DAVIS & HARMAN LLP

ERISA ADVISORY COUNCIL
LIFETIME INCOME SOLUTIONS AS A QUALIFIED DEFAULT INVESTMENT ALTERNATIVE
WRITTEN STATEMENT OF MICHAEL HADLEY
JUNE 19, 2018

My name is Michael Hadley, and I am a partner in the law firm Davis & Harman LLP, here in Washington, D.C. It's my pleasure to testify before the Council once again. I had the pleasure of testifying last year and also in 2012 (in that case to talk about lifetime income) and I'm very happy to be back to provide my perspective.

Our firm represents a range of financial institutions, other large corporations (both public and private), trade associations, tax-exempt entities, and advocacy organizations. I personally serve as outside government relations counsel for the SPARK Institute, which represents defined contribution recordkeepers, mutual fund companies, brokerage firms, insurance companies, banks, consultants, trade clearing firms and investment managers. Our firm represents the Committee of Annuity Insurers, which was formed in 1981 to address federal legislative and regulatory issues relevant to the annuity industry and to participate in the development of federal tax and securities policies regarding annuities. Our firm also represents the American Benefits Council, a Washington D.C.-based employee benefits public policy organization advocating for employers that are dedicated to the achievement of best-in-class solutions that protect and encourage the health and financial well-being of their workers, retirees, and families.

I have testified over the years before government regulators on behalf of all of these groups, but today I am here testifying on my own behalf. My comments today do not necessarily reflect the views of our clients.

Since the Departments of Labor and the Treasury received an amazing response to their request for information on lifetime income, issued in 2010, the Council has focused repeatedly on areas where policymakers, particularly the Department of Labor (the "Department" or "DOL"), can work to address uncertainty in how ERISA regulates the use of annuities and other insurance products in retirement plans. I'm glad to be here to talk about this important issue.

Summary of Recommendations

- DOL should amend subsection (c)(5)(i) of the QDIA regulation so that reasonable liquidity and transferability conditions consistent with income guarantees do not disqualify an investment from being a QDIA.
- DOL should amend the QDIA regulation to make clear that an investment does not fail to qualify as a QDIA simply because the investment allocates a percentage to an annuity, guaranteed income benefit, or similar feature.

- DOL should issue guidance confirming that a fiduciary is not in violation of section 404(a)(1) of ERISA solely because the fiduciary makes available an investment, including as a QDIA, that is limited to participants and beneficiaries meeting a specified age or service condition (or combination of age and service conditions).

Background

The assets accumulated in account-based retirement plans, including 401(k), 403(b), and 457(b) plans, and IRAs, now dwarf what is saved in defined benefit pension plans. Defined contribution ("DC") plans and IRAs held $16.9 trillion as of year-end 2017, while private defined benefit plans held only $3.1 trillion.[1] Individual retirement accounts and individual retirement annuities are now *the largest component of our retirement system*—most of those assets generated in employment-based plans and then rolled over. By this measure, our account-based system has been a success in generating significant savings earmarked for retirement.

Much of the talk about lifetime income centers around the wave of baby boomers who are beginning to retire, but they are not the first Americans to need to make personal savings last during retirement. We should be careful to separate the problem of helping Americans who *have* accumulated significant personal savings for retirement make those savings last, on one hand, from the problem of ensuring that Americans do not reach retirement with just Social Security to rely upon, on the other. Today we focus on the former problem. (The latter is a much more difficult problem to solve, because many Americans have insufficient resources during their working careers, and it is not easy to ensure they will not arrive at retirement with insufficient resources.)

There is significant evidence that retirees are *anxious* about their ability to make their savings last, and that plan sponsors are *concerned* about offering their employees the right tools to help them. EBRI's most recent survey finds that eight in ten workers are very or somewhat interested in an in-plan investment option that would guarantee monthly income for life at retirement.[2] But other data from MetLife suggests a disconnect between what plan sponsors think their workers need and what their plans provide.[3] Nearly half (44%) of plan sponsors in that 2012 survey said that the majority of their DC plan participants would prefer to "receive at least part of their retirement savings as monthly income for as long as they live rather than receiving all of it in a lump sum that they would invest themselves." And yet, only 16% of plan sponsors in that survey offer any form of lifetime income option.

