants have the best understanding of their retirement income needs. Most are not prepared to make decisions about retirement income 10 to 15 years before retirement.

Fourth: Because financial and personal circumstances are as varied as retirees themselves, participants need education on a full array of options. We do not believe that any single investment or product is a "one-size-fits-all" solution for all participants. It is likely many participants will need a retirement portfolio containing a blend of products—ranging from mutual funds to CDs to income annuities.

As the DOL considers its role in helping Americans with lifetime income, we ask that you recognize the importance of participants making lifetime income product decisions at the point of retirement and the need for access to education on the full range of options to meet the unique needs of retirees.

A closer look at income annuities

In addition to the uniqueness of each retiree's situation, there are three very basic strategies of retirement planning:

- The first is to maximize retirement savings through the working years
- The second is to protect account values when nearing retirement, and
- The third is to optimize and guarantee sustainable income through the life of retirement.

Clearly, no one product can effectively address all three strategies. However, there is one product that is specifically designed to optimize guaranteed lifetime income – the traditional income annuity.

Income annuities are used as a distribution option at the point of retirement when the participant has the best understanding of their financial needs.

While most financial experts suggest a 4 to 5 percent annual withdrawal rate from savings, a distribution income annuity payout can range from about 6 to 8 percent of the initial premium depending on the age of the participants and other benefit options selected, but the annuity will not "run out" – it will keep on paying. That makes distribution income annuities an important component in many retirees' investment portfolios.

Plan sponsors are in a good position to explain the benefits of distribution income annuities and, even more importantly, to dispel the myths that make participants reluctant to consider lifetime income options.

I'd like to briefly respond to some of those misconceptions.

- Concerns that the insurance company selling the income annuity will be around to make the payments. Recent history provides the most compelling evidence needed to alleviate this concern. During the fourth quarter of 2008 which was the worst financial crisis since the Great Depression, income annuity owners continued to receive their monthly pension checks on time.
- Worries that the income annuity payments will not keep up with inflation. Many insurance companies offer income annuities with either a fixed annual increase or one that is linked to the Consumer Price Index.
- Misconceptions that income annuities are complex and expensive. A traditional income annuity is one of the simplest products to understand. In exchange for a lump sum amount, investors are guaranteed a monthly, quarterly or annual payment for either the participant's lifetime or a set period of time. They are also very affordable. When plan sponsors make income annuities available at the worksite, retirees have the advantage of group pricing. This group pricing allows more income for the dollar, as much a 3 to 7 percent more,[10] than if the annuity were purchased outside of the plan.

[10] "A Plan Sponsor's Guide: Bridging Employees' Retirement Income Gap with Income Annuities" the Principal Financial Group, 2009

- Fears of financial loss due to early death. Many income annuities provide for either installment refund or cash refund of the initial premium. This insures that, at minimum, either the individual or their heirs (or both in combination) will receive at least the amount of the initial premium.
- Worries that retirees have no access to a lump sum after they purchase an income annuity. This need not be true. Some income annuities have liquidity provisions that a retiring worker can elect that allow lump sum withdrawals ranging from 20 to 50 percent of the initial premium.

Beyond education, plan sponsors are in a very good position to provide access to distribution income annuities but once again are concerned about fiduciary liability.

The DOL has taken and important step to address this with a recent regulation that provides a safe harbor for selection of annuity providers. However the regulation requires the fiduciary to “conclude the annuity provider is financially able to make all future payments.” This is an extremely difficult standard for fiduciaries to meet. We know the DOL has given serious consideration to this concern and we will work with our industry groups to provide some specific recommendations for changes.

Because income annuities address the primary challenges faced by retirees today and in the future, there needs to be strong legal protection for plan sponsors who offer access to and education about lifetime income.

Finally, we support incentives not mandates and we believe plan sponsors should be encouraged to address retirement income education and options on a voluntary basis.

Strong legal protection, such as we have described, would free plan sponsors and plan fiduciaries to make education about and access to lifetime income options appealing without a mandate—especially if it were combined with tax incentives.

We support tax breaks for plan sponsors who make income annuities available at the worksite and for participants who put some of their retirement savings into a guaranteed monthly income.

We ask the DOL to join us in supporting annuity tax incentive legislation like the Lifetime Pension Annuity for You Act of 2007, sponsored by Representative Earl Pomeroy. This type of legislation can help retirees avert the growing risk they may outlive their savings by encouraging them to create their own guaranteed paycheck for life.

I appreciate the opportunity to appear before you today. We look forward to working with you as you consider the critical need for worksite education to help Americans secure lifetime income at retirement. I would be happy to answer any questions you may have.

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