May 28, 2013

To: Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor, Room N-5655
200 Constitution Avenue, N.W.
Washington D.C. 20210, USA

ATTENTION: RIN 1210-AB20 Pension Benefit Statements

Thank you for allowing Unified Trust Company, NA to comment on the Department's consideration of a rule that would require a defined contribution participant's "total benefits accrued" to be expressed as an estimated lifetime income stream of payments, in addition to being presented as an account balance.

Unified Trust Company has spent the past six years developing the UnifiedPlan®. This system is a Qualified Default Investment Alternative ("QDIA") defined goal process that is communicated by expected retirement monthly income illustrations[1]. It is implemented by the discretionary plan trustee, and seeks to provide a fiduciary managed actuarial solution to create a "pension like" experience for the defined contribution plan participant. We have demonstrated that this approach can materially improve outcomes[2]. Today we have more than 11,000 participants utilizing this system[3]. We believe our experience can help you formulate a better regulatory policy.

We have a significant amount of experience with the inherent difficulties and problems with monthly retirement income projections, or what are called "gap reports" in the industry today. We agree that income projections can be very useful for the defined contribution plan participant. We also agree that all future balances and income projections should be in current (inflation adjusted) dollars. Thus we are in general agreement of the Department's goals, but believe several modifications are quite necessary.

We believe that unless certain steps are taken the statements can do more harm than good. Our concern is that an over simplified methodology can unintentionally mislead the plan participant. In particular, we are concerned that the proposed "safe harbor" methodology will lead to widespread adoption by most vendors since it will be perceived as the only "safe choice", even though it might give materially inaccurate projections and stifle innovation.

We believe six modifications will greatly improve the proposed rule by adding flexibility and help more plan participants to reach retirement success. We have incorporated these six modifications into item seven, which are our suggestions for Department's safe harbor language.

[1] Kasten, G. "The Defined Goal Retirement Plan" Journal of Pension Benefits. 17, 1 (pp 23–44) Autumn 2009
[2] https://www.unifiedtrust.com/library/index.cfm#unified-plan
[3] Unified Trust Company UnifiedPlan usage data as of 4/30/2013

Modification of the Department's Proposed Rule:

1. Allow Inclusion of Annual Savings Escalators to Show Beneficial Impact
2. Eliminate the Safe Harbor Assumption for 7% Investment Return Forecasting
3. Allow Discretionary Employer Contribution Illustration Flexibility
4. Allow Inclusion of a Default Income Replacement Goal
5. Require Actuarially Sound Methodology
6. Recognize Stochastic Modeling ("Monte Carlo") Benefits and Limitations
7. Suggestion of Safe Harbor Rules for Projecting a Future Account Balance

1. Allow Inclusion of Annual Savings Escalators to Show Beneficial Impact

We know today how important it is to build "Intelligent Fiduciary Defaults" into defined contribution plan design that would include fiduciary oversight, a pre-defined income replacement goal, automatic enrollment, automatic escalators of savings and prudent portfolio management that takes into account each participant's funded ratio. The contribution assumption methodology promoted by the DOL does not take into account annual escalators of savings. The proposed language states[4]: *"contributions continue to normal retirement age at the current annual dollar amount, increased at a rate of three percent (3%) per year."* This essentially is a zero real growth contribution rate net of inflation. To be clear, we are not referring to higher than inflation projections of wage increases on contributions, but rather that the employee saves a higher percentage of pay each year.