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[1] *ICI Release: Quarterly Retirement Market Data, Fourth Quarter 2017,* Investment Company Institute, https://www.ici.org/research/stats/retirement/ret_17_q4.

[2] Employee Benefit Research Institute, The 2018 Retirement Confidence Survey, https://www.ebri.org/pdf/surveys/rcs/2018/2018RCS_Report_V5MGAchecked.pdf.

[3] METLIFE, RETIREMENT INCOME PRACTICES STUDY: PERSPECTIVES OF PLAN SPONSORS AND RECORDKEEPERS FOR QUALIFIED PLANS (2012), *available at* https://www.metlife.com/content/dam/microsites/institutional-retirement/retirement_income_practices_exp1215.pdf..

Retirees similarly show a disconnect between their reported interest in guaranteed income products and the use of these products. Earlier EBRI surveys find that nearly half of workers report that they are "very likely" or "somewhat likely" to purchase a guaranteed income product at retirement, and yet only 12% actually do purchase such a guaranteed income product at retirement.[4] Similarly, when defined benefit plans offer a lump sum, a significant majority of employees elect a lump sum.[5]

It is a great paradox that, when given the choice, Americans overwhelmingly choose to manage their own assets in retirement through the use of lump sum distributions preserved in an IRA, but when they do not have that choice, as with Social Security or a traditional defined benefit plan that lacks a lump sum option, they do not express displeasure at having an annuity stream for life. What I have taken away from this paradox is that retirement plans, like defined benefit plans and 403(b) plans, which *default* participants into guaranteed income streams find participants generally happy, but getting a participant to actively select even part of their savings in a guaranteed income product is difficult. Using a QDIA that allocates a *portion* of savings, by default, to provide guaranteed income may be the next evolution in plan design. That's why the work the Council is doing this year is so important.

There are a number of barriers to the use of lifetime income products in plans. In my 2012 testimony I discussed the following ways that DOL could address legal uncertainties associated with lifetime income:

- DOL should issue guidance clarifying the circumstances under which plans and service providers can provide education to participants about their lifetime income choices. (This was actually addressed to some extent in the 2016 Fiduciary Rule through amendments to the education carve-out, but that Rule has been vacated.)
- DOL should clarify certain legal uncertainties regarding the status of annuity contracts, and certificates issued under group annuity contracts, distributed from plans.
- It is incumbent upon DOL and the attorneys that advise plan fiduciaries to make very clear that ERISA's fiduciary obligations do not require that a fiduciary who selects an annuity provider have a crystal ball that infallibly predicts the future financial condition of the insurer.

More information on these issues can be found in my 2012 testimony. At your request, I will focus the rest of my statement on the interaction of lifetime income and the QDIA rules.

The Development of the QDIA Rules

It is hard to understate the impact that the Pension Protection Act of 2006 ("PPA") and the DOL's resulting Qualified Default Investment Alternative ("QDIA") regulation had on the

[4] EMPLOYEE BENEFIT RESEARCH INSTITUTE, THE 2012 RETIREMENT CONFIDENCE SURVEY 28 (2012), *available at* http://www.ebri.org/pdf/surveys/rcs/2012/EBRI_IB_03-2012_No369_RCS.pdf.

[5] *See* GOVERNMENT ACCOUNTABILITY OFFICE, GAO-09-642, PRIVATE PENSIONS: ALTERNATIVE APPROACHES COULD ADDRESS RETIREMENT RISKS FACED BY WORKERS BUT POSE TRADE-OFFS 19-20 (2009).

landscape of the private retirement system. In fact, while the bulk of the PPA was aimed at ensuring adequate funding for defined benefit plans, it is likely that the section 624 of PPA, which established the fiduciary relief of QDIA, and the related provisions to facilitate automatic enrollment, were the most consequential of the entire landmark legislation.

