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On behalf of AARP

U.S. Department of Labor
Advisory Council on Employee Welfare and Pension Benefit Plans
On
Lifetime Income Solutions as a Qualified Default Investment Alternative

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Mr. Chair and Members of the Council, thank you for inviting me to testify on behalf of AARP. As a Council Alumni, and former Chair, I am pleased to once again appear before the Council on the important topic of Lifetime Income Solutions. I previously spoke before the Council in 2018 on lifetime income solutions as a qualified default investment alternative. The world has undergone dramatic changes since then, with changes in administrations, a global pandemic, the rise of Artificial Intelligence, and the passage of SECURE 1 and 2. However, the U.S. retirement system and participants needs for a stable and more secure retirement have not changed drastically. Accordingly, I am also providing a link to my previous testimony -- 2018-lifetime-income-solutions-as-a-qdia-certner-written-statement-08-15.pdf (dol.gov) -- and will raise some of the critical elements in my testimony today.

With the Employee Retirement Income Security Act turning 50 this year, we have a mature system that would benefit from examination and reflection. The retirement landscape, including investment products, is vastly different than in 1974. While retirees are generally living longer, longevity is uneven across race, gender, and income levels. Retirees face growing challenges in paying for the rising cost of health care, and health status and long-term care costs are two great unknowns in retirement.[1]

With the pronounced shift from defined benefit plans to defined contribution plans, retirees have been left to serve as their own actuary determining mortality and their own financial advisor selecting prudent investments and developing a spend down plan. And these are problems only for the roughly half of workers fortunate enough to have a workplace retirement plan. For the approximately 55 million workers without access to a workplace retirement plan, they are truly on their own. While improving retirement plan coverage is not the topic at hand today, it is important to note that the questions we address today are made less relevant, and financial disparities in retirement will only continue to grow, if policymakers do not find a way to cover more workers through a workplace retirement savings option. AARP has supported expansion of retirement coverage through programs at both the federal and state level and will continue to advocate for expanded coverage until all workers have access to a workplace retirement plan option, as that is the critical building block to financial security and dignity in retirement.

Fundamental to the capacity of decision-making now required in the individual account landscape is an understanding of basic concepts of financial literacy. It should not come as a surprise that there are great disparities in financial literacy. As AARP highlighted in its recent response to the tri-agency Request for Information as directed by Section 319 of the SECURE 2.0 Act, there is a direct correlation between financial literacy and wealth.[2] Overall, the ***average*** Retirement Income Literacy Score was a shocking 31 percent.[3] Moreover, AARP found in our own studies that too many respondents could not answer basic reading comprehension questions about fees and expenses in a retirement plan.[4] Accordingly, the subject of lifetime income must be approached with these stark realities in mind.

AARP agrees with the need for better lifetime income options in defined contribution plans to help address a large fear for retirees – the fear of running out of money. The shift to defined contribution plans has dramatically changed not only the accumulation phase, but the retirement distribution phase as well. As you know, under the traditional defined benefit system, individuals generally received an annuitized benefit for their lifetime and likely for the life of their spouse. Now, the defined contribution model is that retirees can receive their life savings as a lump sum. According to the 2024 Employee Benefits Research Institute (EBRI) Retirement Confidence Survey, confidence remains relatively strong among workers that they will be financially ready to retire;[5] however, savings rates do not seem to match those expectations.[6] And the lack of financial literacy likely contributes to this disparity.

Some studies have found that almost one-third of these individuals are likely to spend the entire lump sum within 5 years of receiving it, leaving them with decades without a steady source of income aside from Social Security.[7] But it is an important reminder that Social Security is not only the largest source of income for most older Americans, but the only guaranteed lifetime income source for most Americans. Congress must take steps to protect this foundation of income, supplemented by private savings. And even for near retirees who do have access to pensions, the median account balances will provide far less than the annuitized Social Security benefit. Recognizing the role Social Security plays in providing lifetime income is a critical component of this discussion, and the combination of Social Security and pensions as income sources should be taken into account when determining income needs and distribution options in retirement.

Accordingly, AARP urges the Council to recommend ways to improve coverage and ensure that workers have access to prudent lifetime income options in their defined contribution plans at retirement. These options should be offered with sufficient guardrails, including fiduciary protections, cost-effectiveness, and understandability, as well as meeting basic prudent standards for liquidity, demographics and meeting the needs of all plan participants.

One of the questions raised is whether it is prudent for retirement plan participants to be defaulted into investment products that include insurance products, like annuities. While AARP believes that annuity products can and should be options available to participants, particularly upon separation of service at retirement, automatic enrollment or default into an insurance product faces a high bar. There are many reasons for this, but they can easily be summarized by the three C's: cost, commissions, and complexity.

