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Testimony Of
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On Behalf Of The ERISA Industry Committee

Before The Employee Benefits Security Administration, U.S. Department Of Labor And The Internal Revenue Service, U.S. Department Of The Treasury

At The Joint Hearing On Issues Regarding Lifetime Income Options For Participants And Beneficiaries In Retirement Plans On September 14, 2010

Good morning. My name is Allison Klausner, and I am pleased to appear before you today on behalf of The ERISA Industry Committee, generally known as ERIC.

ERIC is a nonprofit association committed to advancing the employee retirement, health, incentive, and welfare benefit plans of America's largest employers who directly sponsor comprehensive retirement and health benefits to tens of millions of employees and their families.

I am honored to serve as the chair of ERIC's Task Force on Lifetime Income. Over the past decade, there has been a significant movement among employers away from defined benefit arrangements to defined contribution plans. As a result, employees have greater responsibility for, and control over, their retirement planning decisions. The Task Force is charged with providing guidance and support to the Agencies as they develop regulations designed to secure during retirement the savings of tens of millions of workers,

I have served as an Assistant General Counsel, Benefits for Honeywell International Inc. for the past seven years. I provide counsel on retirement issues, including the distribution of retirement plan assets.

At Honeywell, I partner with our employee benefits administration and operations teams, as well as those in human resources. It is these people who are in the trenches every day with workers and their families while they face difficult choices in a complicated world with regard to their employer sponsored retirement plans.

While working with Honeywell's employee benefits and human resources teams, I hear our employees' concerns about whether they are saving enough, diversifying adequately, and selecting a retirement distribution option that is appropriate for them. In conjunction with various written plan materials and communications, Honeywell strives to provide our employees and retirees with the information and education needed to understand and comply with the increasingly complex and changing rules, in general, and to navigate the plan asset distribution process, specifically.

In recent years, a tremendous focus has been on the accumulation of retirement plan assets and the need to ensure that the accumulation is not eroded or adversely impacted by loans, in-service withdrawals or excessive fees. Although this focus remains, the employee benefits community has shifted some of its energy to review and consider the regulatory framework relating to the distribution of retirement income. I am pleased to speak to you today about how that regulatory framework should be designed so that the assets employees accumulate in these plans can be secure and enjoyed during retirement.

Let me commend the Agencies for addressing issues associated with the distribution of defined contribution plan assets. ERIC and its members are pleased that the Agencies recognize the importance of these issues and are considering our views.

I will comment on all five issues that are the subject of this hearing. My comments on the first three issues are closely related and I will combine them. These issues involve:

(1) addressing participant concerns about matters such as the risk of insurer insolvency, inflation, and premature death;

(2) providing useful information to participants; and

(3) furnishing participants with estimates of the size of their monthly benefits if their account balance were paid in the form of a monthly lifetime income.

Major employers, like Honeywell, sponsor a wide variety of defined benefit and defined contribution plans. As I am sure you are aware, in recent years, a number of large employers have announced the freezing of their DB plans or the closing of their DB plans to new participants.

Although Honeywell continues to provide defined benefit plans to many of its employees, there are strong indications that, nationally, the percentage of employees who derive all or most of their employer-sponsored retirement benefits from DC plans is likely to increase in the years ahead.

Under most private sector major-employer sponsored DC plans, the default form of distribution is a lump sum, and the overwhelming majority of DC plans do not offer installments or annuities as a distribution option. And, with respect to DC plans that provide other forms of distribution, ERIC members report that nearly all participants take the lump-sum option. Likewise, ERIC members report that 80% to 90% of the employees who have a lump-sum option under a DB plan elect to take their benefits in a lump sum.

Retirees who take their benefits in a lump sum are subject to the risk of overspending and outliving their retirement savings. Others may spend too little and live more frugally than necessary. Without a doubt, a growing body of research suggests that employees (our future retirees) would be well advised to address these risks by including one or more annuity contracts in their investment portfolio.

The mismatch between the academic research and employee behavior may be attributable to employees' lack of information and understanding. Many employees don't understand what annuities are, how they might be helpful, or what they are paying for in choosing an annuity. Many believe that annuities are costly, risky, vulnerable to inflation, a poor investment if the annuitant dies early, and precludes leaving any assets to their heirs.

Many are also unsure of where to go to obtain reliable information about annuities and other lifetime income arrangements.