As a direct result of the PPA and the QDIA regulation, vast amounts have been saved in default investments, overwhelmingly in target date funds. According to Investment Company Institute data, target date funds as a share of 401(k) assets have grown rapidly—from 5 percent at year-end 2006 to 20 percent at year-end 2015. Furthermore, in 2015, 74 percent of 401(k) plan participants were offered target date funds, and 50 percent of 401(k) plan participants held these funds—up from less than 20 percent in 2006.[6]

Prior to the PPA, section 401(k) plans and other defined contribution plans that are participant-directed generally had little need for a "default" investment. While Treasury and IRS guidance had approved the concept of automatic enrollment, it was somewhat uncommon for plans to utilize automatic enrollment. This was because of two concerns plan sponsors generally heard from their attorneys and advisors. First, it was not clear that ERISA preempted state "wage garnishment" laws, that is, laws prohibiting an employer from reducing an employee's wages without consent. (This concern was addressed by another section of PPA (902(f)), which clarified that ERISA did in fact preempt these state laws, under certain conditions.)

The second barrier to automatic enrollment was concern over the fiduciary liability for investing contributions of an automatically enrolled participant. Plan fiduciaries had gotten comfortable with the protection offered by section 404(c) of ERISA, which provides liability protection for fiduciaries with respect to losses that result from a participant's "exercise of control" over their account. Prior to the PPA, it was generally thought that the relief of section 404(c) was not available unless a participant made some sort of "affirmative" investment decision.

Nonetheless, even before the PPA, there were plans that designated a default investment. Besides the few plans that did offer automatic enrollment, there were other circumstances in which a plan might need to designate a default investment. For example, many employers provide a nonelective employer contribution which is made even for employees that do not contribute to the plan. While the plan administrator might tell the employee that he or she needs to choose investments, it can be hard to get 100% of employees to do so. In addition, many plan administrators would find that they could get employees to sign up for a plan and elect a contribution rate, but when it came time to designate investments, the employees would not make a decision. The plan administrator might designate a "default" that could be mentioned to the employee, to prevent the employee from *not* signing up.

Because of the lack of liability relief, many plan fiduciaries would designate as the default a "safe" investment that focused on protection of principal, like a money market fund or stable value fund. Although plan fiduciaries knew that these investments were not appropriate

[6] INVESTMENT COMPANY INSTITUTE, 2018 Investment Company Fact Book, p. 18, *available at* https://www.ici.org/pdf/2018_factbook.pdf.

for most participants with a long-term investment horizon, they felt that the risk of fiduciary liability was significantly reduced, because participants would be unlikely to sue. I personally recall having these conversations with plan clients where we talked about the pros and cons, and the concern about liability for designating other default investments subject to short-term market swings was very strong.

The PPA provided that a participant or beneficiary in an individual account plan meeting certain notice requirements is treated as exercising control over the assets in the account with respect to the amount of contributions and earnings which, in the absence of an investment election by the participant or beneficiary, are invested by the plan in accordance with regulations prescribed by DOL. Congress further provided that the regulations shall provide guidance on the "appropriateness of designating default investments that include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both."

Accordingly, Congress' instructions to DOL were somewhat open-ended:

- Congress said that the fiduciary relief is available only if the assets are invested by the plan in accordance with DOL's regulations.
- Congress directed DOL to issue regulations, and to do so within six months.
- Congress said that these regulations should provide "guidance" on the "appropriateness" of investments that "include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both."

Interestingly, the Joint Committee on Taxation's contemporaneous description of the provision suggests that DOL could designate *other* default investments beyond those mentioned in the statute.[7]

The proposed QDIA regulation, published on September 27, 2006, proposed a set of conditions for an investment to qualify as a QDIA, a term that does not appear in the statute but was defined in the regulation. The regulations included three classes of investments that were largely preserved in the final regulation:

1. An investment fund product or model portfolio that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy. This is generally known as a **target date fund**.
2. An investment fund product or model portfolio that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed

[7] "Such regulations must provide guidance on the appropriateness of certain investments for designation as default investments under the arrangement, including guidance regarding appropriate mixes of default investments and asset classes which the Secretary considers consistent with long-term capital appreciation or long-term capital preservation (or both), and the designation of other default investments." Joint Committee on Taxation, *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX-38-06), August 3, 2006 (page 148).

income exposures consistent with a target level of risk appropriate for participants of the plan as a whole. This is generally known as a **balanced fund**.

