Joint Hearing on Lifetime Income Options for Retirement Plans
Department of Labor's Employee Benefits Security Administration and Department of the Treasury
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Written Testimony Delivered by
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Thank you for the opportunity to submit testimony before your panel today. My name is Jessica Flores and I am the Managing Partner of Fiduciary Compliance Center. I have testified before most of you on controversial initiatives like these Lifetime Income Options in the past, and in most cases during my testimony I attempt to bring your attention to the motives behind the urging of these products.

I will start by stating that I understand and respect the Department's concern regarding the future retirement savings deficit our American workers are undoubtedly facing. I agree that we all have reason to be concerned and the current solutions are proving to be inadequate in rectifying this foreseen potential economic disaster. I will also say that I commend you on taking your time in reviewing the proposed Lifetime Income solutions prior to making any rash policymaking decisions.

As I have done many times in the past and I'm sure most of you have come to expect when you see my name on the witness agenda, I want to present the unpopular viewpoint in the room. I present this testimony in my continued efforts to protect investors from the devastations they find themselves in at the wrath of the financial industry.

As requested I have focused my testimony to the issues specified by the agencies in the Notice of Hearing.

In regards to the 1st Issue posed by the agencies – Certain Specific Participant Concerns Affecting the Choice of Lifetime Income Relative to Other Options, I would like to bring your attention to the following issues:

1. The key issue for participants who are expected to utilize these products for divesting their retirement savings over time is that there is absolutely no requirement for these products to be designed and managed in the sole interests of the participants and their beneficiaries. This is an obvious concern when you consider who is primarily manufacturing and selling these products – the financial and insurance industry powerhouses. Or more specifically, those who continually hide behind the infamous plan asset exemption whenever an issue arises regarding self dealing or wrongdoing with respect to their products. Why should we expect or even worse, require, participants to hand over their hard earned money to companies who are blessed with the privilege of managing this money for the companies' own benefit?

2. This leads us to the next issue, there is no ERISA liability associated with the management of these products. So participants oftentimes have no recourse against providers in situations where they certainly should have this right. Instead, the Department continues to pass the buck to the other agencies, claiming that the SEC, 50 State Insurance Commissioners and the Plan Fiduciaries who select the products will police the industry for the benefit of these participants. When in reality that simply isn't the case. Instead we are increasingly becoming an industry policed by class action attorneys who often find their cases dismissed against service providers due to lack of ERISA fiduciary standing. Again, leaving the participants left with their reduced

retirement savings that has been used to make money for the investment company that sold the product with its own interests as primary focus.

While you are sitting here for the next two days listening to repetitive testimony disclaiming the need for additional fiduciary liability measures and even coercing you into believing that fiduciary liability actually should be reduced to entice fiduciaries to adopt these products, please remember who is making this case. This is the testimony of the industry players who duck the liability while the uninformed and misled fiduciaries are left holding the bag. Because fiduciaries are sick and tired of holding that bag, they are not pulling out their pens to buy into these products. So the industry's solution is to give a free pass to fiduciaries like the one that has already been awarded to investment companies and leave no one liable for offering these self serving, excessively expensive, minimally performing junk contracts to participants. Is this the right thing to do for our participants or the right thing to do to boost industry sales?

3. The product structures necessary to produce a somewhat predictable benefit stream that can be relied upon for the investment companies and participants have been intentionally designed to be far more complex than warranted. Whether considering a Fixed Annuity or Variable Annuity with some sort of guaranteed minimal payment stream, the products are convoluted for the investor and a money tree for the provider.

    a. Fixed Annuities offer a minimum guaranteed crediting rate to the investor that is based on the insurance company's black box for determining the periodic crediting rates. There is no requirement for the insurance company to report what exactly it is earning from the pool of money invested in the guaranteed interest account or general accounts that are used to pay this crediting rate. Meaning, the insurance company can make as much money as it can and then credit whatever the company, in its sole discretion, determines. This is obviously not a structure that is managed in the sole interest of anyone other than the insurance company. There is no fiduciary requirement to manage the money in the exclusive interests of participants and their beneficiaries or to defray reasonable fees and expenses for managing this money. Instead, the insurance company just has to credit the floor percentage that is guaranteed. Even though these companies don't always credit at the floor level, they certainly do not credit all that they can to ensure reasonable growth for the participant's accounts either. The bottom line is Fixed Annuities can be very costly to participants and no one is evaluating the reasonableness or necessity of these costs.

