2018 Advisory Council on Employee Welfare and Pension Benefit Plans
Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA) –
Focus on Decumulation and Rollovers

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Issue Chair Ms. Haverland, Issue Vice Chair Ms Scapino, and members of the ERISA Advisory Council, thank you for the honor and opportunity to submit a statement of testimony focused on decumulation from individual account retirement savings plans (e.g., 401(k), 403(b), 457(b), Individual Retirement Accounts (IRA), etc.) PSCA is a non-profit national association of employers who sponsor individual account retirement savings plans for their workers. PSCA members believe that voluntary profit sharing, 401(k), 403(b) and related retirement savings programs strengthen our free-enterprise system, empower and motivate workers, improve domestic and international competitiveness, and provide a vital source of retirement income.

Summary

The plan sponsor's point of view or perspective on retirement income differs from that of other industry professionals. Effective promotion of lifetime income includes solutions which anticipate and recognize that:

- Most workers will experience a career of varied employment and diverse retirement benefit coverage,
- Retirees have been and will continue to be a diverse group reflecting varied combinations of work and leisure, who will need flexibility to meet income replacement and other irregular financial needs, and
- Preconditions to an adequate retirement income include:
    - Greater accumulations of savings – prompting changes that will increase coverage, participation, and contribution rates while reducing leakage, and
    - Highlighting readily available, easily accessed retirement income sources.

The ERISA Advisory Council may want to consider including in its recommendations:

- Acknowledging that full and/or partial annuitization is not optimal for all retirees,
- Endorsing two safe harbors recommended by the Government Accountability Office (GAO):
    - Clarifying the safe harbor from liability for selecting an annuity provider, and
    - Providing fiduciaries legal relief when offering a mix of annuity and withdrawal options.
- Encouraging service providers to adopt 21st Century banking functionality (electronic banking) and (re)consider Deemed IRA in order to:
    - Acknowledge retiree and worker behavior changes in financial transactions/processing,
    - Facilitate retirement income in the form of installment payout processes,
    - Accommodate account consolidation/aggregation and post-employment contributions, and
    - Improve plan loan repayment functionality.
- Facilitating amendments/guidance for plan sponsors of individual account retirement savings plans who want to voluntarily adopt a default retirement income payout form, and

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[1] This information is provided solely in my capacity as someone with knowledge and experience in the industry and not as legal advice – based on my experiences in a plan sponsor role at Fortune 500 employers, as a legal research and compliance attorney for mostly small/mid-sized employers, as an independent benefits consultant and in my current role as Executive Director of the Plan Sponsor Council of America. The issues presented here may have legal and tax implications. This information is not (and should not be used as a substitute for) legal, accounting, actuarial, tax or other professional advice. My comments are my own and do not necessarily reflect those of any employer, educational institution or trade association I have been employed by or affiliated with, past, present or future.

- Acknowledging that where Target Date Funds (TDF) are deployed as a QDIA incorporate annuity investments or other retirement income concepts, there is a need for improved transparency - perhaps through encouraging greater use of Target Date Models (TDM), so as to improve participant knowledge of the underlying investment allocations, prepare participants for the next market correction, and confirm to participants the trends regarding deferral of retirement commencement and payout activity.

PSCA does not support the introduction of any new mandates for employer-sponsored, individual account retirement savings plans, nor any new mandated disclosures that would project retirement income.

Although comprehensive retirement income solutions may seem optimal, partial solutions, used individually or in combination, will offer value to participants while preserving needed liquidity, portability and flexibility.

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Varied Employment and Retirement Benefits Career

The primary purpose of a qualified, individual account, retirement savings plan is to provide retirement income. However, for most workers, retirement and the provision of retirement income is remote from their period of employment with all but their final plan/plan sponsor.[2] Census data suggest an emerging trend of turnover at older ages. For example, one study showed that while 90+% of those ages 58 – 62 work full time, the percent working for the same employer they had at age 50 declined from 70% (1983) to 46% (2006).[3]

Age 65 – 69 labor force projections show dramatic changes: male participation rates are projected to increase from 26.8% (1994) to 40% (2024), female participation rates are projected to increase from 17.9% (1994) to 32.8% (2024).[4] In 2015, fully 68% of surveyed workers plan to work past age 65, while only 30% of surveyed retirees actually did so.[5] The reasons cited for continuing employment included a wide range of perspectives, ranging from lack of money (71% workers, 37% retirees), adding assets to ensure financial security (69% workers, 51% retirees), and health benefits (50% workers, 34% retirees). Consciously or unconsciously, the actions confirm a diverse spectrum of demographic and financial circumstances.[6]

These and other employment developments, demographic changes, and trends in individual account retirement savings plans have resulted in a diversity of needs across a wide spectrum of "retirees" – which further complicate the challenge plan sponsors face in crafting "one size fits all" decumulation strategies and implementing payout solutions.[7] Similarly, these employment and coverage trends, as well as our history of repeated code and regulatory changes in tax-qualified, individual account, employer-sponsored retirement savings plans all but ensure that any new mandated disclosures that attempt to project retirement income while limiting those projections solely to employer-sponsored plans will be more misleading than informative because projections will vary among plans and may not apply to retirement asset accumulations in IRAs.

Participants typically pay most plan expenses. So, the cost and legal exposure from adding an annuity or QDIA with retirement income functionality may be shouldered by all participants – although most will not benefit.

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[2] Census Bureau, Employee Tenure in 2016, 9/22/16, Median tenure of American workers is < 5 years, 2.8 years for those ages 25 – 34. Accessed 4/17/18 at: https://www.bls.gov/news.release/pdf/tenure.pdf See also: Craig Copeland, Employee Tenure Trends, 1983 – 2016, Employee Benefits Research Institute, September 2017. The median tenure for all wage and salary workers ages 25 or older was 5.1 years. Accessed 6/10/18 at: https://www.ebri.org/pdf/notespdf/EBRI_Notes_v38no9_Tenure.20Sept17.pdf See also: Bureau of Labor Statistics, Number of Jobs, Labor Market Experience and Earnings Growth Among Americans at 50: Results from a longitudinal survey. 8/24/17. Individuals born between 1957-1964 are now age 50 – they held an average of 11.9 jobs from age 18 to age 50, half of those during the ages 18 to 24. Accessed 6/10/18 at: https://www.bls.gov/news.release/pdf/nlsoy.pdf

[3] Census Bureau, Note 2 Supra. See also: G. Sanzenbacher, S. Sass, C Gillis, How Job Changes Affect Retirement Timing by Socioeconomic Status, Boston College Center for Retirement Research, IB#17-3, February 2017. Figure 1 highlights that the percentage of employed men, ages 58 – 62, who changed jobs at age 50 or later has increased from ~30% (1983) to ~50% (2003) to ~45% (2013). Accessed 6/10/18 at: http://crr.bc.edu/briefs/how-job-changes-affect-retirement-timing-by-socioeconomic-status/

[4] Bureau of Labor Statistics, Projections of the Labor Force, 2014 – 2024, December 2016, Accessed 6/10/18 at: https://www.bls.gov/opub/mlr/2015/article/pdf/labor-force-projections-to-2024.pdf

[5] Society of Actuaries 2015 Risks and Process of Retirement Survey, Report of Findings, Accessed 6/10/18 at: https://www.soa.org/research-reports/2015/2015-risk-process-retirement-survey/

[6] National Center for Health Statistics, U.S. Life Expectancy at Birth, Age 65, By Gender, 2015. Male life expectancy at birth was 67.1 (1970), 71.8 (1990), 76.2 (2010) and at age 65, 13.1 (1970), 15.1 (1990) and 17.7 (2010). Female life expectancy at birth was 74.7 (1970), 78.8 (1990) and 81.0 (2010), and at age 65 17.0 (1970), 18.9 (1990) and 20.3 (2010). Accessed 6/10/18 at: https://www.cdc.gov/nchs/data/hus/2016/015.pdf

[7] Towarnicky, 401(k) Trends - Where We've Been and Where We May be Headed – Part 1, 04/18/2018, Accessed 6/10/18 at: https://www.psca.org/blog_jack_2018_23 ; Towarnicky, 401(k) Trends … Where we've been … Where we may be headed – Part 2, 04/23/2018, Accessed 6/10/18 at: https://www.psca.org/blog_jack_2018_24

For comparison, requiring participants to actively elect/decline a longevity annuity purchase may have value.[8]