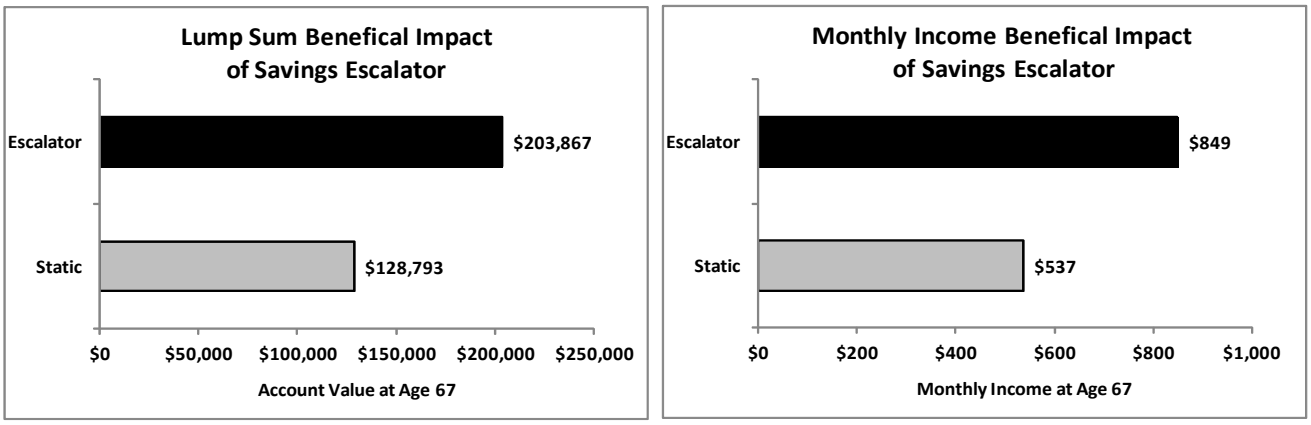
Although plan design is ultimately subject to the goals of the plan sponsor, when possible we strongly encourage plans to include both automatic enrollment and automatic escalators of savings. The details are maintained in the plan's Benefit Policy Statement ("BPS"), which outlines the process for setting, calculating and managing the retirement income goal. The reason for including the impact of savings escalators is consistent with the DOL's expressed goal of providing monthly income on the benefit statement in the first place[5]: *"Showing a participant the monthly retirement income he or she will receive from his or her retirement plan may help change that perception and, perhaps as suggested by many commenters, motivate workers to increase their savings."* On the contrary, to omit the impact of the savings escalator would cause the participant to not value the escalator program he is currently in.

As shown in Figure 1 below, the visual impact of the savings escalator is huge. This example assumes we have two 40 year old participants, each earning $50,000 per year, and are using Social Security Normal Retirement Age (age 67) for their retirement date. They both enroll in the plan at 6% of pay savings, but the escalating participant increases his savings via a default pathway 1% of pay per year to a final savings ceiling of 10% of pay. For this illustration each participant is assumed to earn a nominal 6% return, or 3% real return (adjusted for rounding) in a way that is consistent with their actual account holdings.

Thus for merely increasing savings just 1% per year for 4 years, the escalator participant has 58% more money either expressed as a lump sum or as a monthly benefit. Such an illustration is very powerful to keep the participant in the escalator program! Otherwise they might drop out if the benefit is not easily understood. The methodology and ceiling assumption must be clearly disclosed to the participant.

[4] DOL RIN 1210-AB20 Proposed Rule Pension Benefit Statements Page 18
[5] DOL RIN 1210-AB20 Proposed Rule Pension Benefit Statements Page 8

Figure 1: Beneficial Impact of Savings Escalator



2. Eliminate the Safe Harbor Assumption for 7% Investment Return Forecasting

The safe harbor 7% investment return assumption should be eliminated. In fact, there should be no market return forecast by the Department in the safe harbor language. There are four main reasons for the elimination.

First, any prudent projection of future returns for each participant should be based upon their actual holdings and capital market forecasts related to the asset classes making up such holdings. It makes no sense to project the same rate of return (7%) for a participant holding 100% small capitalization stocks as one holding a money market fund. The subtle message would be that the participant should always invest in the safest portfolio since the returns forecasted are the same. This is not consistent with Modern Portfolio Theory. In fact, it is in direct opposition to the DOL's stated goal: "*that the process should be consistent with generally accepted investment theory*[6]. In addition the asset allocation based returns should be adjusted downward by the fees paid by the participant. Otherwise participants in a high fee plan (250 basis points) and a low fee plan (50 basis points) would be given the same projected rate of return. This would send the message to plan participants that fees inside 401(k)s do not matter.