Major employers would like to help employees but are concerned that any assistance that they provide will expose them to fiduciary liability under ERISA—that no good deed will go unpunished.

We have some concrete suggestions on how to address these concerns.

The Agencies should embark on an educational initiative to acquaint employees and retirees with:

- the potential risks and benefits of investing in annuity contracts;
- how to compare contracts and how to compare annuity contracts with self-funding options;
- how to evaluate an issuer's financial condition and how to evaluate state guaranty associations; and
- how to obtain more information about annuity contracts.

The Agencies should partner with the Department of Education to undertake a major initiative, starting with our students, to improve the financial literacy of the Nation's workforce. Although it might not be realistic to expect students and younger workers to focus on retirement issues, the educational process must begin early in order to maximize its effectiveness.

Many employees and retirees are accustomed to receiving useful, accurate and unbiased information from their current or former employers. The Department of Labor should make clear that employers can educate their employees and retirees about both savings and distribution options without being threatened with fiduciary liability and exposing themselves to litigation or penalties. IB 96-1, regarding investment education, is a precedent that the Department should follow with regard to distribution education.

Helping employees to estimate the size of the annuity that can be purchased with their account balance could also be useful—as long as employees are cautioned appropriately about the uncertainties associated with estimates. But there is no reason to require every plan administrator to prepare such estimates on its own. Indeed, most plans would be wary of doing so.

Instead, the Agencies should establish a website that allows individuals to make such estimates, after inputting key assumptions, such as the size of the account balance, interest rate, age, and annuity commencement date.

If—contrary to ERIC's recommendation—an annuity estimate were required to be included in each participant's account statement, generic examples should suffice. Plan administrators cannot reasonably be required to provide individualized estimates based on volatile and unpredictable factors, such as the size of the participant's account balance and annuity purchase rates at an uncertain future date.

The fourth issue relates to changes in the Department of Labor's regulation regarding the selection of annuity providers to make benefit distributions from defined contribution plans.

The Department has characterized its regulation as a safe harbor. In fact, it is not. Merely characterizing a regulation as a safe harbor doesn't make it a safe harbor.

Under the regulation, a fiduciary's selection of an annuity provider satisfies the duty of prudence only:

- if the fiduciary engages in an *objective, thorough and analytical* search;
- *appropriately considers* information that is sufficient to assess the annuity provider's ability to make all future payments;
- *appropriately considers* the cost of the contract in relation to the benefits and services to be provided;
- *appropriately concludes*, at the time of the selection, that the annuity provider is financially able to make all future payment; and
- *if necessary*, consults with an *appropriate* expert or experts.

The Department's regulation is not a safe harbor. It does not provide that the law will be considered satisfied if specific objective steps are taken. Rather, the Department's regulation is laced with critical but vague terms that require subjective judgments.

The DOL should establish a genuine safe harbor based on objective and uniformly applicable criteria, such as approval by an independent fiduciary that meets criteria specified by the DOL or the issuer's receipt of a given rating by one or more rating agencies approved by the DOL.

The fifth issue relates to in-plan and out-of-plan lifetime income distribution options. Experience has shown that offering in-plan annuity distribution options is not attractive to employees and just doesn't work.

As I have explained, ERIC's members report that when a DB plan offers a lump-sum option to retirees, a vast majority of the retirees elect the lump-sum option. This is true even though the annuity is the default option and even though married participants need spousal consent in order to elect a lump sum.

This DB experience indicates quite persuasively that requiring DC plans to offer annuity distribution options would be a pointless and costly exercise and, for many employers, yet another disincentive to offering a plan.

By contrast, it remains appropriate to permit the distribution of DC plan assets be in the form of a lump sum and, to the extent retirees choose to have their benefits paid in the form of annuity, to permit the retirees to roll their lump sum into a vehicle outside the employer-sponsored plan that supports a lifetime stream of income.

DC plans that rely on out-of-plan distribution options offered by insurers, mutual funds, and other financial institutions have chosen, in effect, to assign responsibility for the design and marketing of distribution options to firms that are in the business of designing and marketing such products. This is an entirely sensible approach in my judgment, and it should be encouraged.

This concludes my prepared remarks. I will be happy to address any questions that the members of the panel might have. Also, if it would be helpful, ERIC will be delighted to supplement my comments. And we are prepared to work with the Department to ensure a regulation that provides workers with appropriate information and choices and employers with a secure and objective regulation.

Thank you for your attention.

ERIC

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