Many plan sponsors favor retirement income distribution processes other than annuities because they are much less complicated and expensive to implement and maintain – yet they offer value to a much larger group of participants. Decisions to add in-plan retirement income features are typically not top priorities given diverse participant desires and the more than adequate, easily customized, decumulation/retirement income products/options in the IRA marketplace – such as those offered to Thrift Savings Plan participants.[9]

Some suggest retirement readiness is recovering from the Great Recession. However, "… 63% of all generations fear running out of money in retirement more than death … (and) 87% … believe there is a retirement crisis."[10] Despite increased life expectancy (including longer life expectancy at age 65), and despite demographic trends such as the aging-in of Baby Boomers, the demand for retirement income products remains relatively weak.[11]

Demand for annuities continues to be challenged by historically low interest rates, the pending fiduciary regulations, high fees (relative to other investments), and a variety of other factors.[12] Other data suggest that demand for such retirement income products may be weak in part because:

- Older workers may have more retirement income than is generally understood,[13] and
- Many current retirees find income from Social Security, vested pensions and required minimum distributions provide a more than adequate amount of retirement income.[14]

Annuitization May Not Be Optimal For All Retirees – PSCA Testimony of July 8, 2005

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[8] G. Gong, A. Webb, Evaluating the advanced life deferred annuity, an annuity people might actually buy, September 2007, Accessed 6/10/18 at: http://crr.bc.edu/wp-content/uploads/2007/09/wp_2007-151-508.pdf

[9] Withdrawing Your TSP Account After Leaving Federal Service, January 2018. "… Your annuity will be purchased from the TSP annuity vendor, currently Metropolitan Life Insurance Company. …" Accessed 6/10/18 at: https://www.tsp.gov/PDF/formspubs/tspbk02.pdf

[10] Allianz Life, Generations Ahead Study, 2017, Accessed 6/10/18 at: https://www.allianzlife.com/-/media/files/global/documents/2017/09/21/18/00/2017-allianz-generations-ahead-fact-sheet.pdf

[11] Kaiser Family Foundation population estimates using the Census Bureau's March 2017 Current Population Survey (CPS: Annual Social and Economic Supplements) – 2016 data: Adults ages 35 – 54, 82,072,200; Adults ages 55 – 64, 42,324,800; Adults age 65+, 49,273,900; Accessed 6/14/18 at: https://www.kff.org/other/state-indicator/distribution-by-age/ See also: A. Kurtz, Why Annuity Sales Are Slumping, US News, 9/29/17, Accessed 6/10/18 at: https://money.usnews.com/investing/investing-101/articles/2017-09-29/why-annuity-sales-are-slumping

[12] G. Iacurci, DOL fiduciary rule continues to take toll on annuity sales, Investment News, 2/21/18, Accessed: http://www.investmentnews.com/article/20180221/FREE/180229977/dol-fiduciary-rule-continues-to-take-toll-on-annuity-sales ; See also: IRI Issues Fourth Quarter 2017 Annuity Sales Report, 4/17/18. "… fixed and variable annuity sales totaled $192.1 billion, down 9.1 percent from 2016 total sales of $211.4 billion. …" Accessed 6/10/18: http://www.irionline.org/newsroom/newsroom-detail-view/iri-issues-fourth-quarter-2017-annuity-sales-report

[13] A. Bee, J. Mitchell, Do Older Americans Have More Income Than We Think? U.S. Census Bureau, July 2017. In 2012, households age 65+ had median income of $33,800, 9.1% lived in poverty. "… When we instead use an extensive array of administrative income records linked to the same CPS ASEC sample, … median household income was $44,400 (30% higher) and the poverty rate was just 6.9%. … the discrepancy is mainly attributable to underreporting of retirement income from defined benefit pensions and retirement account withdrawals. … that … most households do not experience substantial declines in total incomes upon retirement or any increases in poverty … We caution, however, that our findings apply to the population aged 65 and over in 2012 and cannot easily be extrapolated to future retirees. …" Accessed 6/10/18 at: https://www.census.gov/content/dam/Census/library/working-papers/2017/demo/SEHSD-WP2017-39.pdf

[14] Society of Actuaries, Post-Retirement Experiences of Individuals over 85 Years Old, May 2018, "… older Americans have learned to balance income and spending in the short run … (while) most have incomes of less than $2K per month (and have far fewer assets than might be recommended), they usually do not spend more than their income. … and they use these assets as an emergency fund (avoiding payouts) except to take the required minimum distribution, which they don't necessarily spend. …" See: https://www.soa.org/research-reports/2017/2017-post-retire-exp-85-years-old/

Clearly, valid retirement income strategies encompass both annuity and non-annuity approaches. PSCA specifically rejects new mandates – whether in the form of in-plan retirement income provisions or mandated disclosures in the form of retirement income projections. Mandates are ineffective at addressing the variations in individual circumstances. Annuity mandates do not identify options that offer optimal value to all participants. Most important, however, is that a mandate runs counter to the significant level of flexibility participants already have with regard to their individual account retirement savings plans - 401(k), 403(b), 457(b) and/or IRAs.

As PSCA's Executive Director, Mr. Wray testified in 2005: "… the government should not impose additional requirements on defined contribution plan sponsors unless there are compelling reasons to do so. There are no such compelling reasons for the government to mandate that annuities … be offered as distribution options from a defined contribution plan. In fact, requiring that plan sponsors make specific annuity products available through their defined contribution plans may harm the defined contribution system ..."

Our testimony noted the baseline of retirement income provided to most workers by Social Security. We also confirmed that "… there is no evidence that participants who choose not to purchase annuities through their plan (or via an IRA purchase) when they retire are harming themselves. …" noting "… Does it make sense to convert a lump sum to an annuity when the purchase rates are at historic lows? …"

The testimony also confirmed: "… plan sponsors do not provide annuities … for good reason. … (a) plan sponsor offering an annuity option must manage attendant administrative and compliance requirements. … Sponsors offering a plan annuity option assume fiduciary responsibly for selecting the annuity vendor. Sponsors know that where annuity options are offered they are not utilized. Also, their own employees have not asked for an annuity option. Finally, sponsors know that if a … retiring participant wants to annuitize some or all of their lump sum they can do so in an IRA. …"

While our testimony did not highlight all of the annuity compliance requirements, including mandated forms (Qualified Preretirement Survivor Annuity, Qualified Joint and Survivor Annuity) and unisex mortality pricing, we did confirm that those changes introduced inefficient pricing challenges that prompted a number of plan sponsors to *remove* in-plan annuities.[15] Sponsors know from their pre-REACT/Norris experience, their more recent money purchase pension plan experience and defined benefit plan studies,[16] that participants rarely select annuity payouts – even where an annuity is the mandated default payout option.

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[15] Retirement Equity Act of 1984, Pub.L. 98-397, 8/23/84. Arizona Governing Comm. v. Norris, 463 U.S. 1073 (1983). American Bar Association, Encouraging Pension Participants to Choose Lifetime Income Option, 2012. "… disadvantages to men of … in-plan unisex single life annuities was not fully offset by … (group) rates ... men can obtain more … (in) individual annuities. … longevity insurance annuities (are even more likely to be) … unfavorable (to) males. … (if there is substantial antiselection) no males will purchase an in-plan annuity … women will … (be) priced at female rates … ." Accessed 6/10/18: https://www.americanbar.org/content/newsletter/groups/labor_law/ebc_newsletter/12_spring_ebc_news/12_spring_aball_ebc_choose.html

[16] Sudipto Banerjee, Annuity and Lump-Sum Decisions in Defined Benefit Plans: The Role of Plan Rules, EBRI Issue Brief #381, January 2013. "… Amidst growing concerns about workers outliving their retirement savings, a key question—both as a matter of national retirement policy and understanding the potential role of plan design and education in influencing individual decision-making—is how many retiring workers actually choose to annuitize (to take a stream of lifetime income) vs. opting for a lump-sum payment. … This study shows that annuitization rates vary significantly across these different plan types … (workers ages 50 – 75 with 5+ years tenure and a minimum balance of $5,000 who had no payout restrictions) had an annuitization rate of only 27.3 percent. … In 2010, the combined annuitization rates for (all DB plans) for younger … workers was 5.2%..." https://www.ebri.org/pdf/briefspdf/EBRI_IB_01-13.No381.LSDs2.pdf

