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TO: Employee Benefits Security Administration, U.S. Department of Labor

FROM: Morningstar, Inc.

SUBJECT: Comment Request on Presentation of Worker's Accrued Benefits as an Estimated Lifetime Income Stream of Payments, RIN 1210-AB20

Morningstar appreciates the opportunity to comment on the advance notice of proposed rulemaking about whether, and how, workers could receive an illustration of accrued benefits as an estimated lifetime payment stream. Workers have a difficult time visualizing how their savings might translate into sustainable retirement income. They also have a difficult time knowing whether or not they are on track to reach their retirement goals. Illustrations of the income stream from accrued benefits greatly help investors better save and plan for retirement, and many financial services companies are offering innovative educational tools and materials in this area.

While we support the Department of Labor in this effort to encourage the use of such illustrations, we do not believe that new rulemaking in this area will provide significant benefits and could have unintended consequences. Millions of plan participants already rely on advice and managed account programs that illustrate sustainable spending in retirement to help them plan and save. In addition, according to the 2013 DC Plan Recordkeeping Survey conducted by *PLANSPONSOR* magazine*,* 72% of plan providers already supply participants with monthly retirement income estimates without a mandate or safe harbor.

We applaud the Department for recognizing that any new rules should not inhibit more advanced tools and resources currently in use or stifle innovation in this area, but this recognition may not go far enough. We are concerned that fear of non-compliance with the safe harbor guidelines could cause providers that previously offered highly tailored, sophisticated forecasts to simplify and generalize their illustrations to adhere to the explicit guidelines outlined in the rulemaking. This could result in less useful projections for a significant segment of participants.

While we do not support a mandate for projections or safe harbor guidelines, we would like to recommend some best practices for how providers could present income illustrations to participants. Morningstar's subsidiaries, Ibbotson Associates and Morningstar Associates, provide independent investment advice and managed accounts to defined contribution plan participants. These services include wealth projections and illustrations of sustainable spending in retirement. Morningstar researchers have conducted extensive studies on asset forecasting, capital market assumptions, and retirement income drawdown strategies. We also work closely with plan providers and sponsors to help them provide account reporting and educational tools and services to participants. Our work with plan providers, sponsors, and participants as well as our foundation in retirement research places us in a unique position to offer suggestions on how illustrations might best serve participants.

There are many reasonable ways to estimate future wealth and income, from very basic and universal calculations to extremely sophisticated and customized simulations. There is also a great deal of variation among providers in terms of the breadth and depth of participant information they have at their disposal for forecasting. Given the variety of forecasting techniques and participant inputs, what follows are minimum guidelines for basic forecasting and income illustrations as well as recommendations for more customized and sophisticated approaches:

Income Illustrations for Current Balance, Projected Balance, or Both?

Illustrations of how a current and projected balance would translate into retirement income should be displayed in tandem because both depictions provide important information to plan participants. The current balance is a known sum and income illustrations can give participants a good idea of how their current savings would translate into retirement income. While a projected balance may be slightly more difficult for participants to understand and relies on a number of assumptions, it can help participants who are years away from retirement gauge whether or not they may have enough money when they leave the workforce. Taken together, both income estimates should allow workers to make better-informed decisions.

Projecting the Balance

There are five key variables needed to make a wealth projection—current balance, years to retirement, future contributions, portfolio return, and inflation rate. The need for the current balance is obvious; however, to determine the years to retirement it is necessary to define the retirement age.

While Full Retirement Age as defined by the Social Security Administration is 66 for those born between 1943 and 1954 and 67 for those born after, the majority of Americans retire younger, either by choice or because of layoffs or illness. Because working even one additional year can have a significantly positive effect on a participant's retirement readiness, we think it is important for the default retirement age to reflect actual participant behavior as closely as possible. Ideally, the participant would indicate the planned retirement age, but barring that, the plan sponsor itself is in a good position to know what the average retirement age is for its participant base. The retirement age could also be customized by industry, as participants in some professions tend to retire earlier than others. If a plan provider does not have the capability to use customized retirement age defaults at the individual or plan level, then age 65 could be a reasonable input as well.

We believe that projections should be shown in today's dollars and take into account future contributions and investment returns. A 3% per year contribution increase in future savings is a reasonable assumption as it is in line with the long-term inflation rate and salaries tend to rise with inflation. Better yet, providers could offer more personalized projections using actual participant salaries and contribution rates.

