Testimony to the 2024 Advisory Council on Employee Welfare and Pension Benefit Plans (the "ERISA Advisory Council") on the Topic of Qualified Default Investment Alternatives (QDIAs) - Start to Finish, Default to Payout

Kenneth E. Levine, FSA, *is Executive Director, Global Retirement Strategy, for RTX Corporation, one of the world's largest aerospace & defense companies, which was created by the April 2020 merger of United Technologies and Raytheon. Ken is part of RTX's Pension Investments team. His primary responsibility is overseeing the investment lineup of the $59 billion RTX Savings Plan. Ken's tenure with the company dates back to 1996, when he became the in-house actuary for a mid-sized manufacturing company, which, after a series of acquisitions, led him to an executive role in the Total Rewards group at the corporate office of UTC. Prior to going in-house, Ken spent a decade as a consulting actuary at Coopers & Lybrand and Mercer. Ken graduated from the University of Virginia in 1986 with a BA in Economics, and is a Fellow of the Society of Actuaries.*

Opening Statement / Executive Summary

Thank you for inviting RTX Corporation to testify today before the ERISA Advisory Council on the important topic of expanding the reach of QDIAs to the decumulation phase of defined contribution plan participants' journeys from workers to retirees. As the Council is aware from the prior testimony of my former RTX colleague Kevin Hanney, who is also here today to testify, RTX, formerly known as United Technologies Corporation, has utilized Lifetime Income Strategy as its QDIA since June 1, 2012. RTX believes, and with over 12 years of experience backing it up, that Lifetime Income Strategy as a QDIA is an effective way for RTX employees to build meaningful retirement income guaranteed to last for life, without sacrificing on the accumulation aspect. My written testimony will demonstrate this to you with some illustrations and by addressing some of the Council's questions regarding Lifetime Income Strategy that Issue Chair Jack Towarnicky was kind enough to send in advance.

In conjunction with AllianceBernstein, the investment manager of Lifetime Income Strategy since its earliest stages, we have prepared a summary of the Key Benefits of RTX's Lifetime Income Strategy and its use as the QDIA in the RTX Savings Plan:

- Addresses longevity risk – lifetime income guaranteed by multiple insurers to never run out
- Does not introduce regret risk nor mortality risk – participants always retain full liquidity and access to their assets and any remaining balance on death passes to heirs
- Marginal total insurance cost with transparent and explicit insurance fee – higher growth exposure than typical TDF has potential to cover the cost of insurance
- Retirement income with protection against Investment, sequence of return, and inflation risks – income does not reduce in bad markets and the investment portfolio's higher growth allocation and exposure to TIPs gives potential to increase during periods of high inflation
- Translating savings into guaranteed income has a positive impact on participant saving behavior – higher savings rate increases over time for those with secured assets

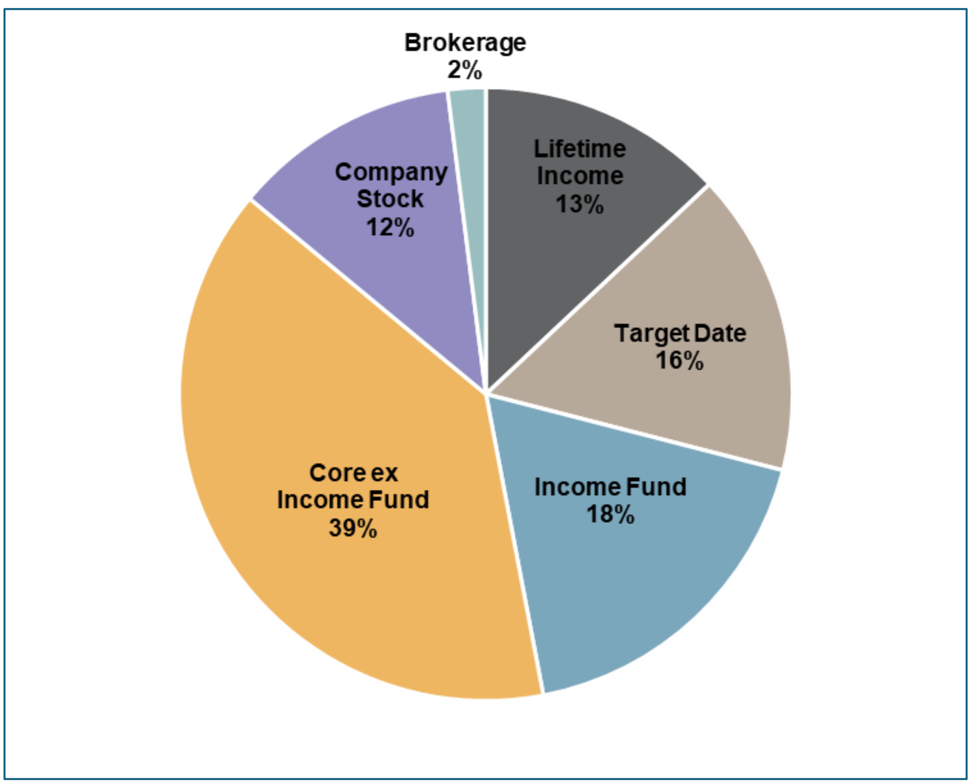
We believe by prudently incorporating fully revocable income insurance, maintaining significant growth exposure and eliminating the risk of running out of income, the RTX Lifetime Income Strategy will continue to deliver better outcomes to participants at a marginal cost compared to a typical TDF