    b. Variable Annuities which offer a guaranteed minimum payment stream do so at a significant cost to the investor. These products are often packed with an assortment of expensive, less than mediocre actively managed mutual funds which are selected for the sole reason of the revenue sharing arrangements they offer. Then these funds are wrapped in a separate account to increase the fees charged to participants. The other riders, such as a guaranteed income stream, only add to the costs incurred by participants and the profits received by the insurance companies. These arrangements are not required to be managed in the sole interests of the participants and will never produce a rate of return achieved by a properly allocated passively managed portfolio. So why is this a better solution for participants?

These products are attached with volumes of disclosures that are confusing to participants and beneficial to the insurance companies who issued the products and their disclosures. The old "disclose yourself out of trouble rule" has been widely adopted. They bury the disclosures of unnecessarily complex investment strategies in these documents which have no meaning to the participants, while at the same time allowing the investment companies to enter into risky investment strategies that often produce additional revenue sources to the companies with no regard to the suitability for participants.

4. The threat of mandatory usage as alluded to in the RFI, has undoubtedly come up as a result of significant lobbying efforts. Who is this really going to benefit? We are going to promise participants some minimal payment stream that could quite frankly be achieved without the execution of any sophisticated investment skill to keep them from spending their own money too fast. On the other hand and more importantly, we are going to guarantee the future product growth, assets under management and profits to our nation’s largest financial powerhouses. And the fact is that’s why so much money is being spent on selling the Department on this initiative. Mandatory usage is absolutely absurd under the current structure and limitations of liability blessed upon the financial companies.

I think a history lesson is important here. We already bought these sales pitches when we passed the QDIA regulations. We gave mutual funds a free pass to self deal and full discretionary authority to take unnecessary risks with 401k accounts, while guaranteeing they would have no liability for doing so by reiterating their exemption time and time again. Then we guaranteed record product growth and profit streams by allowing them to automatically default participants into fraudulently represented junk!

Do you really believe these target date products which claim to manage volatility yet in many cases offered greater volatility than a 100% allocation to US equities for Americans two years from retirement incurred the losses by accident? I hope not, as there are plenty of independent investment authorities who saw this coming. This investor experience was incurred by design. The products were built, as Mr. Bush so famously put it, using “fuzzy math.” And they sold this scheme to you all with the support of this fuzzy math. Backtesting index allocations to design age appropriate investment allocations makes a lot of sense on the surface; however, the fraud occurred during implementation when they used their active managers, who do not manage according the those same indexes, to fill each asset category.

The Department continues to ignore that target date funds are made up of around 70% of employee benefit assets, they provide investment advice and assume full discretionary authority and should incur fiduciary status by every single ERISA measure. Thanks to the ongoing efforts of the ICI we continue to close our eyes to this cute little set of facts.

I realize we are not at the target date hearing and you requested testimony on lifetime income options, but in order to recognize what’s being pitched to you today as it has for a couple years now, a history lesson packaged with a reality check was necessary.

The lifetime income pitch is no different. Just like target date funds, the industry has already created lifetime income funds. Most of your providers here today have already been pitching these schemes to plan sponsors since the 2008 catastrophes and the simple fact is – it just isn’t selling! This was their same problem with target date funds prior to 2006. They have a product manufactured that they need moved, that is the simple truth in all of these stories of righteousness. They are hoping to score big just like they did after lobbying extensively for QDIA. You guys buy into the stories of how they are going to save the world and they get to make a lot of money with minimal liability. It truly is a marvelous scheme they keep repeating every couple years.

Americans do not go to work every day, year after year, to line the pockets of the financial industry. In case the people here to pitch you today are unaware, slavery was abolished in this country in 1865. So forcing plan participants to give the financial firms part of their paychecks is in itself unconstitutional. This money will not be available in its entirety to participants, because it is not required to be managed in the exclusive interests of the participants since the bulk of the money will be held at mutual fund complexes and insurance companies. And you have confirmed they do not have to manage money in the interests of participants and are in fact blessed with the free pass to self deal at the expense of the very people you are charged with the responsibility to protect.