3. An investment management service with respect to which an investment manager allocates the assets of a participant's individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based on the participant's age, target retirement date (such as normal retirement age under the plan), or life expectancy. This is generally known as a **managed account**.

There were many comments filed during the comment period, and a few key issues appeared for DOL to resolve. By far the most contentious issue was the extent to which stable value funds, money market funds, and similar investments providing a guaranteed return could qualify as QDIAs. These principal-protected investments had become the default investment of choice in the absence of fiduciary relief and, of course, groups representing these investments and the firms that offer them were asking DOL to preserve their status. The final regulations did accommodate stable value funds, in two important ways. First, the final regulations provide that principal-protected investments can serve as a QDIA for up to 120 days. Second, the final regulations provided relief for any principal-protected investment with respect to the amount invested prior to December 24, 2007.

It is important to note, however, that the debate during the creation of the QDIA regulation over whether or not stable value funds and other principal protected investments can qualify as a default is *different than the issues the Council is currently examining***.** The Council's current project is to focus on asset accumulation and decumulation issues in the context of lifetime income needs and solutions and to examine the problem of portability of lifetime income investments.

There was, in fact, little question during the debate surrounding the QDIA regulations that DOL intended to support the use of lifetime income products, or put another way, investments that could support a stream of guaranteed income. In response to comments, DOL added a paragraph to the final regulation that confirms that the availability of annuity purchase rights, death benefit guarantees, investment guarantees, or other features ancillary to the investment fund product or model portfolio will not disqualify the investment from qualifying as a QDIA.[8]

Barriers to Use of Lifetime Income Features in QDIAs

Among the three investment funds listed in the QDIA regulation, target date funds have become by far the most common default investment in plans, representing the default in more

[8] 72 Fed. Reg. 60452, 60460-61 (Oct. 24, 2007).

than 3 out of 4 plans—even more among the largest plans.[9] Among plans serviced by Vanguard, the number of plans with a QDIA that use a target date fund is an astounding 96%.[10]

Target date funds used by plans are typically registered mutual funds or collective trust investments that do not have guaranteed income features. But the QDIA regulation does not – at least not explicitly – prohibit a target date fund from having guaranteed income features. The regulation simply defines a target date fund as "[a]n investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy. Such products and portfolios change their asset allocations and associated risk levels over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age."[11]

Similarly, for a plan that uses a managed account as the QDIA, there is no fundamental reason that the service would not be considered a managed account solely because the managed account service allocated part of the account to an annuity or other guaranteed income product.

DOL confirmed as much in a 2014 Information Letter sent to Mark Iwry, the then-Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy at Treasury.[12] That information letter discussed a target date fund that purchased unallocated deferred annuity contracts which constitute a portion of the fund's fixed income investments. DOL confirmed that such a fund could be a target date fund within the meaning of the QDIA regulation.

As a practical matter, however, many plan fiduciaries are reluctant to use target date investments or managed accounts that include guaranteed income features as a QDIA, for reasons which I lay out below.

Liquidity Requirement. The QDIA regulation contains two requirements that can cause issues for guaranteed income products.

- First, the QDIA regulation requires that, within the first 90-day period after a participant is automatically enrolled, the participant "shall not be subject to any restrictions, fees or expenses (including surrender charges, liquidation or exchange fees, redemption fees and similar expenses charged in connection with the liquidation of, or transfer from, the investment)."[13]

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[9] PLAN SPONSOR COUNCIL OF AMERICA, 59th Annual Survey, Table 67 (2016).

[10] VANGUARD, How America Saves 2017, at 8 (2017), *available at* https://pressroom.vanguard.com/nonindexed/How-America-Saves-2017.pdf.

[11] DOL Reg. § 2550.404c-5(e)(4)(i).

[12] https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/information-letters/10-23-2014.

[13] DOL Reg. § 2550.404c-5(c)(5)(ii)(A).

- Second, the regulation requires that a participant must be allowed to transfer assets held in the QDIA "to any other investment alternative available under the plan with a frequency consistent with that afforded to a participant or beneficiary who elected to invest in the qualified default investment alternative, but not less frequently than once within any three month period."[14]

Many guaranteed income products, by their nature, trade guaranteed income or guaranteed returns in exchange for restricted access to liquidity. This is essentially how a defined benefit plan works – the participant often is not able to access the benefit until retirement, which allows the plan to invest assets with a longer investment horizon. The same is true for annuity issuers, who can provide more generous guaranteed income if the assets are preserved and invested for a longer term.