The first problem with annuities is that they can be expensive. There are a variety of fees that can be imposed on an annuity from administrative fees to underwriting fees to surrender fees. There are fees for additional provisions like inflation protection or survivor benefits. Moreover, some fixed annuities have been marketed as charging no fees, but the "fee" is a reduction in the returns. As these insurance products become more complicated, the costs increase. As discussed, most Americans are not sophisticated when it comes to financial literacy.[8] Mere disclosure alone will not result in sufficient understanding of the fees, costs, risks, and benefits associated with annuities.

Related to costs, there are often commissions associated with insurance products. These commissions can be quite high with great variation, ranging from 1 to 8 percent depending on the type and complexity of the annuity. We cannot discuss commissions and fees without also noting that conflicted advice often drives many of these decisions. Though the Department of Labor issued a common-sense rule that would require professionals providing advice to retirement savers to put their customers' financial interests above their own, the insurance industry has fought the implementation of the rule, which is currently stayed nationwide by a district court in Texas.[9] And once again, individuals are left to determine whether an adviser is truly acting in their best interest. We also know, particularly in the accumulation phase, that fees and costs can be the biggest driver of overall returns.

These insurance products can also be complicated, often glossed over in the marketing as a guaranteed income solution. While the focus may be on providing lifetime income, these products are often complex investment vehicles. There is often a lack of transparency regarding the investments of these products, but consumers focused on longevity risk may be unaware of potential investment risk. Additionally, the complexity is often intertwined with the costs and commissions and consumers must consider contracts closely. Ideally, consumers would receive a comprehensive breakdown of fees, expenses, commissions, and any other cost-related provisions in the annuity contract; however, in practice, these products are opaque, and fees are hidden. And again, disclosure alone of fees does not always mean the consumer fully comprehends the fees and true costs being paid.

Complexity also extends to the difficulty of predicting future financial needs in retirement. Many, if not most, employees will likely not remain with an employer for many years – far less will stay till retirement. Is it prudent to default into – or even offer employees -- a long-term annuity vehicle when most will not be employed long-term? What will the penalties or costs be to untangle from such a product? What liquidity is available, and what are the lost opportunity costs for more liquid and more portable investments? While lifetime income and insurance products may be appropriate for certain individuals, more liquidity may be far preferable for some (if not most), while others may need greater access to their assets in retirement for unexpected emergencies or health situations. Indeed, other assets and sources of income should also be considered. By purchasing an annuity, retirement savings may be locked up and accessible only after sometimes significant penalties. In addition, the financial marketplace has changed dramatically over the past several decades – is it prudent to pay into or lock into a financial product at a point that may be several decades from retirement or actual need? Since these products are highly personal, selection should be left to the individual – it is difficult to see under what circumstances it would be prudent to default or automatically enroll participants in a costly, complex, and illiquid product that would not work for all.

However, fixed annuities do make more sense as an option upon separation from service at retirement, either for all or part of one's asset balance. At that time, a participant has a better sense of their entire financial picture, including Social Security and any other assets, including for a spouse. We urge that, similar to defined benefit plans, all defined contribution plans have a group annuity option (including a spousal option) as part of distribution options at retirement.

Other types of products that have been developed attempt to provide a lifetime income stream. For example, some plans have adopted a version of a post-retirement target date-type fund. Such a fund would be managed more conservatively, given the use of an already-passed retirement date, but would otherwise look similar to a target date fund pre-retirement. This fund could have a monthly pay-out stream based on a percentage (e.g., 4% of the account balance) determined as the first day of the year (with potentially the ability to access additional amounts as needed). The monthly pay-out would change annually, based on plan returns and plan balance amounts on the first day of each year. Thus, payment streams would not be steady or guaranteed from year to year, but may fluctuate with market returns. However, plan assets would be liquid and fees could be lower.

AARP urges the members of the Council to consider emphasizing the necessary fiduciary guardrails for any of the potential options. Again, AARP is supportive of offering lifetime income options in defined contribution plans, but policymakers and regulators must be careful to remain product neutral and evaluate all potential streams of lifetime income under the same high fiduciary standards. This is particularly true if the government is seen as placing its finger on the scale for any one product. Moreover, the financial services landscape evolves at a much faster rate than the development of legislation and regulations. Regulating and legislating in such a way that steers to a specific product or type of product limits flexibility for innovation and improvements that could benefit participants in the future.

Finally, AARP strongly urges that policy with respect to lifetime income products should not be based on age. The quality of a lifetime income product should be determined wholly on its own merits, not whether it is appropriate for someone in a particular age cohort. Assumptions about an age cohort and different rules based on age distinctions are at best inappropriate and at worst discriminatory.

Again, thank you for the opportunity to present AARP's views to the Council on the use of lifetime income in defined contribution plans, and we would be pleased to answer any questions.