The reality is the industry doesn't need this regulation. These products have been on the shelves for years, they are called annuities. They routinely self deal with no consequences in those products and have since they were created. Now they want you to guarantee the growth of the products and more importantly the profits by forcing participants into them. When exactly is enough, truly enough?

You cannot hide behind the conviction the SEC and State Commissioners are handling these problems and pass another regulation merely to benefit these self interested lobbyists. At some point, this is just crazy.

We can't bake rat poison into cookies and tell fiduciaries and participants that grandma baked them so therefore they must be wonderful.

In regards to the 4th Issue posed by the agencies – the Fiduciary Safe Harbor for Selection of Lifetime Income Issuer or Product, my comments are as follows:

1. Additional guidance is necessary in order to comply with the requirements set forth in the 26 CFR 2509.95-1 Interpretive Bulletin. In addition to the guidance, compliance needs to be enforced. Many plans currently have annuities being sold to participants, yet in few situations have fiduciaries spent much time evaluating or approving these products. It is not uncommon for the products to be sold by the service provider's call center and oftentimes these transactions occur unbeknownst to the fiduciaries who are liable for the suitability of such offerings. We have reviewed plans with 30+ annuities listed on the 5500s, most of which have undoubtedly been sold by the call center or education providers without the explicit review and approval of the plan fiduciaries.

2. One of the tasks imposed on the plan fiduciary is to evaluate the costs associated with the products. This is virtually impossible under the current reporting requirements of these vehicles and it is unclear at this point whether the new 408(b)(2) disclosure regulations will rectify this issue. I have already explained the issues around figuring out the costs associated with fixed annuities and in both fixed and variable annuities the buried costs associated with complex investment strategies are not currently reported to fiduciaries or other investors. Therefore, compliance with this rule has been nonexistent and clearly not enforced by the Department.

3. In the limited instances where fiduciaries have performed some sort of minimal review of the annuity products that have been sold to their participants, they certainly are not performing this same evaluation effort on an ongoing basis. Reality is that the service providers often sell a variety of annuity products over the years to a participant population. There is always some new sales initiative to get new products or features out to their client base and the call centers are a key distribution center for getting those sales. So, you will find that a plan that has been around a while and serviced by a provider that employs an aggressive call center team will contain many unique annuity products which have been sold to participants. This makes it almost impossible for fiduciaries to engage any sort of ongoing evaluation process which is part of their obligations. Furthermore, because these products are often imbedded with creative lock up features, it is

pointless for fiduciaries to engage an ongoing process as they cannot terminate the product without imposing significant costs on participants and making themselves vulnerable to a lawsuit.

4. It is imperative for the Department to understand the product issues relating to the use of annuities and recognize that no real fiduciary oversight has been or could have been truly engaged. Again, at this time, it is not clear that the 408(b)(2) regulations will rectify these concerns.

In summary, while I realize there is a conglomerate of leading financial institutions encouraging you to make Lifetime Income Options a mandatory aspect of participant directed retirement plans, I urge you to consider why exactly they are pushing so hard to sell you on this concept.

Do you see one single plan participant, making an average American salary, who does not represent a financial powerhouse or special interest group waiting to testify before you today?

Do you see one single special interest group that "actually" represents participants, instead of merely claiming to do so by representing a membership of financial powerhouses and plan sponsors, before you today?

We all know the answer to these questions. But the point is certainly worth making given what we are pondering with this initiative. With a few exceptions, we are listening to highly paid, highly educated industry leaders here today. Who all come to you with a "pitch" to "save" American's from themselves and force them to divest their hard earned retirement savings over a lifetime in their firm's proprietary products.

Leading this effort today as they did not too long ago during the QDIA "pitch" you also see the ICI and various large industry associations. Why are these people here? Is it to protect the American Dream or are they here for no other reason but to lobby for another product at the urging of their financial industry members? Again, I think we all know the answer to these questions.

The effort is admirable, but the reality is we do not hold our product manufacturers to any requirement of managing these products in the sole interests of who they are designed for and sold to. Allowing any default or mandatory arrangement into these vehicles should not be a consideration without significant regulatory overhaul and the imposition of extensive liability on those who will manage and profit from this initiative.

We cannot pass another regulation that guarantees the future income stream and product growth for the financial firms at the expense of selling out the retirement savings of the people who worked all of their lives to earn this money.

I wish you luck in this journey through the mud.

Thank you,

Jessica Flores