In 2016, DOL addressed the liquidity problem in an Information Letter issued to Christopher Spence of TIAA.[15] This letter discussed a target date fund that "allocates investment funds to a fixed guaranteed annuity (Annuity Sleeve). The Annuity Sleeve provides a guaranteed return element to the portfolio and the option of guaranteed lifetime income as a benefit distribution alternative. [The] glide path increases the allocation to fixed-income funds as a participant ages, along with gradual increases to the Annuity Sleeve over time (e.g., 7% at age 45 and 40% at age 65). The percentage allocation to the Annuity Sleeve is capped at 50 percent."

The Annuity Sleeve, however, contained a liquidity restriction, which applied after an initial 12 month period: "Specifically, the [Income for Life Custom Portfolio ("ILCP")] will allow participants to transfer or withdraw from the Annuity Sleeve without restriction for 12 months after the initial investment. After this 12-month period, any funds invested in the Annuity Sleeve of the ILCP would be available for transfer to another investment option only in installments over an 84-month period. All other funds in the ILCP would be liquid and transferable. During this 12-month opt-out period, the plan directly or through TIAA would furnish educational materials periodically to participants defaulted into the ILCP. These materials would explain the features of the ILCP, including the Annuity Sleeve, and the delayed liquidity provision following the initial 12-month opt-out period. After the initial 12-month period, participant education about the ILCP will continue on at least an annual basis."

DOL concluded that the investment product described would not be a QDIA (because of the liquidity restriction), but also concluded in the Information Letter that it would be consistent with a fiduciary's prudence obligations to use this investment, or any investment with lifetime income elements, as a default investment, if it complies with the QDIA regulation except for reasonable liquidity and transferability conditions.

DOL points out in the Information Letter that the QDIA regulation is not intended to be the exclusive means of selecting a default investment for a plan consistent with ERISA's fiduciary obligations. DOL also states that after the QDIA regulation was published, "a national

[14] DOL Reg. § 2550.404c-5(c)(5)(i).

[15] https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/information-letters/12-22-2016.

discussion surfaced around the availability, need for, and importance of lifetime income products and features as a way to protect participants and beneficiaries against the longevity risk of outliving the assets they saved to provide retirement income, the risk of having retirement savings eroded by investment losses, and the risk of declining cognitive abilities that can hamper portfolio management and other financial decision-making skills."

The Information Letter is very helpful but, unfortunately, many plan sponsors will want to have the full protection of ERISA section 404(c)(5). Accordingly, I would **recommend that DOL amend subsection (c)(5)(i) of the QDIA regulation so that reasonable liquidity and transferability conditions consistent with income guarantees do not disqualify an investment from being a QDIA.** [16]

In my experience, the liquidity issue is less of an issue for the initial 90-day period described in subsection (c)(5)(ii)(A) of the QDIA regulation, because an insurance company can account, from an actuarial standpoint, for the possibility that there will be a withdrawal in a short period. This 90-day initial period is also important to ensure that a participant defaulted into an investment has time to exercise affirmative control over his or her account. The investment product described in the 2016 Information Letter provided full liquidity for 12 months.

"Ancillary" Issue. The current QDIA regulation states that an investment fund or model portfolio that otherwise qualifies is not disqualified "solely because the product or portfolio is offered through variable annuity or similar contracts or through common or collective trust funds or pooled investment funds and without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment fund product or model portfolio." This language was added to the final regulation in response to comments from the industry requesting confirmation that the availability of annuity purchase rights, death benefit guarantees, investment guarantees or other features common to variable annuity contracts would not affect the status of a variable annuity contract that otherwise met the requirements for a QDIA. The preamble to the final regulation refers to these features as ones that are "common" to variable annuity contracts, but the regulation itself refers to them as "ancillary" to the investment fund product or model portfolio.