Little has changed in the past 13+ years. Despite dramatic increases in accumulated assets since 2005,[17] and despite significant demographic changes (~10,000+ Baby Boomers reach age 65 each day and a third of all Baby Boomers are now age 65+), PSCA survey data confirms no significant change in decumulation provisions offered by individual account retirement savings plans.[18] Further, participant preferences have not changed and are reflected by single digit annuity take-up rates – a level of interest that, for many, perhaps most plan sponsors, does not justify the administrative cost or fiduciary risk involved in offering an in-plan annuity.[19]

Academic and industry studies and survey results vary significantly when it comes to estimating whether Americans have and will have enough assets to allocate a portion as retirement income.[20]

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[17] ICI Factbook 2005, as of 12/31/04, mutual fund assets in retirement plans totaled $3.053 Trillion dollars, of which $1.566 T were in individual account, employer-sponsored retirement savings plans, plus $1.487T in IRAs, in total, representing 24% of all retirement assets. Accessed 6/10/18 at: https://www.ici.org/pdf/2005_factbook.pdf, See also: ICI Factbook 2018, as of 12/31/17, individual account employer-sponsored retirement savings plans had assets of $7.7T, while Individual Retirement Account assets were $9.2T, combined, they represented 60% of all retirement assets. Accessed 6/10/18 at: https://www.ici.org/pdf/2018_factbook.pdf

[18] PSCA's 52nd Annual Survey (2008) – 99+% offer lump sum payouts, 52% offer installment payouts, 21% offer in-plan and/or purchased annuities; PSCA's 60th Annual Survey (2016) showed minimal change, 90% offer lump sums, 59% offer installment payouts, 22% incorporated in-plan and/or purchased annuities. Of that 22%, 9.7% offered in-plan annuities. See also: Callan, Note 10, Supra. "… Very few plans offer in-plan guaranteed income for life products such as in-plan annuities (3.8%) or longevity insurance (1.9%) – and are not likely to offer in 2017. …"

[19] S. Shu, R. Zeithhammer, J. Payne, Consumer Preferences for Annuity Attributes: Beyond Net Present Value, Journal of Marketing Research, April 2006. "Decisions about life annuities are an important part of consumer decumulation of retirement assets … When descriptions of annuities are enriched with cumulative payment information, consumers no longer undervalue inflation protection, but nonlinear preferences for period certain options remain. … It has … been a puzzle that life annuities (are not) more popular … Demand … is correlated with demographics and psychographics. … First, respondents who have more money saved (>$75,000) like annuities less. This finding is a bit of a paradox … the people who can afford annuitization are the same people who are not interested in it. Second, more numerate consumers exhibit a higher preference for maximizing expected financial gain (the slope of their utility in expected gain is about 18% steeper than that of less numerate consumers), consistent with the idea that annuities are complex financial products that require the ability to "do the math" to understand. … respondents who consider annuities to be fair … like annuities more, consistent with behavioral explanations for the annuity puzzle … The highest-demand products are good "smart defaults" … medium-length period certain guarantees and no annual increases." Accessed 6/10/18 at: http://www.anderson.ucla.edu/faculty/robert.zeithammer/ConsumerPreferencesforAnnuityAttributes.pdf See also: J. Agnew, L. Anderson, J. Gerlach, L. Szykman, The Annuity Puzzle and Negative Framing, Boston College Center for Retirement Research, July 2008. "… Economists have suggested that individuals can achieve substantial gains to their welfare if they eliminate the uncertainty related to their lifespan by purchasing annuities. Yet the overall annuity market is much smaller than economic models would predict. This situation is what academics call "the annuity puzzle." … One theory … suggests that the limited demand for annuities could be caused by negative framing …" Accessed 6/10/18 at: http://crr.bc.edu/wp-content/uploads/2008/07/ib_8-10_508.pdf See also: Callan, 2018 Defined Contribution Trends, which confirms that the three most prevalent reasons a plan sponsor gave for not adopting an annuity were: Unnecessary or not a priority, uncomfortable/unclear about fiduciary implications, no participant need or demand. Accessed 6/10/18 at: https://www.callan.com/wp-content/uploads/2018/01/Callan-2018-DC-Survey.pdf

[20] T. Ghilarducci, M. Papadopoulos, A. Webb, "Inadequate Retirement Savings for Workers Nearing Retirement" 2017, The New School for Social Research. Authors estimate median account balance for DC Plans and IRAs for all workers ages 55 – 64 as $15,000 (where 35% have neither retirement savings nor DB coverage). Accessed 6/10/18 at: http://www.economicpolicyresearch.org/images/docs/research/retirement_security/Account_Balances_adjusted_appendix_tables.pdf See also: A. Munnell, Key findings in the National Retirement Risk Index, "… 50% of households are "at risk" of not having enough to maintain their living standards in retirement." Accessed 6/10/18 at: http://crr.bc.edu/special-projects/national-retirement-risk-index/

Other studies suggest many Americans are well prepared for retirement and that a substantial number can accommodate their retirement income needs.[21] Every month, tens of thousands of Americans are entering retirement – however each individual chooses to define that term.[22]

Insufficient assets is often asserted as the #1 reason for failure to purchase an annuity or adopt installment payouts of savings so as to create retirement income. Many recommend annuities as a means of closing any gap. Many view the immediate annuity as the perfect retirement vehicle – particularly for those concerned with outliving their money – as it offers a superior return due to mortality credits while resolving longevity risk. Many perceive the failure to annuitize as irrational behavior.

However, there isn't consensus among financial and economic professionals. Some now assert that an immediate annuity's value changes after a severe health shock – which creates a demand for liquidity (to cover treatment costs, custodial care) and reduces the residual value of the remaining annuity payments. Those researchers assert that for some, perhaps many, particularly those with modest or minimal accumulated assets, the most rational annuity allocation might be zero.[23] These same professionals suggest annuitization may be a better strategy for those in their 80s where the value of mortality credits may overwhelm the health shock risk.

So, regardless of which retirement future you believe will occur or whether you embrace immediate annuities as a perfect retirement vehicle, increasing coverage, participation, and contributions while reducing leakage can improve retirement preparation and facilitate achieving desired levels of retirement income.

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[21] A. Biggs, S. Schieber, Is There a Retirement Crisis? Summer 2014 "… Unsurprisingly, 92% of Americans believe that we face a retirement crisis … Probably the most detailed and best-vetted computer model for retirement purposes is maintained by … Social Security … (and) the Urban Institute … "Modeling Income in the Near Term" … In a 2012 study, SSA analysts used the MINT model to project retirement income for four groups: "depression babies," born from 1926–1935; "war babies" (1936–1945); "leading boomers" (1946–1955); "trailing boomers" (1956–1965); and "GenXers" (1966–1975). For each group, the study calculated replacement rates relative to inflation-indexed average lifetime earnings. The median, or typical, replacement rate for Depression Babies was 109%, rising to 119% for War Babies, and then gradually declining to 116% for Leading Boomers, 113% for Trailing Boomers, and 110% for GenXers. These figures indicate both that future generations of retirees typically will have incomes substantially exceeding the real incomes they enjoyed while working, and that replacement rates for future retirees will not be dramatically lower than for Americans retired today. Accessed 6/10/18 at: https://www.nationalaffairs.com/publications/detail/is-there-a-retirement-crisis

[22] S. Kolluri, C. Hutchins, Seven Life Priorities in Retirement, Pension Research Council Working Paper, 2016, Accessed 6/10/18 at: https://pensionresearchcouncil.wharton.upenn.edu/wp-content/uploads/2017/02/05-Kolluri-and-Hutchins.pdf See also: Merrill Lynch, Age Wave, Work in Retirement: Myths and Motivations Career Reinventions and the New Retirement Workscape, 2014, Accessed 6/10/18 at: https://agewave.com/wp-content/uploads/2016/07/2014-ML-AW-Work-in-Retirement_Myths-and-Motivations.pdf