As an analogy, imagine the confusion if the income projection used the average savings rate for the plan, rather than each participant individually. "Low Saver" participants saving 2% would be shown the same monthly income as "High Saver" groups saving 12%, if the illustration was based on an average savings rate of 7%. This same confusion holds for an average rate of return assumption.

One of the more useful best practices we have currently in place with the UnifiedPlan is illustrating to the participant the improvement in their forecasted monthly income if their portfolio allocation is changed to a higher expected rate of return. The risk of this approach is also considered. This change in monthly income is the key reason the participant has an understanding for the rationale for the portfolio change recommendation. If a static 7% return is used in all cases it will be very difficult to explain and illustrate to participants why they should ever change their asset allocation.

[6] DOL RIN 1210-AB20 Proposed Rule Pension Benefit Statements Page 17

The second, and most important reason, is that the forward looking prediction of 7% nominal (approximately 4% real net of inflation) is likely too high for a typical participant in a balanced portfolio or target date fund. Assume the participant is invested in a 60% equity portfolio and 40% fixed-income. The most recent Federal Reserve publication of median CPI data lists inflation at 2.1%[7]. The current Wall Street Journal 10 year Treasury bond yield curve indicates the 10 year Treasury bond yield was 1.9%[8]. Thus the real return, before fees, of the 40% fixed income portion was -0.2%. Assuming 100 basis points in total plan fees, the real net of fee return on the fixed income portfolio is currently -1.2%. Thus the "return contribution" from 40% fixed income is -0.48% (40% x -1.2%).

This means that the "return contribution" from 60% equity for a 4% overall real return must be +4.48% net of fees (+4.48% -0.48%= 4.0%). To achieve this, the net of fee real equity return must be +7.46% since 60% of this figure is +4.48% (60% x +7.46%). Again adding back the 100 basis points in total plan fees, the average real return must be +8.46% for equities, or +11.46% on a nominal basis. This is substantially higher than most experts predict today for the equity markets, by some 200 to 500 basis points[9]. It is substantially higher than the rationale used in the DOL proposed regulation[10].

The third reason is that the safe harbor static 7% return interferes with an asset-liability driven investment strategy to manage asset allocation. We have shown outcomes can be improved by linking asset allocation to the funded status of each plan participant[11]. In general participants are typically overfunded at market tops and underfunded at market bottoms. No system can consistently time the market and we discourage such activity. But using generally accepted investment theory, along with capital market forecasts consistent with the plan participant's actual holdings, the funded status (asset/liability ratio) can be calculated for each participant that include several scenarios to increase the asset and decrease the liability. By making small changes to the asset allocation (decreasing risk when over funded and increasing risk when underfunded) the outcomes can be improved but this requires having matching return assumptions to the changes made in the asset allocation. Thus there must be a realistic connection between the asset allocation and the forecasted return.

Finally the fourth reason is that a "straight line" 7% analysis does not take into account the uncertainty by different asset allocations that can be somewhat understood by stochastic modeling or now more importantly by deterministic model[12]. Without risk being part of the equation, the asset/liability ratio funded status cannot be as prudently managed. Straight line return analysis does not include any measurement of portfolio risk. Indeed it treats 100% stock and 100% money market allocations as holding exactly the same risk.

3. Allow Discretionary Employer Contribution Illustration Flexibility

The proposed DOL regulations were silent about differences between types of employer contributions. Our experience has shown big differences between the willingness of employers to illustrate reasonably certain future

---

[7] Federal Reserve Bank of Cleveland CPI data press release May 16, 2013

[8] *Wall Street Journal* bond yield curve data May 21, 2013

[9] Interview with David Blanchett, Head of Retirement Research for Morningstar on May 13, 2013 indicating Morningstar Retirement Manager uses +2.0% real return estimate for a 50% stock 50% fixed income portfolio

[10] DOL RIN 1210-AB20 Proposed Rule Pension Benefit Statements Pages 22-23

[11] Kasten, G., Blanchett, D. "Improving Retirement Success by Managing the 'Target-Date'" Journal of Pension Benefits. 18, 2 (pp 17-27) Winter 2011

[12] Kasten, G. "Using a Simplified Deterministic Model to Estimate Retirement Income Sustainability, to be published Journal of Financial Planning, July 2013

employer contributions such as 401(k) matching employer contributions, versus discretionary profit-sharing contributions.