With regard to investment return, current bond yields have historically been a good predictor of bond returns over the subsequent decade, and current yields of 10-year government bonds are approximately 2.5%. While these rates may rise to the long-term average in time, a prolonged period of low bond yields will have a significant effect on participants' ending wealth. Our 20-year forecast for the stock market is just under 8%, and the costs of investment and plan administration fees can average around 1% each. Given these inputs, we believe a 6% nominal return forecast would be a reasonable and conservative assumption for a 60% equity and 40% fixed income portfolio. Further, to simplify the forecasting process, we suggest using a real rate of return because it eliminates the need to discount the future income stream back to today's dollars. We believe a real rate of return of 3% (a 6% nominal return reduced by a 3% inflation rate) is an appropriate assumption today.

A more tailored approach would be for providers to forecast the return of a participant's actual asset allocation, either statically over time or assuming it changes over an average participant glidepath. They could also model the actual investment and administration fees the participant pays.

Converting Savings into an Income Stream

To convert savings into an income stream we suggest the simple, yet effective Required Minimum Distribution (RMD) method. Used by the Internal Revenue Service, RMDs are the minimum amounts that a retirement plan account owner must withdraw annually when he or she reaches 70½ years of age or retires—whichever is later. The RMD method significantly simplifies the income estimation process and eliminates the need to consider interest rates and spousal mortality as well. Moreover, research by Blanchett, Kowara, and Chen (2012) and Sun and Webb (2012)[1], among others, have estimated the high relative efficiency of the RMD approach.

The percentage withdrawal is determined by dividing one by the remaining retirement period. For example, if a participant has an account balance of $100,000 and wants to know the income it could produce over 20 years, the answer would be $5,000 per year (1/20=5.0%; 5.0% of $100,000 is $5,000). The only variables necessary to calculate the RMD withdrawal percentage are retirement age (or current age if already retired), estimated (or actual) balance at retirement, and an ending (or death) age. We can estimate the first two variables based on steps noted previously. We suggest that the ending age should be age 90 or 10 years past the current age, whichever is older, rather than an age based on mortality calculations. Because life expectancy is, by definition, the average age of death, half of all participants will live beyond this age. Investors are commonly encouraged to plan beyond the mortality tables to reduce the chance of running out of money, and we think the income illustrations should do the same. Planning to age 90 will capture the life expectancy of 75% of the U.S. population according to the 2009 Social Security Administration Period Life Table. Alternately, a tool or illustration that allows participants to see income levels or probabilities of success for different mortality ages would be beneficial.

Some participants hold annuities or other types of insurance products within their defined contribution plans. When calculating the projected retirement balance, we believe that regardless of whether a participant holds mutual funds, cash, stocks, or in-plan annuities, it would be reasonable to treat these investments equally to simplify the forecasting process. Providers who want to provide additional information, however, could instead consider the specific attributes of the income guarantees. When converting holdings to income, we suggest using the RMD method for the traditional investments—stocks and funds—and the contracted or guaranteed payment amount for the insurance investments.

Lastly, any projection or income stream calculations should have prominent, easy-to-understand disclosure that explains all assumptions and emphasizes that projections are not guarantees and that actual results may be materially different from estimates.

Mandate or Encourage

Because the majority of plan providers are already offering income illustrations and more providers are likely planning to add them, a mandate may not be necessary. However, we believe that the Department

[1] Blanchett, David, Maciej Kowara, and Peng Chen. 2012. "Optimal Withdrawal Strategy for Retirement-Income Portfolios." *The Retirement Management Journal*, vol. 2, no 3: 7-20.
Sun, Wei and Anthony Webb. 2012. "Should Households Base Asset Decumulation Strategies on Required Minimum Distribution Tables?" Center for Retirement Research at Boston College Working Paper: http://crr.bc.edu/wp-content/uploads/2012/04/wp_2012-10-508.pdf.

should use its influence to strongly encourage the use of and best practices around income illustrations via speeches, opinion pieces, and other public channels and platforms.

Morningstar appreciates the opportunity to provide comment on the advance notice of proposed rulemaking, and strongly supports the Department in its effort to promote income illustrations. Although some retirement needs are filled by pensions and Social Security, there is often a large gap that can only be funded with personal savings. Making the right savings, investment, and drawdown decisions to provide income for life, however, is a challenging puzzle for workers. They must confront financial market risk, inflation risk, and longevity risk, and they need the help of experts in the financial services industry. Income illustrations can go a long way toward helping investors gauge their retirement readiness and make changes today that can significantly affect their retirement years tomorrow. We look forward to continuing to work with the Department and would be happy to share additional thoughts about how best to educate investors about sustainable income in retirement.

Sincerely,

Morningstar, Inc.