[23] F. Reichling, K. Smetters, Optimal Annuitization with Stochastic Mortality Probabilities, NBER Working Paper 19211, July 2013. "… The conventional wisdom dating back to Yaari (1965) is that households without a bequest motive should fully annuitize their investments. … Annuities are investment wrappers that should statewise dominate all non-annuitized investments because annuities produce a mortality credit—derived from the pooled participants who die and forfeit their assets—in addition to the return from the underlying principal. … Numerous market frictions do not break this sharp result. … Yaari's paper has received considerable attention because lifetime annuities, paying a fixed amount each age until death, are fairly uncommon. … We modify the Yaari framework by allowing a household's mortality risk itself to be stochastic. Annuities still help to hedge longevity risk, but they are now subject to valuation risk. Valuation risk is a powerful gateway mechanism for numerous frictions to reduce annuity demand, even without ad hoc "liquidity constraints." **We find that most households should not annuitize any wealth.** (emphasis added by Towarnicky) The optimal level of aggregate net annuity holdings is likely even negative. Accessed 6/10/18 at: http://www.nber.org/papers/w19211.pdf See also: Sven H. Sinclair, Kent Smetters Technical Paper 2004-09, CBO, July 2004), Health Shocks and the Demand for Annuities, Accessed 6/10/18 at: https://cbo.gov/sites/default/files/cbofiles/ftpdocs/56xx/doc5695/2004-09.pdf

Aggregation/Consolidation of Accounts – Coverage, Portability, Leakage Avoidance

Some PSCA members believe aggregation/consolidation of assets and accounts is an obvious, rational precondition to increasing participant use of retirement income solutions. However, encouraging aggregation/consolidation will require coordinated changes among agencies, as well as statutory changes. So, the recommendations below anticipate that the DOL will reach out to Congress and coordinate regulatory actions with the Internal Revenue Service (IRS) and the Securities and Exchange Commission (SEC).

Most households are likely to encounter a diversity of retirement income sources, perhaps:

- Social Security,
- A defined benefit/defined contribution pension plan,
- An employer-sponsored, individual account retirement savings plan, and/or
- An Individual Retirement Account.

Multiply the above by two or three or more to reflect the multiple plans workers typically encounter during a working career. Further, multiply that result by two or three or more, in terms of complexity, for a married couple where both spouses were employed. There is great diversity here, in terms of benefits, payout provisions and potential commencement dates. Plan sponsor experience confirms that managing income streams with varied commencement dates and payout forms may be confusing to workers attempting to prepare for retirement.

Importantly, a significant portion of the assets accumulated in employer-sponsored retirement plans, including defined benefit and defined contribution pension plans, 401(k), 403(b), 457(b), employee stock ownership plans and other plans, have been and will be rolled over to IRAs.[24]

The key causes of small accounts are well known – our mobile workforce (resulting from turnover that is voluntary, involuntary, or due to changing business conditions), coupled with increased use of automatic enrollment features, and business growth, either by acquisition or organically. The challenges of small accounts for plan sponsors include higher plan costs (lower average balances often results in higher record keeping fees), missing participants, resolving uncashed checks, returned mail, increased fiduciary risk, etc.

A change that increases the involuntary distribution maximum while concurrently eliminating the involuntary cash out of balances of less than $1,000 will increase competition for IRA rollovers, reduce leakage and missing participants. It may also increase the percentage of plans that incorporate involuntary distribution/rollover provisions.[25]

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[24] ICI Factbook 2018. As of year-end 2017: "… employer-sponsored DC plans—which include 401(k) plans, 403(b) plans, 457 plans, the federal Thrift Savings Plan (TSP), and other private-sector DC plans—held an estimated $7.7 trillion in assets. … IRA assets totaled $9.2 trillion at year-end 2017, accounting for 33 percent of US retirement assets. … Investment returns and rollovers from employer-sponsored retirement plans, more than new contributions, have fueled the growth of IRAs. For example, the IRS Statistics of Income Division reports $473B was rolled over to IRAs in tax year 2015, compared with $64B that was contributed. Although most US households are eligible to make contributions to IRAs, few do so. Indeed, only 12 percent of US households contributed to traditional or Roth IRAs in tax year 2016 and very few eligible households made "catch-up" contributions (the additional contributions individuals aged 50 or older are allowed to make). …" Accessed 6/10/18 at: https://www.ici.org/pdf/2018_factbook.pdf

[25] PSCA, 60th Annual Survey, 2018. 18.5% of all plans do not involuntarily distribute monies, regardless of the balance. 27.9% of all plans only apply involuntary distributions to accounts of less than $1,000. 53.7% of all plans apply cash out provisions for accounts of up to $1,000, IRA rollovers for accounts between $1,000 and $5,000. Unsurprisingly, and for comparison, 33.9% of the smallest plans (< 50 participants) do not involuntarily distribute monies.

Studies show involuntary IRA rollovers have reduced leakage and the number of missing participants. Other studies show that leakage declines as account balances increase.[26] So, one option to consider would:

- Eliminate the up to $1,000 involuntary distribution cashout,
- Increase the maximum involuntary distribution that can be rolled over to an IRA to $20,000,
- Enable rollover of defaulted loans to IRAs (allow IRA vendors to accept the loan as an asset),
- Offer investment direction (in the form of a QDIA) for involuntary rollovers to IRAs, and
- Facilitate the aggregation/consolidation of all accounts a participant has with that IRA vendor.

Other recommendations include statutory and regulatory (DOL, IRS, SEC) changes that would facilitate account aggregation/consolidation, rollovers, and improved coverage options – including actions to:

- Update regulations to facilitate the adoption of Deemed IRA provisions,
- Encourage plan sponsors to clarify that employer-sponsored individual account retirement savings plans are separate legal entities, unaffected by a participant's change in employment status,
- Encourage service providers to adopt electronic banking functionality,[27]
- Encourage plan sponsors to add in-plan Roth conversion capability,
- Encourage plan amendments to delay defaulting a plan loan to the maximum permitted period,[28]
- Encourage addition of rollover provisions (rollover in and rollover out regardless of employment status, including facilitating the "rollover" of an outstanding loan),[29] and
- Encourage adoption of installment payouts, and an in-plan, penalty-free, installment "safe harbor".[30]

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[26] Leakage significantly declines once the account balance exceeds $15,000. Analysis also shows that IRA vendors are much more capable at locating and maintaining contact with participants who no longer work for the plan sponsor. Accessed 6/10/18 at: https://www.ici.org/pdf/2018_factbook.pdf See also: Vanguard, How America Saves, 2018. In Vanguard's 2018 Survey of 2017 activity, as account balances increase, leakage declines and assets are "preserved" – either by leaving assets in the plan or rolling monies to an IRA or a subsequent employer's plan. Specifically, the preservation rates were: 43% (accounts < $1,000), 65% (accounts of $1,000 - $4,999), 68% (accounts of $5,000 - $9,999), 75% (accounts of $10,000 - $24,999), 82% (accounts of $25,000 - $49,999), 89% ($50,000 - $99,999), 94% ($100,000 - $249,999), 97% ($250,000 - $499,999), 98% ($500,000+). Accessed 6/10/18 at: https://pressroom.vanguard.com/nonindexed/HAS18_062018.pdf

[27] 2017 Plansponsor Defined Contribution Survey, 26.2% of surveyed plan sponsors indicated Automated Clearinghouse (ACH) processing has been or will be added, 5% more are considering adding this feature in the future.

[28] A plan may provide that a loan does not become a "deemed distribution" until the end of the calendar quarter following the quarter in which repayment was missed. For example, if payments were due 3/31, 6/30, 9/30 and 12/31, and the participant made the March payment but missed the June payment, the loan would be in default as of the end of June, and the loan would be treated as a distribution at the end of September.

[29] The Tax Cuts & Jobs Act of 2017 allows "rollover" of outstanding plan loans until the due date (including extensions) for filing the return of tax for the taxable year in which such amount is treated as distributed from a qualified employer plan. Various studies confirm most loans are not defaulted during employment, while conversely, most outstanding loans are defaulted upon separation from employment. If the worker immediately obtains new employment with an employer that sponsors an individual account retirement savings plan that allows for loans, the receiving employer can implement plan provisions that will facilitate "rollover" and avoid leakage. It may require the receiving plan to offer two loans for this purpose. Here is an example: Prior Employer Plan Account Balance: $30,000, Outstanding Loan Balance At Term: $12,000:

- Step #1: Rollover remaining assets from prior plan to new plan. Receiving plan account balance now = $18,000.
- Step #2: Max loan, $10,000 taken from new employer plan,
- Step #3: $10,000 used to complete a partial rollover to the new employer plan of $10,000, receiving plan account balance now $28,000 of which $10,000 is an outstanding loan,
- Step #4: Repeat Step 2, take a second loan in the amount of $2,000 from the new employer plan,
- Step #5: Repeat Step #3, $2,000 used to complete the rollover to the new employer plan, receiving plan account balance now $30,000 of which $12,000 are two outstanding loans.