There are still many defined contribution plans (money purchase pension and straight profit sharing plans) today that are funded only with employer contributions. In addition there are many 401(k) plans that have both employer discretionary profit-sharing contributions and employer 401(k) matching contributions. In some cases even the 401(k) matching contributions are discretionary if not part of a safe harbor match arrangement.

We have found many plan sponsors are not comfortable forecasting and illustrating account balances with employer contributions that in the future may ultimately not be contributed. Other plan sponsors want their employees to see the benefit of these contributions, even if discretionary, and desire to include such data on the participant statement. We believe flexibility must be maintained with regards to discretionary employer contributions. The plan sponsor should make this decision.

Unified Trust Company best practices indicate that this should be determined on a case-by-case basis with the plan sponsor deciding whether or not to include discretionary contributions into the future account balance forecast. In addition disclosure language should be included for a discretionary contributions that makes clear they are not guaranteed, and may be discontinued in the future, and the future account balance may be smaller than illustrated.

4. Allow Inclusion of a Default Income Replacement Goal

Defined Contribution plan participants can be characterized by five significant financial behaviors: inertia, procrastination, choice overload, endorsement, and framing[13]. Their behavior is a significant reason why Congress and the Department adopted QDIA, automatic enrollment, and other automated plan features as part of the Pension Protection Act of 2006[14]. In addition their behavior is why the DOL is considering illustration of monthly income. However most plan participants cannot fully relate the monthly income to a goal, since the majority of plan participants have no income replacement goal.

Unified Trust Company, as part of the UnifiedPlan process, provides a predetermined income replacement goal for each for participant at the time of plan enrollment. The goal has three components. The defaulted goal seeks to replace 70% of income counting Social Security, as near as possible to the Social Security Normal Retirement Age, and with the least amount of risk if multiple portfolio strategies allow the participant to be fully funded based on prudent actuarial calculations.

Because most defined contribution plan participants have no retirement income replacement goal, it is important to give them a defaulted goal. In fact we have found more than of 80% of participants do not change the income replacement goal from what they were defaulted into as part of the QDIA process[15]. Illustrating monthly income without comparison to any meaningful income replacement goal will not be as useful.

---

[13] Mitchell, O. and Utkus, S. "Lessons from Behavioral Finance for Retirement Plan Design", Pension Research Council Working Paper, PRC WP 2003-6 (2003)

[14] PPA 2006 Rationale Preamble EBSA Proposed Rule Default Investment Alternatives Under Participant Directed Individual Account Plans [09/27/2006] Volume 71, Number 187, Page 56805-56824

[15] Unified Trust Company UnifiedPlan usage data as of 4/30/2013

Finally, plan sponsors must have flexibility with regards to the illustrated retirement age because many participants will not be able to meet their income replacement goal at age 65, or even at Social Security Normal Retirement Age. The Department's safe harbor requirement to use the plan's normal retirement age is inadequate. Most plan sponsors select the normal retirement age off of a plan adoption agreement "checklist" rather than having any thoughtful relationship to the actual demographics of their workforce.

Stated differently the solution must be adequate income replacement at any variable retirement age. What the Department is proposing is a static retirement age with a variable amount of monthly income. This will lead to the majority of participants being woefully underfunded.

5. Require Actuarially Sound Methodology

It is important for each vendor providing the analysis to the plan sponsor and plan participants to use a holistic process that is actuarially sound. At least once every three years the vendor performing the analysis should have the methodology reviewed by an independent actuarial firm and certified that the process, when viewed in its totality, meets generally accepted actuarial practice.

6. Recognize Stochastic Modeling ("Monte Carlo") Benefits and Limitations

The straight line 7% return analysis does not take into account the risk, or uncertainty, that plan participants must deal with in managing their investment accounts. This is particularly important as plan participants move closer to their expected retirement date, as many learned in 2008[16]. We are also concerned that Monte Carlo ("stochastic analysis") can sometimes been seen to provide a high degree of certainty when that may not be the case.