At the time, the industry was focused on products that accumulated assets through traditional investment structure and then, only at retirement, gave the participant the right to annuitize the benefit. But over time, innovative products and structures like those described in the 2014 and 2016 Information Letters, designed to purchase guaranteed income over time through the use of defaults, have been developed. The language in the regulation was not written

[16] One argument that I have heard in connection with the "three-month" rule in subsection (c)(5)(i) of the QDIA regulation is that a requirement to allow complete withdrawal from the QDIA at least every three months is necessary because the QDIA regulation is providing relief similar to ERISA section 404(c). But it is critical to understand that 404(c) regulations do not include such a rule. The 404(c) regulations only require that the three *core* investments that must be offered must be eligible for reallocation at least once every three months. DOL Reg. § 2550.404c-1(b)(2)(ii)(C)(1). Plans that qualify under ERISA section 404(c) can, and do, offer investments with liquidity restrictions.

with these products in mind. The regulation refers to guaranteed income as "ancillary" to the investment, which is not quite accurate.

Accordingly, I recommend that the DOL amend the QDIA regulation to make clear that an investment does not fail to qualify as a QDIA simply because the investment allocates a percentage to an annuity, guaranteed income benefit, or similar feature. The recommendation is entirely in line with the statute and the 2014 and 2016 Information Letters. In creating the QDIA safe harbor, policymakers sought to prompt plan sponsors to choose default investments that are *appropriate for retirement savings*. In fact, Congress made clear that the key to an appropriate QDIA is that it must include "a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both." The policy behind the QDIA safe harbor was to encourage *long-term* investments appropriate for assets being saved for retirement and that can help generate a secure retirement, and an annuity is entirely appropriate to be included in the *mix* of asset classes.

Benefits Rights and Features, and Associated Fiduciary Obligations. One concern with offering investments with lifetime income features is that many of these investments are best used by participants in a particular age band. Often the product is designed exclusively for those over a certain age, and the actuarial assumptions behind the product are critical to proper pricing. It isn't appropriate for a 25-year-old, for example, to purchase a living benefit guarantee aimed for someone approaching retirement. Thus, ideally, a product designed for those over a certain age should be restricted to those over that age.

Unfortunately, such a restriction could be viewed as causing issues under the Internal Revenue Code's nondiscrimination requirements. Under the implementing regulations, any "benefit, right or feature" (BRF) of a plan, which includes the right to a particular investment, must be available on a nondiscriminatory basis.[17] Because older employees tend to be higher paid, restricting investments to those over a certain age could violate the Code's nondiscrimination rules, or at least require expensive and unpredictable testing.

IRS addressed this problem in Notice 2014-66, which was issued at the same time as DOL's 2014 Information Letter. That Notice examined a suite of target date funds with the unique feature that some of the fixed income exposure in the target date funds for older age groups results from the purchase of deferred annuities, which will be distributed to participants when the target date fund is dissolved at its target date. As each group's age advances, an increasing portion of the portfolio is applied to the purchase of deferred annuities.

IRS's solution to the problem was elegant, if somewhat narrow. IRS concluded that since at least one target date fund in the suite was available to a particular participant, the entire suite of investments could be treated as a single investment for purposes of the nondiscrimination rules. This sidestepped the problem and provided relief, but to only one possible design. At the same time, IRS essentially confirmed that age- or service-based investments would need to be tested under the BRF rules, even when the employer has no desire to benefit highly compensated

[17] Treas. Reg. § 1.401(a)(4)-4.

employees. IRS's guidance states that it would not apply to a target date fund which provides a guaranteed lifetime withdrawal benefit (GLWB) or guaranteed minimum withdrawal benefit (GMWB) feature.[18]

It is not obvious – at least not to me – that age-limited investments should violate the Code's nondiscrimination rules as Congress originally envisioned them. The BRF rules already make clear that an age or service limited *distribution* option is not nondiscriminatory,[19] because all employees have the chance to use that distribution, eventually. Nonetheless, Notice 2014-66, while providing limited relief, also confirms that the BRF rules are a barrier.