[30] PSCA, Note 16, Supra. 59% of plans offer installment payouts. Few plans avoid early withdrawal penalty taxes by offering a "substantially equal installment payout" provision as permitted at IRC §72(t)(2)(A)(iv).

The combination of changes noted above, particularly the combination of electronic banking functionality, rollover provisions and Deemed IRAs may increase account consolidation/aggregation, reduce leakage and the number of missing participants. Such provisions may also address a substantial portion of the coverage gap given the employment, turnover, and tenure data noted earlier.[31] Term vested participants who currently work for an employer that has not adopted a plan will have a new opportunity to continue participation. Just as important, term vested participants who are now part of the contingent workforce or "gig" or independent contractor workers will have the same opportunity.[32]

Plan sponsors do not agree with recommendations in the GAO study that would preclude them from disregarding rollovers when identifying balances eligible for IRA transfers. Plan sponsors would generally agree with the GAO's position that the current safe harbor investment provisions requiring investments with no risk to principal should be expanded to allow for use of a QDIA. Such a change would make IRA rollovers more attractive, to plan sponsors, IRA vendors and participants alike, despite the fact that the rollovers would include accounts valued at less than $1,000. The use of a QDIA would remove or reduce the potential loss when comparing retention of assets in the plan with an IRA rollover that uses a safe harbor investment with no risk to principal.

Of course, as is currently required, a participant/beneficiary will be notified of any pending involuntary distribution and solicited to either receive the distribution directly or make an election to roll over the amount to an IRA or an eligible retirement plan of her choice. Where the participant/beneficiary does not respond, the plan administrator would continue to be required to transmit the distribution to an individual retirement plan of a designated trustee or issuer and to notify the participant/beneficiary in writing.

Some plan sponsors have increased participation, coverage and contributions and reduced leakage by confirming that an individual account, employer-sponsored retirement plan is a separate legal entity where participation need not stop concurrent with employment separation. Too many workers believe that participation must end once employment ends.

Finally, plan sponsors would likely increase adoption of Deemed IRA provisions, and add retirement income features within those Deemed IRAs, where agencies implemented changes that include, but are not limited to:

- Protection of a plan's tax qualified status for any processing errors in administering the Deemed IRA provisions (treating each as if in a separate trust),
- Allow for a rollover to a Deemed IRA, prior to separation from service and/or attaining age 59 ½, where those monies are used to purchase a deferred annuity, and
- A firewall between the Deemed IRA and the remainder of the tax-qualified plan, so that annuity or other retirement income features could be added to the Deemed IRA (as an investment, as a payout form, etc.[33]) while leaving other qualified plan provisions unaffected (so that REACT and unisex requirements, etc. would not apply to either the assets in the qualified plan nor the assets in the Deemed IRA).

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[31] A. Munnell, D. Bleckman, Is Pension Coverage A Problem in the Private Sector, Boston College Center for Retirement Research, April 2014, Number 14-7, Accessed 6/10/18 at: http://crr.bc.edu/wp-content/uploads/2014/04/IB_14-7-508.pdf
Author's note: A myriad of other studies and analyses come to different conclusions about the actual level of coverage.

[32] Census Bureau, Note 2, Supra. See also: Bureau of Labor Statistics, Contingent and Alternative Employment Arrangements Summary, 6/7/18. In addition to workers at employers who have not adopted a retirement savings plan, BLS estimates, using Current Population Survey data, that in May 2017, 5.9MM held contingent jobs, 10.6MM Independent Contractors, 2.6MM "on-call" workers, 1.4MM temp agency workers, and 933k workers provided by contract firms. Accessed 6/10/18 at: https://www.bls.gov/news.release/conemp.nr0.htm

[33] Treasury Regulation §§1.408(q)(1)(c), (e), (f)(3) (g) (separate entities, application of distribution rules, separate annuity contracts, disqualifying defects)

Flexibility and Portability of Retirement Income Solutions

As noted earlier, many workers and retirees fear running out of money in retirement.[34] This fear and other factors give rise to the so-called "annuity puzzle".[35] Three voluntary solutions are suggested for consideration:

- Encouraging adoption of Deemed IRAs (see above) so that Roth 401(k) assets can be transferred to a Deemed Roth IRA with its more favorable, more flexible distribution provisions,[36]
- Amend IRC §401(a)(9), Minimum Required Distributions, to cap the mandated, annual payout at 5% of the prior year-end account balance,[37] and
- DOL guidance (and potentially a "safe harbor") for voluntary adoption of a default form of non-annuity, installment distribution payout option designed to maximize guaranteed, indexed retirement income.

While a few plan sponsors have fully embraced lifetime income solutions by implementing in-plan annuities, most plan sponsors have not adopted any decumulation strategy for their individual account, retirement savings plan other than tax code and ERISA compliance (required beginning date, required minimum distributions).

Survey data confirm many offer lump sum payment options (effectively transferring longevity and other retirement risks to participants), while a bare majority accommodate income needs through installment payments or ad-hoc withdrawal provisions. Most surveys confirm that less than 10% of plan sponsors offer an in-plan annuity.[38] While there is no regulatory or statutory mandate, some surveys also suggest that service providers voluntarily provide a projection of lifetime income to a majority of plan participants.[39]

Adding electronic banking/payout functionality, coupled with encouraging plan sponsors to add installment payout provisions, has been shown to increase asset retention and improve retirement preparation. For example, the 401(k) that has my lifetime of savings added loan provisions in 1996, eliminated hardship withdrawals at the same time, and soon thereafter, added electronic banking functionality. As a result, leakage was significantly reduced by curtailing hardship withdrawals and providing 21st Century functionality that allowed participants to:

- Continue loan payments post-separation,
- Initiate a loan following separation (if only to continue to defer taxation and avoid penalty taxes), and
- Initiate monthly installment payments at minimal cost to the plan.

This same plan made various other changes, including changing the "default" at separation to be continuation of the account (instead of automatically sending distribution paperwork at separation).

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[34] Allianz, Note 8, Supra.

[35] S. Shu, R. Zeithhammer, J. Payne, Note 14, Supra.

[36] Internal Revenue Service Publication 590-B (2017), Distributions from Individual Retirement Arrangements (IRAs). "… If you are the original owner of a Roth IRA, you don't have to take distributions regardless of your age." Accessed 6/10/18 at: https://www.irs.gov/publications/p590b

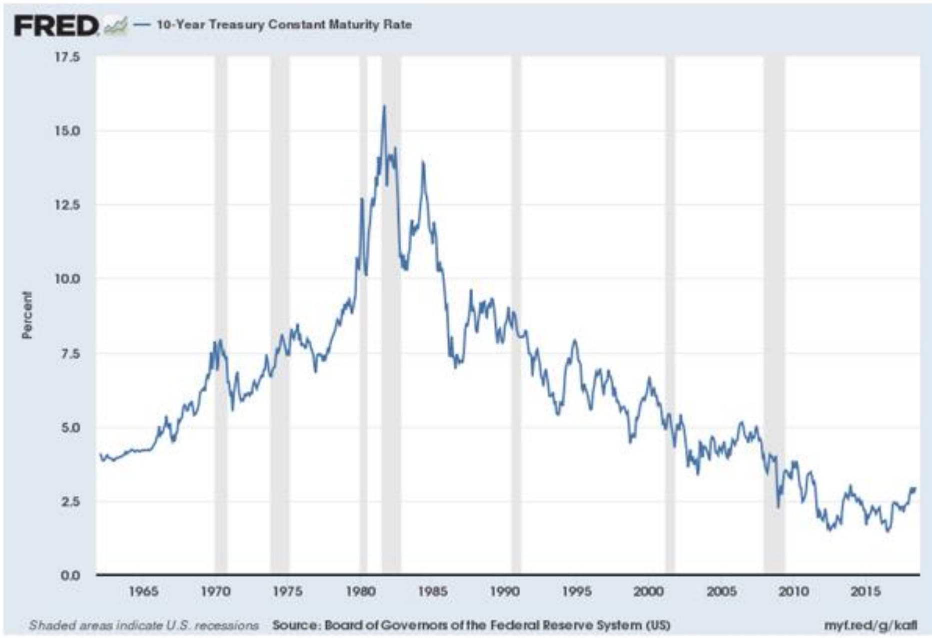
[37] Treasury Regulation 1.401(a)(9)-9, Q&A2, Uniform Lifetime Table, currently triggers distributions of 3.65% (age 70), 3.77% (age 71), 3.91% (age 72), 4.05% (age 73), 4.20% (age 74), 4.37% (age 75), 4.54%, (age 76), 4.72% (age 77), 4.93% (age 78), 5.13% (age 79), increasing thereafter.