Many financial planning software programs incorporate Monte Carlo probability analysis into a forecasting program to predict retirement income sustainability. As pointed out by several researchers, all too often financial planners and clients do not understand that Monte Carlo results are highly sensitive to even small changes in arithmetic (mean) return, standard deviation and other risk assumptions[17,18]. In fact, a recent study conducting analysis on ten different calculators revealed a wide range of results for a hypothetical retiree, with the lowest giving a sustainability probability of 48 percent and the highest was 88 percent[19].

In fact Nawrocki stated, *"Essentially, Monte Carlo simulation is useful only when nothing else will work. It has proved to be useful in academic financial and statistical research, but only when the data or the analytic solution is not available. This is not the case in the investment decisions typically faced by financial planners."* But the main focus of this commentary is not a criticism of Monte Carlo programs on the market today. Instead we have shown that a simplified deterministic model, based upon the same capital market inputs (expected average arithmetic return and portfolio volatility) can efficiently provide "Monte Carlo" type answers to retirement income sustainability. The deterministic model is simpler to use, and since it is not generating a new randomized distribution, the results are the same with each repetitive run[20].

---

[16] Senate Special Committee on Aging hearing on target date problems, Wednesday, October 28, 2009

[17] Brayman, S. "Beyond Monte Carlo Analysis: An Algorithmic Replacement for a Misunderstood Practice", Journal of Financial Planning, 2007

[18] Nawrocki, D. "Finance and Monte Carlo Simulation", Journal of Financial Planning, 2001.

[19] Milevesy, M. and Abaimova, A. "Will the True Monte Carlo Number Please Stand Up", Journal of Financial Planning 7, 4 July, 2006, pp 171–180

[20] Kasten, G. "Using a Simplified Deterministic Model to Estimate Retirement Income Sustainability, to be published Journal of Financial Planning, July 2013

The deterministic model is stable, always reproducible and highly correlated to Monte Carlo results. The deterministic model allows financial planners to easily incorporate customized withdrawal or success calculations into their proprietary workflows using a simple spreadsheet program.

The historical success and more recent failure of the "Four Percent Rule" can be explained by the ratio of the real withdrawal rate to the portfolio arithmetic average return, and also recent market related reductions in the expected geometric average return.

The deterministic method is especially useful for periodic "re-sampling" when using an adaptive approach to distribution planning, where the ongoing withdrawal rate is fluid and not constant, and can further improve the probability of success of a distribution strategy.

7. Simplification of Safe Harbor Rules for Projecting a Future Account Balance

Section 2520.105-1(d) rules and assumptions for projecting an account balance to normal retirement age should be changed to create a more simplified system, and, most importantly to not stifle innovation in the industry. Without a more simplified and open safe harbor virtually no plan sponsor would use any calculation methodology other than steps specifically described in the safe harbor.

This is indirectly pointed out in the DOL section on litigation[21]: "*...the Department is considering establishing a regulatory safe harbor under section 105 of ERISA for plan administrators to rely on when developing lifetime income illustrations for pension benefit statements. By specifying the precise standards and assumptions a plan administrator would use to make a lifetime income illustration on a pension benefit statement, a regulatory safe harbor would substantially reduce the likelihood of lawsuits against that administrator based on an imprudent or improper calculation of lifetime income.*" The corollary of this DOL statement is that plan sponsors not following the precise standards and assumptions would face potential lawsuits from disgruntled participants.

The safe harbor should be revised along the steps listed below:

(d) Rules and assumptions for projecting an account balance to retirement age.

(1) General. For purposes of paragraph (c)(2)(vi) of this section (which sets forth the requirement to project a current account balance to retirement age under the plan), projections shall be based on reasonable assumptions taking into account generally accepted investment theories. A projection is not reasonable unless it is expressed in current dollars and takes into account future contributions and investment returns.

(2) Safe harbor. The following set of assumptions, when used together, are deemed reasonable for purposes of paragraph (d)(1) of this section:

(i) Retirement age may be selected by the plan sponsor to be either the plan's normal retirement age, or the plan participant's Social Security Normal Retirement Age ("SSNRA").