When UTC implemented Lifetime Income Strategy into its Savings Plan in 2012, we anticipated that other plan sponsors would introduce guaranteed lifetime income products into their defined contribution plans. Unfortunately, by and large, this has not been the case, with some plan sponsors citing an uncertain regulatory environment or lack of a safe harbor design, among many other reasons. My view is that the lack of take up has more to do with misperceptions about these types of products and a pervasive lack of knowledge and understanding among the investment, consulting, and plan sponsor communities. However, we have witnessed renewed interest among our peer companies and the investing and consulting communities, and many innovative products for providing guaranteed lifetime retirement income within defined contribution plans have recently come to market.

RTX Savings Plan Current State

As of July 31, 2024, the RTX Savings Plan held total assets of $57.7 billion on behalf of 215,829 participants. Of this total participant count, 121,850 (56.5%) are current employees and 93,979 (43.5%) are former employees. Among eligible RTX employees, the participation rate is 93% with an average deferral rate of 10% of pay.

The asset allocation among all the Plan's investment options is shown in the chart below.



There is well over $7 billion invested in Lifetime Income Strategy, held by 117,888 participants – that is about 55% of total participants (60% of active participants and 47% of former employees) have at least a portion of their Savings Plan balance invested in Lifetime Income Strategy.

The RTX Savings Plan covers just about all US employees of RTX with a common design, the basics of which are:

- **Employee contributions of 0 to 50% of pay on a pre-tax, Roth, and/or after-tax basis**
- **Maximum employer matching contributions of 4% of pay (for employee at 6%+), PLUS**
- **Age-based company retirement contribution ranging from 3% to 7% of pay**
- **Auto-enrollment at 6% pre-tax contribution, with annual 1% auto-escalation, up to 10%**
- **QDIA is Lifetime Income Strategy**

<u>History</u>

As Kevin previously testified, UTC entered the 21st century keenly aware that traditional defined benefit pension plans would be phased out by most corporate plan sponsors, and defined contribution plans would rapidly become the primary vehicle for employees to build retirement income. UTC was no exception – the company closed the traditional final-average-pay pension formula to new entrants in 2002, closed the cash balance pension formula to new entrants in 2010, froze traditional pension accruals for those still earning them in 2014, and finally ceased providing additional cash balance pay credits in 2019. Indeed, **there was a need for the UTC Savings Plan to "function as a pension for the 21st Century" to enable these changes to the DB plan, and it became that with the June 1, 2012, introduction of Lifetime Income Strategy as an investment option within the Plan and the QDIA. This need became even more apparent with UTC's merger and acquisition activity, which included multiple, large-scale corporate transactions with companies who had also closed their traditional pension plans to new entrants prior to 2010. In each case, there was significant movement of DC Plan balances into the Lifetime Income Strategy, both by affirmative election and default.**

UTC also went through significant divestiture activity in the past decade, and, as is the case with most large corporations, many employees leave the company prior to retirement, working less than a full career with RTX. However, in most aspects (other than ongoing payroll contributions) the RTX Savings Plan treats former employees who maintain a balance in the Plan equivalently to active employees. That is, **former employees are permitted to continue to repay loans, take new loans, access all the investment options, including Lifetime Income Strategy, and, importantly, rollover balances into the Plan from IRAs, other employer plans, and lump sum payments from RTX's defined benefit pension plans.**

<u>Review of how it works and experience</u>

At its core, as a default option, Lifetime Income Strategy works for a participant like a Target Date Fund would in that its underlying investments consist of a portfolio of equity and fixed income investments with the mix following a glide path toward more conservate investments based on years until a target retirement date. However, there are several key differences:

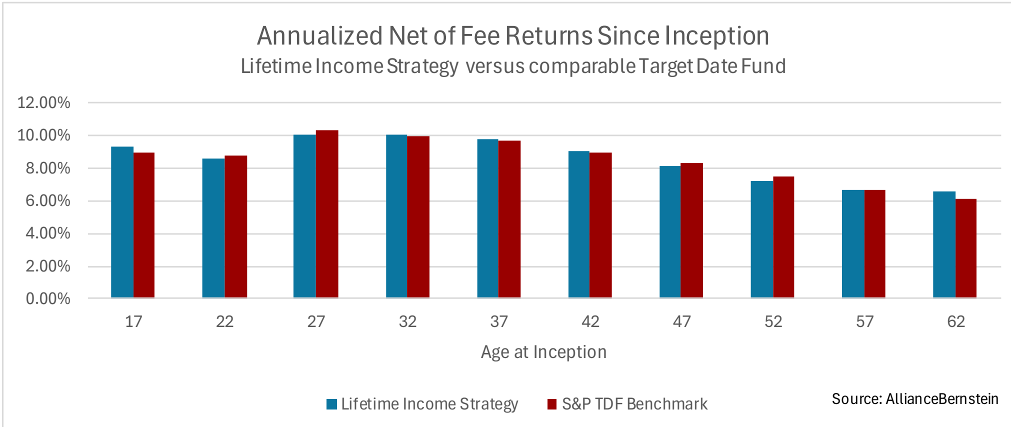
- **More personalized** – the target retirement date is the participant's age 65, not simply a vintage year closest to age 65
- **Higher long-term expected return** – the glide path's terminal allocation of 60% equity / 40% fixed income is reached at age 62, whereas Target Date Funds continue to become

more weighted toward fixed income, typically reaching a terminal allocation of roughly 30% equity / 70% fixed income 15 years beyond the vintage year

- **Uses insurance to build retirement income guaranteed to last for life –** starting at age 50, the underlying investments start to shift into the Secure Income Portfolio, which is a 60% equity / 40% fixed income investment portfolio that provides a variable annuity with a Guaranteed Lifetime Withdrawal Benefit, with the shift completed at age 62, whereas Target Date Funds do not have an insured component

These differences give Lifetime Income Strategy an advantage over Target Date Funds in both the accumulation and decumulation phases. There is an explicit cost of 100 bps for the insurance associated with the Secure Income Portfolio, plus another 12 bps of administrative fees; the non-secure investment portfolios are primarily built on index/passive investing and carry fees of 4 to 6 bps. The insurance in the Secure Income Portfolio provides a retirement income that is a) guaranteed to last for life, b) can increase in periods of rising financial markets, and c) will not decline even in periods of falling financial markets. It is this insurance that allows for a higher risk investing during a participant's pre-retirement and retirement years. That is, **not only does Lifetime Income Strategy provide a participant with guaranteed retirement income for life, but also sacrifices little, if anything, on the net of fee of performance of the investments, as demonstrated in the chart below.** In fact, over the lifetime of the solution if we compare the net-of-fee performance for a participant of a specific age in the Lifetime Income Strategy to the performance of an age-appropriate target-date fund vintage, the cost to participants in the Lifetime Income Strategy has been zero, on average. Net investment performance is essentially the same but Lifetime Income Strategy participants have the benefit of guaranteed income for life.

The impact of the higher growth exposure has also benefited income rates for participants. Because of the solution's ability to reward positive performance with higher permanent guaranteed income rates, participants have experienced increases of 38% to 67% in their income rates by the time they reach retirement. **Further, there is never an irrevocable trade-off of account balance for guaranteed income – the participant always has full access to their account balance in Lifetime Income Strategy with no surrender penalties** (although Early or Excess Withdrawals will reduce the level of guaranteed income).



TDF Vintage	2060	2055	2050	2045	2040	2035	2030	2025	2020	2015
Relative Return (net)	0.3%	-0.2%	-0.2%	0.1%	0.2%	0.1%	-0.2%	-0.3%	0.0%	0.5%
WAVG Income Rate					5.8%	4.3%	4.2%	4.0%	3.8%	3.9%
Effective Income Rate					9.7%	6.8%	6.2%	5.7%	5.8%	5.4%