[38] PSCA, Note 16, Supra. See also: Callan, 2017 Defined Contribution Trends, 10th Anniversary Edition, "… Very few plans offer in-plan guaranteed income for life products such as in plan annuities (3.8%) or longevity insurance (1.9%)—and are not likely to offer these in 2017." Accessed 6/4/2018 at: https://www.callan.com/wp-content/uploads/2017/01/Callan-2017-DC-Survey.pdf

[39] Callan, 2018 Defined Contribution Trends, 11th Anniversary Edition, 78.4% of surveyed plans provide a retirement income projection, 75% provided the projection on the benefits website, 24% on the participant statement; 79% provide a projection of monthly income in retirement, recordkeepers provided the projection 84% of the time. Accessed 6/4/2018 at: https://www.callan.com/wp-content/uploads/2018/01/Callan-2018-DC-Survey.pdf

Because of these, and other provisions, approximately $1.5B of the $5.0B in plan assets (as of 12/31/15) belong to participants who, like myself, no longer work for that employer.[40]

Non-annuity payouts may be superior retirement income options given annuity costs,[41] and low interest rates[42].



[40] For comparison, see: GAO: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants, GAO 16-433, August 2016. For comparison, the GAO recommends providing everyone distribution paperwork in a timely fashion concurrent with separation. "… We have also reported that existing federal requirements do not ensure plan sponsors provide complete and timely information on distribution options when participants separate from employment, and we recommended the Secretary of Labor develop a concise, written summary (see GAO-13-30). As a result, separation packets may arrive too late to be of use because, according to one service provider, once a participant separates from an employer it is likely too late to discuss lifetime income options with them." In terms of annuitization rates, the GAO confirms: "… The results of our record keeper questionnaire suggest relying on participants to make proactive decisions to ensure lifetime income has resulted in few participants selecting such options. Less than 1 percent of participants in plans covered by our record keeper questionnaire chose annuities, and less than 1 percent of participants chose systematic withdrawals. We previously reported that because people are prone to inertia and procrastination, a default option often becomes the most common choice when making financial decisions. … Furthermore, one record keeper told us in the 10 years it has had a lifetime income option available, only six clients have adopted it and only three participants have elected it. Another record keeper said that 27 percent of new plans were adopting a lifetime income option but that less than 1 percent of participants in those plans selected it." Accessed 6/10/18 at: https://www.gao.gov/assets/680/678924.pdf

[41] Fixed income annuities are a "transfer of risk" product – securing protection of principal and income for life. Annuity guarantees are only as good as the issuing insurance company guaranteeing them; plus, for individual annuity products, the state guaranteed fund, accessed 6/10/18 at: http://ncigf.org/public/guarantyfunds Deferred variable or fixed annuities include various charges – commissions, insurance/underwriting charges, underlying investment management fees, surrender charges, fees for riders (e.g., death benefit, long term care, etc.), and a contract fee. Whether deferred or immediate, a fixed income annuity will include an interest rate or a payout rate that reflects reductions for expenses and insurance company profits. Other items include: (1) "Opportunity costs": Monies invested in an annuity miss out on potential market returns, (2) "Tax costs": Pro-rata taxation, potential penalty taxes for early withdrawals prior to age 59 ½.

[42] Most annuity product pricing incorporates 10-year Treasuries which are currently at historically low levels. The single-premium immediate annuity SPIA is the annuity product that most reflects the 10-year Treasury. None of us knows where interest rates are going to go (short term or long term), and it is cavalier to say "well, interest rates have to go higher."

Upon reaching typical retirement ages, some surveys show that many American workers have not saved enough to make buying an annuity a viable option. Other surveys show that a significant number of Americans are not prepared for emergencies – whether the result of an interruption or variation in income or an expense shock.[43]

Because most participants only have a modest level of accumulated assets upon reaching retirement ages, our third recommendation is to provide guidance which would enable, but not mandate, plan sponsors to add a default form of installment distribution payout so as to "nudge" participants to consider lifetime income installments. This installment payout would be designed to maximize guaranteed, indexed monthly income. The service provider would be called upon to estimate the amount of individual Social Security benefits payable at age 70 deferred commencement. Then, taking that estimate or a projection provided by Social Security, the default payout amount would be set equal to the estimated Social Security benefits plus the initial Minimum Required Distribution amount.

Some researchers believe delayed commencement of Social Security is an optimal retirement income strategy.[44] Others described it as buying a cheap annuity from Uncle Sam. A retiree can, in effect, purchase annuity income by delaying Social Security benefit commencement. Every month of delay in commencement of Social Security after age 62 and before age 70, will increase a retiree's monthly benefit by .5% to .75%, about 7% - 8% per year. Because these Social Security benefit adjustments may be slightly greater than an actuarial adjustment, each dollar of retirement savings that is used to provide an income and delay commencement of Social Security effectively buys a larger stream of income than had those same monies been used to purchase an annuity.

I have solicited plan sponsors to consider adopting a default payout form for workers who elect to commence payout prior to reaching the required beginning date[45]; however, there appears to be minimal interest in the plan sponsor community without DOL guidance. So, this voluntary, in-plan, payout form default could be one of the "safe harbor" recommendations.

As with any default, the participant can opt out and make their own decision/election. And, of course, the participant retains total control over the residual account.[46] In that way, this "default" avoids asking participants to make a one time, permanent payout decision with regard to retirement savings. The "default" is comparable to a "level income" option designed to dovetail with Social Security benefits and RBD/RMD payouts, assuming Social Security benefits are delayed to commence at age 70.

Here is how I envision it would work. The income stream from 401(k), 403(b), 457(b) or IRA assets paid prior to age 70 would be a monthly amount equal to:

- The projected amount of Social Security (SS) benefit payable at age 70, plus
- The estimated RBD/MRD amount (assuming the payment stream reduces the available account balance).

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[43] Board of Governors of the Federal Reserve System, Report on the Economic Well-Being of U.S. Households in 2017, May 2018. "Four in 10 adults in 2017 (41%) would either borrow, sell something, or not be able pay if faced with a $400 emergency expense. While still disconcertingly large, the share of families who would struggle with such an expense has decreased over the past five years. In 2013, half of adults could not easily cover such an expense. …" Accessed 6/4/2018 at: https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf

[44] Steve Vernon, How to "Pensionize" Any IRA or 401(k), 2017. Accessed 6/10/18 at: http://longevity.stanford.edu/wp-content/uploads/2017/11/How-to-pensionize-any-IRA-401k-final.pdf

[45] Towarnicky, Looking For A Few "Good" Plan Sponsors, 11/28/17, Accessed 6/10/18 at: https://www.psca.org/blog_jack_2017_16

[46] For comparison, see: J. Tomlinson, We Can Build Better Retirement Products, But Will Anyone Buy Them?, Society of Actuaries Securing Future Retirements Essay Collection, May 2018, Accessed 6/10/18 at: https://www.soa.org/essays-monographs/2018-securing-future-retirements/

Upon reaching age 70, the participant would commence Social Security, and concurrently reduce the amount paid from the qualified plan to the estimated amount payable as the required minimum distribution.

Here are three examples – one commencing at age 65, two commencing at age 62 – all assume a median wage of $48,270 (1st Qtr. 2018, age 25+ full time), an age 66 SSPIA of $1,806 (90% of 1st $895, 32% of next $3,127), deferral for four years to age 70 @ 8% = $1,806 * 1.32 = $2,457 * 12 = $29,490 of annual Social Security income commencing at age 70:[47]

Example #1: Commence payout at age 65 (create a level income up to age 70, and up to MRD, assuming deferral of Social Security to age 70): Target annual income: $32,365 (67% replacement ratio):

- 401(k) Account balance at age 65 is $200,000, assumed 6% earnings in projection of balance to age 70,
- The annual payment from the individual account plan (401(k), 403(b), IRA) for five years between ages 65 – 70 would be approximately $32,365, $29,490 (what will be payable from SS at age 70), plus the estimated initial MRD payment of $2,875.
- At age 70, SS benefits would commence ($29,490), individual account payouts would decline to $2,875.