---

[21] DOL RIN 1210-AB20 Proposed Rule Pension Benefit Statements Page 38

(ii) Contributions continue to retirement age at the current annual dollar amount, increased at a rate of three percent (3%) per year; and for those plan participants utilizing an annual escalator of savings deferral percentage increases, the plan sponsor may include projected future expected increases in deferral percentage rates.

(iii) Discretionary employer contributions may or may not be included in future calculations as decided by the plan sponsor.

(iv) Investment returns are based upon capital market forecasts relying upon generally accepted investment theory. Return forecasts should be reasonable when viewed in conjunction with each participant's actual holdings, and should take into account fees paid by the plan and the participant.

(v) A discount rate of three percent (3%) per year (for establishing the value of the projected account balance in current dollars).

(vi) At least once every three years the vendor performing the analysis should have the methodology reviewed by an independent actuarial firm and certified that the process, when viewed in its totality, meets generally accepted actuarial practice.

(vii) The assumptions and methods used in the safe harbor methodology should be clearly disclosed and explained to the plan participant in a way that does not require a sophisticated financial education.

_____

(e) Rules and assumptions for converting current and projected account balances into lifetime income streams. For purposes of paragraphs (c)(2)(vii) and (c)(2)(viii) of this section—

(1) Measuring lives. A lifetime income stream shall—

(i) Be expressed as a level monthly payment, payable for the life of the participant beginning on the assumed commencement date, as defined in paragraph (e)(4) of this section;

(ii) The plan sponsor may elect to also show a holistic retirement income projection which includes the participant's expected Social Security benefit. If the plan sponsor elects to show the Social Security benefit, it must be clearly differentiated from the income expected from the defined contribution plan balance.

(iii) If the participant is married, the plan sponsor may elect to illustrate the defined contribution balance as a level monthly payment, payable for the life of the participant beginning on the assumed commencement date, as defined in paragraph (e)(4) of this section, with a survivor's benefit, which is equal to fifty percent (50%) of the monthly payment payable to the participant, payable for the life of the surviving spouse. For this purpose, it is permissible to assume the spouse is the same age as the participant; and

(iv) Be based on the assumptions set forth in paragraph (e)(2) of this section subject to the requirements in paragraph (e)(3) of this section.

(2) Assumptions.

(i) General. The interest and mortality assumptions behind a lifetime income stream shall each be reasonable taking into account generally accepted actuarial principles.

(ii) Safe harbor. The following assumptions are deemed reasonable for purposes of paragraph (e)(2)(i) of this section:

(A) A percentage annual withdrawal strategy based upon a stated percentage rate, adjusted annually by 3% inflation, may be used as long as the process is consistent with generally accepted investment theory. The annual percentage withdrawal rate should be clearly disclosed to the plan participant.

(B) For lifetime annuity calculations a rate of interest equal to the 10-year constant maturity Treasury securities rate, for the first business day of the last month of the period to which the statement relates; and

(C) Mortality as reflected in the applicable mortality table under section 417(e)(3)(B) of the Internal Revenue Code, in effect for the month that contains the last day of the period to which the statement relates.

(3) Plan terms. If the plan offers an annuity form of distribution pursuant to a contract with an issuer licensed under applicable state insurance law, the plan shall substitute actual plan terms for the assumptions set forth in paragraphs (e)(2)(ii)(A) and (B) of this section.

(4) Assumed commencement date. For purposes of paragraph (e) of this section, the assumed commencement date shall be the first day following the period to which the statement relates, and the participant shall be assumed to be retirement age (as defined in section 3(24) of the Act) on this date (unless the participant is older than normal retirement age, in which case the participant's actual age should be used).

In conclusion, Unified Trust Company wishes to thank you for allowing us to comment on this important project. We hope our experience can be helpful to the Department in developing a rule to help more defined contribution plan participants retire successfully.

With Best Regards,

Gregory W. Kasten, MD, MBA, CFP®, CPC, AIFA®

Certified Financial Planner™
Certified Pension Consultant
Accredited Investment Fiduciary Analyst™

Chief Executive Officer
Unified Trust Company, NA