The above describes how Lifetime Income Strategy works as the QDIA with the participant not taking any action. Lifetime Income Strategy is an investment option within the RTX Savings Plan, and participants are free to transfer any part of or all of their account balance into or out of Lifetime Income Strategy. Furthermore, our second generation of Lifetime Income Strategy, which went live in October 2023, provides participants the opportunity to choose a target retirement age and a "secure income level". The initial generation (and still the default) was based on a target retirement age of 65 and that 100% of the participant's balance in Lifetime Income Strategy would get allocated to the Secure Income Portfolio. **The participant now has the flexibility to choose a target retirement age anywhere between age 60 and 70, and how much ultimately will be allocated in the Secure Income Portfolio – from 0% to 100% (in 10% increments). These choices impact the personalized glide path within Lifetime Income Strategy,** but do not lock in the participant prior to Activating their Income Benefit. The table below is a recent snapshot of the split of total assets in Lifetime Income Strategy between the non-secure investment only portfolio and the Secure Income Portfolio, and the level of guaranteed income associated with the Secure Income Portfolio.

6/30/2024 Lifetime Income Strategy Assets ($millions)

Employment Status	Non-Secure	Secure Income Portfolio	Total Balance	Aggregate Income Base	Aggregate Guaranteed Annual Income
Current Employee	$3,213.6	$1,755.1	$4,968.7	$1,685.3	$72.1
Former Employee	1,096.4	1,043.2	2,139.7	1,016.2	41.2
Total	$4,310.1	$2,798.3	$7,108.4	$2,701.5	$113.3

Activation – the act of turning on the guaranteed lifetime retirement income, the Income Benefit, analogous to requesting commencement of a defined benefit pension payment – is the one aspect of the Lifetime Income Strategy that currently does not have an automatic default feature. After a participant with a balance in the Secure Income Portfolio of Lifetime Income Strategy has separated from service with RTX, he or she can Activate the Income Benefit anytime at age 60 or later. Activation differs substantially from *annuitization* in that it does not require a participant to irrevocably exchange their assets for income and forego control of their balance and future growth potential. The activation process is also much simpler and requires only a brief application to be completed. Despite this, our experience is that a small percentage of participants currently eligible to Activate have done so. Therefore, **in addition to enhancing the targeted communications to this group, we are examining adding a feature to automatically Activate the Income Benefit for eligible participants who have not done so by some fixed age, at or before Required Minimum Distribution Age.** For participants who have Activated, Lifetime Income Strategy is RMD-friendly – that is, even if the amount of RMD taken from the Secure Income Portfolio is in excess of the participant's annual Income Benefit, it will not reduce the participant's future Income Benefit. However, for participants who have not Activated, the entire amount of RMD taken from the Secure Income Portfolio will be an offset to the future Income Benefit.

Early results of the targeted communications are positive and we have seen an uptick in activations recently. It's also important to note that while Lifetime Income Strategy has been available for 12 years, only a small proportion of the participants with a balance in it are eligible to activate (must be 60+ and separated from service) and the income benefit grows each year participants defer activation, up to age 70. While some participants are consciously deferring to maximize the benefit and others are inadvertently waiting to activate it, they are not hurting themselves by waiting (until RMD start age as described above). Automating the income benefit for those who reach 70 will help ensure higher usage of the income benefits.

Future Changes

In addition to the potential for adding an automatic Activation feature, RTX continues to analyze Lifetime Income Strategy and its performance and appropriateness as the QDIA for the RTX Savings Plan. Currently, we believe Lifetime Income Strategy to be appropriate as the Plan's QDIA – building meaningful, guaranteed lifetime retirement income for those participants who are automatically enrolled in the Plan and defaulted into Lifetime Income Strategy, without sacrificing on the accumulation phase. **The focus will be toward encouraging employees who have been defaulted into Lifetime Income Strategy to engage and make their own choices regarding Target Retirement Age and Secure Income Level.**

Summary / Call for other sponsors to adopt

As an actuary and an American concerned with the future welfare of our country's workers in a post-defined benefit pension era, I am grateful to the Council for doing all in its power to facilitate other plan sponsors adding a guaranteed lifetime retirement income solution to their defined contribution plans as RTX did a dozen years ago.

RTX believes that utilizing a QDIA, which builds meaningful retirement income that is guaranteed to last for life, is in the best interest of plan participants. Lifetime Income Strategy is able to not only accomplish this with the use of insurance, but to do it in a way that the insurance has the potential to pay for itself because of the higher expected return on the investment portfolio compared with a typical TDF without insurance. There are, of course, other products and solutions available to plan sponsors. We've seen the uptick in interest, and we are hopeful that more plan sponsors will find solutions to serve as the QDIA in their defined contribution plans that are the right fit for them and their employees.