Example #2: Commence payout at age 62 (create a level income up to age 70, and up to MRD, assuming defer Social Security to age 70): $29,750 (62% replacement ratio):

- 401(k) Account balance at age 65 is $200,000, assumed 6% earnings in projection of balance to age 70,
- The annual payment from the individual account plan for eight years between ages 62 – 70 would be approximately $29,750, $29,490, plus the estimated initial MRD payment of $260.
- At age 70, SS benefits would commence, individual account plan payouts would decline to $260.

Example #3: Commence payout at age 62 (create a level income up to age 70, and up to MRD, assuming defer Social Security to age 70) as a means of facilitating Phased/Flexible Retirement/Employment: $32,750 (68% replacement ratio):

- Phased/Flexible Retirement/Employment at 50% of pre-retirement wages, $24,135, from ages 62 to 65,
- 401(k) Account balance at age 65 is $200,000, assumed 6% earnings in projection of balance to age 70,
- The annual payment from the individual account plan for the three years between ages 62 and 65 would be $8,615, $5,355 (the amount, when added to wages, creates $29,490 in income equal to estimated age 70 SS) plus $3,260 (the estimated initial MRD amount),
- The annual payment for five years between ages 65 and 70 would be $32,750, ($29,490 + $3,260).
- At age 70, SS would commence, payouts from the individual account plan would decline to $3,260.

[47] Author's calculations.

Government Accountability Office (GAO) Recommendations

The Plan Sponsor Council of America opposes new employer mandates – such as expansions in the already cumbersome number and variety of mandated disclosures.[48] The GAO study endorses a mandate to provide Lifetime Income Illustrations. Because of demographic, economic, financial, product, and employment trends, such projections are more likely to mislead than to inform.[49] That is particularly true where illustrations project future participation and contributions in the current, employer-sponsored plan as if employment would continue indefinitely and that the plan would remain in place, unchanged, for decades. If the goal is to increase participation and/or contribution rates among eligible workers, experience since the Pension Protection Act of 2006 confirms what works – automatic features.[50] Similarly, there is no documented, substantial change in participant behavior following addition of burdensome disclosure regulations.[51]

Generally, many PSCA members would agree with the first two GAO recommendations[52]:

1. Clarifying the safe harbor for selecting an annuity by providing sufficiently detailed criteria to better enable plan sponsors to comply with safe harbor requirements related to assessing a provider's long-term solvency.
2. Considering providing legal relief for plan fiduciaries offering an appropriate mix of annuity and withdrawal options, upon adequately informing participants about the options, before participants choose to direct their investments into them.[53]

While plan sponsors would appreciate agency guidance that confirms they can voluntarily adopt a "RMD-consistent" default form of payout, most PSCA members would not support agency action that favors one form of retirement income over another – including the GAO recommendations that the DOL "encourage" plan sponsors to favor service providers, recordkeepers, etc. who:

3. Include annuities from multiple providers on their record keeping platform,
4. Offer participants the option to partially annuitize their account balance,
5. Provide for unknown/unknowable future changes that affect the value of lifetime income guarantees, nor
6. Provide participant access to advice on lifetime income.

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[48] Towarnicky, Why Don't Employees Read What We Send Them? Would Reading Mandatory Disclosures Make A Difference, Anyway? 08/28/17, 8/30/17, 9/5/17, Accessed 6/10/17 at: https://www.psca.org/mandated_disclosure_testimony_part1 https://www.psca.org/mandated_disclosure_testimony_part2 https://www.psca.org/mandated_disclosure_testimony_part3

[49] Census Bureau, Note 2, Supra

[50] PSCA, Annual Survey, 2018.

[51] For example: DOL, Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, A Rule by the EBSA, 10/20/10, where the agency adopted extensive fee disclosure requirements. Accessed 6/10/18 at: https://www.federalregister.gov/documents/2010/10/20/2010-25725/fiduciary-requirements-for-disclosure-in-participant-directed-individual-account-plans ; See also: IRS, Disclosure of Relative Values of Optional Forms of Benefit, 1/12/04. "… The final rules consolidate the content requirements related to QJSA and QPSA notices and provide specific requirements for disclosing information (about) … the relative value of each available form of benefit as well as the financial effect of selecting a specific form of payment. … to provide enough information to the participant so that he or she can make an informed choice when selecting benefits. …" Accessed 6/10/18 at: https://www.irs.gov/irb/2004-02_IRB#TD-9099

[52] Government Accountability Office, 401(K) PLANS: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants, GAO-16-433: 8/9/16, Accessed 6/10/18 at: https://www.gao.gov/products/GAO-16-433

[53] Legal relief to fiduciaries should be granted whenever appropriate disclosures are provided – and - they should not be conditioned on an arbitrary definition of "appropriate" nor should they require a "mix of annuity and withdrawal options.".

Qualified Default Investment Alternatives (QDIA) As A Retirement Income Solution

Today, the three most important factors for plan sponsors in selecting retirement savings plan investments are litigation, litigation and litigation.[54] To obtain ERISA "safe harbor" protections, a fiduciary must prudently select and monitor the QDIA. In 2008/2009, the QDIA regulations had just recently been issued to facilitate the use of automatic features and investment changes.[55] Target Date Funds (TDF) were highlighted by those regulations. In a TDF, underlying investments must themselves be diversified and have materially different, "normally (age) appropriate" risk-return characteristics, to minimize overall risk thru diversification, by adjusting asset allocations and associated risk levels. A QDIA must comply with generally accepted investment theories.

In PSCA's 52nd Annual Survey (2008 experience), 55% of plans offered TDFs, however, the survey did not even ask a question about QDIAs. By 2016, 69% of plans incorporated a QDIA and 79% of those plans used a TDF.

Many plan sponsors were surprised that newly added TDF QDIAs didn't trigger more litigation after the 2008–2009 Great Recession market decline exposed significant differences in TDF allocations. A study of 2010 target date funds had equity allocations of: "… a startling range … from 72% to 26%."[56] Most do not know their TDF's equity risk exposure.[57] The Great Recession also triggered participant behavior changes – more participants plan to delay retirement. Most TDFs adopt target dates using five year increments (years ending in 0 or 5) closest to a participant's 65th birthday. Many studies show most participants accept the default. QDIA disclosures may need to more clearly confirm what a target date represents and the DOL might also consider modifications to glide path disclosures. A focus on improved understanding is needed before adding new complexity given widespread participant misunderstanding regarding TDFs and modest worker financial knowledge/capability.[58]

Retirees invest in stable value. The 401(k) that has my lifetime of savings added a GIC in 1980 (the crediting rate has steadily declined from double digits to ~3%). Despite that, as of 12/31/15, $1.7B out of $5.0B (34%) of plan assets are invested in the GIC. However, litigation involving stable value investments has never been as confusing as it is today.[59] Clarifying fiduciary duties in selecting stable value would be appreciated.

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[54] With apologies to Lord Harold Samuel (or someone in Chicagoland history). See: William Safire, "On Language", 6/25/09, NY Times Magazine. Accessed 6/10/18 at: https://www.nytimes.com/2009/06/28/magazine/28FOB-onlanguage-t.html

[55] Pension Protection Act of 2006, Pub. L. 109–280, 8/17/06. See also: 29 CFR 2550.404(c)-5, Fiduciary Relief for Investments in Qualified Default Investment Alternatives, [72 FR 60478, 10/24/07; 73 FR 23350, 4/30/08] Accessed 6/10/18 at: https://www.gpo.gov/fdsys/granule/CFR-2010-title29-vol9/CFR-2010-title29-vol9-sec2550-404c-5

[56] Morningstar, Inc. Target date Series Research Paper: 2009 Industry Survey. 9/9/09.