Representative Richard Neal, the Ranking Member of the House Ways and Means Committee, included in his Retirement Plan Simplification and Enhancement Act of 2017, a provision that would address this problem.[20] Section 201 of that bill would direct Treasury to amend its regulations to clarify that any specified age or service condition (or combination of age and service conditions) with respect to a lifetime income investment under a defined contribution plan shall be disregarded in determining whether such lifetime income investment is currently available. Of course, Treasury and IRS do not need legislation. The regulations already give the Commissioner of IRS broad authority to provide any additional guidance that may be necessary or appropriate in applying the nondiscrimination requirements, including additional safe harbors and alternative methods and procedures for satisfying those requirements.[21]

I have also had discussions with investment managers who would like to build investment solutions that are similarly "tiered" based on retirement needs. Some of these solutions, like laddered fixed income portfolios or payout mutual funds, are intended only for older workers. Plan sponsors and their outside consultants and attorneys have expressed concern about offering these products and solutions only to a subset of employees because of the BRF rules. But they are similarly concerned about offering them to *all* employees, when the products or solutions are not appropriate for younger participants. One idea that has been discussed is providing an exemption from the BRF rules for any investment product or solution offered to all employees age 50 or older—which is similar to the special contribution rule called "catch-up" contributions.

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[18] In a footnote, IRS stated: "Under a contract that provides GLWBs with respect to a participant's account, the participant is guaranteed to receive a specified lifetime stream of income regardless of the investment performance of the account, while still retaining access to the funds in the account. This GLWB feature permits a participant to withdraw annually a certain percentage (for example, 5 percent) of a contractually specified income or benefit base. In the event that the participant's account balance (determined without regard to any potential future GLWB payments) is reduced to $0 as a result of these guaranteed annual withdrawal amounts, the insurer will continue to pay the guaranteed withdrawal amount annually for the remainder of the participant's life. A GMWB feature is similar to a GLWB feature, but a stream of income is guaranteed for a specified period rather than for the lifetime of the contract owner or annuitant. Treasury and the IRS are considering whether or not to provide guidance related to issues arising from the use of GLWB and GMWB features in defined contribution plans." Four years later, no such guidance has been issued.

[19] Treas. Reg. § 1.401(a)(4)-4(b)(2)(ii).

[20] H.R. 4525, 115th Congress.

[21] Treas. Reg. § 1.401(a)(4)-1(d).

The forgoing issues related to the BRF rules arise under the Internal Revenue Code, but there are related issues under ERISA that would be appropriate for consideration by the ERISA Advisory Council. In particular, ERISA requires that fiduciaries act for the exclusive purpose of providing benefits to participants and their beneficiaries (the duty of loyalty) and with care, skill, prudence and diligence (the duty of prudence).[22] Some fiduciaries may be concerned that restricting certain investments to participants over a particular age could run afoul of these rules. In my view, as long as the fiduciary engages in a prudent process to evaluate the investment, like any other, taking into account the relevant facts and circumstances, it would be entirely consistent with fiduciary obligations to include an age- or service-restricted investment. DOL's 2014 Information Letter did not, however, address this issue.

I would recommend that **DOL issue guidance confirming that a fiduciary is not in violation of section 404(a)(1) of ERISA solely because the fiduciary makes available an investment, including as a QDIA, that is limited to participants and beneficiaries meeting a specified age or service condition (or combination of age and service conditions)**. I also recommend DOL work with IRS and Treasury, as was done in 2014, to provide additional relief from the BRF rules for investments, including those with GLWB or other lifetime income features, that are restricted to participants or beneficiaries meeting specified age or service conditions.

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There is no one single approach to achieving lifetime income that works for everyone. Nor is there one approach to default investments that is right for each plan. The QDIA regulation has been successful because it provided broad parameters around the kinds of investments that are appropriate as defaults. Plan sponsors took this flexibility and ran with it. But the market, and our thinking, has evolved since then. Lifetime income products like annuities and GLWBs do not meet every retiree's needs, but there is increasing interest in trying to harness the power of inertia to provide guaranteed income within a defined contribution plan. The goal of the Department of Labor and other policy makers should be to make sure workers have the tools they need and understand the pros and cons of their choices. Regulatory uncertainty should not prevent plan sponsors and plan fiduciaries from helping workers understand and utilize the robust lifetime income solutions that insurers, mutual funds, advisers and banks have developed.

[22] ERISA § 404(a)(1).