[57] Siegel & Gale, LLC, on behalf of the U.S. Securities and Exchange Commission (SEC) - Investor Testing of Target Date Retirement Fund (TDF) Comprehension and Communications, 2/15/12. "… Many respondents believed that the target date is the point at which the fund is at its most conservative allocation and that the allocation does not subsequently change. Only 36% … correctly indicated a TDF does not provide guaranteed income in retirement. Many (believed the TDF guaranteed) the original investment. … 54% failed to correctly indicate that TDFs with the same year in their names do not necessarily have the same mix of stocks and bonds at the target date. Over 50% of TDF owners expected that a TDF's stock allocation would be 40% or less at the target date. 45% believed it is important to know the asset allocation of a TDF at all times. Accessed 6/10/18 at: https://www.sec.gov/comments/s7-12-10/s71210-58.pdf

[58] Bidwell v. Univ. Med. Ctr., Inc., 685 F.3d 613. (6th Cir. 6/29/12). See also: Three Questions with Implications for Your Financial Future, Knowledge@Wharton, 2/11/15, Accessed 6/10/18 at: http://knowledge.wharton.upenn.edu/article/three-questions-major-implications-financial-well/

[59] N. Ross, S. Block, Stable Value Funds: A Financial Investment with Risky Litigation Consequences, 12/18/17. "…there are three typical types of lawsuits filed against fiduciaries offering stable value funds. … 1) offering a stable value fund that is too risky and 2) offering a stable value fund that is not risky enough. … fiduciaries have also been sued for 3) not offering a stable value fund. … Only Goldilocks, it seems, could safely offer a stable value fund." Accessed 6/10/18 at: https://www.usbenefits.law/2017/12/stable-value-funds-a-financial-investment-with-risky-litigation-consequences/

The DOL may want to consider other changes that might improve transparency and participant understanding.

The DOL may wish to update guidance where the TDF is used as a QDIA - given the increase in delayed retirement, SOA decumulation studies that confirm widespread decisions to defer payout commencement,[60] variations in equity allocations for TDFs using the same target date,[61] and studies that suggest there is a "0" bias in TDF selection (that widespread industry practice of using target dates ending in "0" or "5" closest to age 65 may not be optimal).[62] The DOL may wish to review studies of TDFs with a glide path that increases the equity allocation after the target date as a means to reduce retirement risks and facilitate installment-based retirement income.[63]

The DOL previously accepted an annuity allocation within a TDF as prudent – even though the TDF no longer met the liquidity requirements to be a "qualified" default investment alternative.[64] Treasury issued guidance allowing deferred income annuities in target-date funds (TDFs) as a fixed income investment - even if the annuity feature TDF is only offered to older participants (who may disproportionately be highly compensated). Given current participant comprehension levels and TDF complexity, proposals that would allow a TDF with annuities as a fixed income allocation to qualify as a QDIA might further depress participant understanding.

One option would be to encourage use of Target Date Models (TDM) as QDIAs – particularly if the QDIA is permitted to include an allocation to a fixed income annuity. A TDM is a simple, no-cost set of electronic investment instructions that allocate all plan assets across the core investment options so as to mimic TDF asset allocation/glide paths/rebalancing. A TDM will:

- Improve transparency by highlighting, no less frequently than in each quarterly statement:
    - The actual allocation of assets (including any allocation to retirement income), and
    - The composition of each underlying investment.
- Improve fiduciary compliance as each core investment option is evaluated quarterly,
- Clarify/confirm situations where tactical allocations are used in a target date setting,
- Potentially Increase "open architecture" in QDIA/target date allocations to avoid proprietary fund conflicts,
- Potentially lower (avoid) investment costs by eliminating a layer of fees and achieving greater economies of scale – by concentrating assets in the Core investment options, and
- Reduce confusion/"choice blindness" among participants by reducing the number of investments.

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[60] Society of Actuaries, Note 8, Supra.

[61] T. McLaughlin, R. Dudley, Special Report: Fidelity puts 6 million savers on risky path to retirement, Reuters, 3/5/18, Accessed 6/10/18 at: https://www.reuters.com/article/us-funds-fidelity-retirement-special-rep/special-report-fidelity-puts-6-million-savers-on-risky-path-to-retirement-idUSKBN1GH1SI ; See also: Towarnicky, S&P STRIDE TDFs: Evaluating the Performance of Retirement Solutions, 10/31/17, Accessed 6/10/18 http://www.indexologyblog.com/2017/10/31/sp-stride-target-date-funds-making-strides-in-evaluating-the-performance-of-retirement-solutions/

[62] X. Liu, W. Zhang, A. Kalra, Zero Bias in Target Retirement Fund Choice, (undated). "… we find a strong "zero" bias in that investors exhibit a strong preference for TRFs which end with 0's … as compared to TRFs that end with 5's … bias manifests … with people with birth years ending in 0, 1 or 2 selecting TRFs that imply they intend to retire at 70 whereas those born in years ending in 8 and 9 select TRFs aspiring to retire at 60. … impact(ing) wealth accumulated by influencing the amount people contribute towards their retirement and exposing them to inappropriate levels of risk" Accessed 6/10/18 at: http://www.rotman.utoronto.ca/-/media/Files/Programs-and-Areas/Marketing/papers/Paper_ZeroBias_Liu_X.pdf?la=en

[63] W. Pfau, M. Kitces, Reducing Retirement Risk with a Rising Equity Glide-Path, The American College, McLean Asset Management, 9/13/13, Accessed 6/10/18 at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2324930

[64] DOL Information Letter, 12/2/16, "… It is the view of the Department that a fiduciary of a participant-directed individual account plan could, consistent with the provisions of Title I of ERISA, prudently select an investment with lifetime income elements as a default investment under the plan if it complies with all the requirements of 29 CFR 2550.404c-5 except for reasonable liquidity and transferability conditions beyond those permitted in paragraph (c)(5)(i) of the regulation." Accessed 6/10/18 at: https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/information-letters/12-22-2016 See also: Treasury Notice 2014-66, Accessed 6/10/18 at: http://www.irs.gov/pub/irs-drop/n-14-66.pdf

Attachment 1

2018 Advisory Council on Employee Welfare and Pension Benefit Plans

Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA) – Focus on Decumulation and Rollovers

The US retirement system continues to move toward individual savings via defined contribution plans (DC plans) and individual retirement accounts (IRAs). This trend has largely focused attention on individuals' asset accumulation, with more limited attention on understanding and/or educating people on the decumulation phase of retirement savings.

The 2012 Council examined the topic of income replacement in a retirement system predominantly underpinned by DC plans with a focus on understanding: (1) participant challenges, (2) alternative options available to create lifetime income, (3) plan sponsors' considerations and challenges in making lifetime solutions available, and (4) plan sponsors' considerations and challenges in educating participants about lifetime income.
The 2014 and 2016 Councils' focused on lifetime plan participation, trying to understand the following: 1.) problems associated with keeping assets in employer-sponsored DC plans during retirement, 2.) portability challenges preventing assets from moving between plans, and 3.) why solution sets were limited and inconsistent across the retirement system.

In 2016, the US Government Accountability Office ('GAO') issued a report entitled 'DOL Could Take Steps to Improve Retirement Income Options for Plan Participants,' which made several recommendations to the Department of Labor ('DOL') including: (1) clarify for plan sponsors criteria for selecting an annuity provider, (2) provide limited liability relief for offering an appropriate mix of lifetime income options, (3) issue guidance to encourage plan sponsors to select a record keeper offering annuities from other providers, and (4) consider providing required minimum distribution ('RMD') -based default lifetime income to retirees.

The 2018 Council's objective is to focus recommendations on promoting lifetime income within DC plans through providing further guidance on an annuity selection safe harbor and modifying the Qualified Default Investment Alternative (QDIA) rule to focus on asset accumulation and decumulation issues in the context of lifetime income needs and solutions. The 2018 Council intends to complement the previous efforts and not duplicate them. The 2018 Council will seek witness testimony that includes recommendations on the definition of the QDIA, portability of lifetime income solutions, opportunities and challenges with target date funds (TDFs) as they apply in accumulating and decumulating assets, and new or innovative solutions and approaches to addressing lifetime income.

Our study will include the following:

- Definition of Lifetime Income ('LTI') within a DC plan
- Rationale for including LTI features in a DC plan option
- Lifetime Income products and innovations in the DC market place or elsewhere
- Observations on the usage of Lifetime Income products in DC plans
- Analysis of QDIA Issues:
  - Current QDIA language and safe harbors
  - Definition of defaulted participants and notice requirements
  - Selection of annuity providers embedded in QDIA such as a Target Date Fund: who (e.g. plan sponsor, 3(38) managers) and how
- Assessment of Deterrents to incorporating LTI products in DC plans
- Review of Portability of LTI options including plan-to-plan rollovers
- Ideas to encourage participants' use of LTI products