

Department of Labor/Department of the Treasury
Joint Hearing on Lifetime Income Options
September 15, 2010

Welcome

Robert Doyle:

Good morning. Welcome to the second day of the joint Department of Labor/Department of the Treasury hearing on lifetime income options. Before we get started and as we reviewed yesterday but for those who did not have the benefit of being here; just kind of a reminder of some of the rules that we are trying to abide by. One, testimony is being limited to those who have actually scheduled testimony. This is necessary really to accommodate the number of witnesses that we have scheduled as well as the competing schedules of the government panel representatives. But we are going to keep the public record open for 30 days, so everyone that has a view or comments that they want to submit are encouraged to use that process to submit written comments to the agencies. Those comments will be posted on our website as well as available at regulations.gov.

And again a few administrative matters, we do ask those who are testifying to identify themselves, their affiliation and the organization, if any, on whose behalf they are giving the testimony. Also we are requesting that the speakers limit their testimony to the allotted ten minutes. And we do have a time clock to assist in that regard and I chime reminder as to the expiration of that time frame. Again, no inferences should be drawn from any of the questions that come from the government panel in terms of views, positions or anything else. We are just trying to develop the record and encourage discussion. We will have periodic changes in the government panel and there will be additional people joining us this morning. I will go through that in a moment. Finally we are being web cast live and I ascertained yesterday apparently that web cast continues during breaks and elsewhere at times. For those of you who are into more affectionate greetings, just be aware that it is all on tape -- [laughter] -- and will forever be available I think on our archive through the EBSA web site.

So with that let me introduce the panel members of at least thus far today. I am Robert Doyle, Director of Regulations

and Interpretations for EBSA. Michael Davis, our Deputy Assistant Secretary will be joining us shortly. To my immediate right, Jeffrey Turner, Chief of our Division of Regulations, Division of Regulations in the Office of Regulations and Interpretations. And Zenaida Samaniego, our Chief Actuary with the Office of Research and Policy. And Patricia McDermott with the Office of Chief Counsel IRS. And with that, we are going to call the panels in order, so if there is any questions as to what order your panel is or what number it is, let us know and we will help you out. But with that we will move to invite panel one to join us.
Good morning.

Panel One

Frank Todisco:

Good morning. I am Frank Todisco and to my right is Noel Abkemeier and we are here on behalf of the American Academy of Actuaries. We would like to commend the Department of Labor and the Department of Treasury for addressing the issue of lifetime income security. And we thank the agencies for the opportunity to testify today. We support the agency's efforts to facilitate access to and use of lifetime income arrangements. From an actuarial perspective we recognize lifetime income arrangements protect against longevity risk, the risk of people outliving their financial resources. Lifetime income arrangements are also economically efficient since it is significantly less expensive to pool longevity risks through a lifetime income arrangement than to self-insure the risk by accumulating assets adequate to last until a very old age. Lifetime income arrangements also provide other benefits. They provide retirees with a budgeting signal to help protect against over spending. They help retirees avoid unnecessarily under spending out of fear of outliving their resources. And they reduce senior citizen money management responsibilities at advanced ages when they might be significantly less able to manage investments and finances.

A multi-pronged effort would be most effective in expanding access to and use of lifetime income arrangements, including improving financial literacy, incorporating behavioral finance ideas in disclosures and plan design, utilizing diverse types of lifetime income options to address participant concerns and individual circumstances and requiring that a guaranteed lifetime income option be offered in tax qualified plans, more on that later. We turn now to the agency's specific questions starting with questions two and three which deal with information to help participants make choices regarding lifetime income arrangements, including disclosure of account balances as income streams. How much information should be provided to participants? There is a delicate balance between providing participants with adequate information to make informed choices versus overwhelming participants with too much information and over burdening plan sponsors with excessive administrative requirements. A tiered approach can be useful. Basic information could be presented on a

first page and extended information on a second page for those who wish to dig more deeply.

A set of standardized required disclosures would create uniformity across plans so that all employees get the same message regardless of where they work. We recommend that the agencies provide model disclosures and safe harbors, both for information provided and for assumptions updated annually used to derive it. To facilitate good faith efforts to provide accurate and appropriate information, plan sponsors could always voluntarily go further in providing additional information. We do support showing the account balance as an equivalent monthly or annual income stream. In fact an annual income stream could be a more effective comparison against the lump sum. And prioritizing this in the order of presentation, the specific wording to present the lump sum and its equivalent lifetime income should be chosen carefully based on the findings of behavioral finance to convey fundamental risks and benefits about these options.

In projecting future lifetime income an assumption has to be made about when the participant will retire. Here the participant's age for full eligibility for Social Security benefits would be a good choice for consistency across programs. Also an assumption has to be made about future contributions to the account. Two possibilities are a continuation of the participant's current contribution rate or a uniform percentage of salary for all participants. It would also be useful to illustrate as a variation the effect of contributing one percent more than the assumed contribution rate in order to demonstrate the effect on retirement security of increased savings. However such additional information might be relegated to secondary disclosure. Another consideration is whether the lifetime income amount should include inflation protection, a certain period or other form of death benefit and coverage for a surviving spouse. A cautionary note should be raised here; projecting future income or account balances creates comparability issues because a dollar 20 years from now is worth less than a dollar today. Consequently it would be useful to show projected lifetime income as a percentage of final compensation that is as a replacement ratio.

Similarly it would be useful to show any projected lump sum amount as a multiple of final compensation. A second cautionary note involves the way in which future investment

return is calculated whether to use conservative, high quality bond yield or to include anticipated stock market returns. Including a return on stocks would be problematic for two reasons. First it would mean estimated investment returns that vary from participant to participant based on each participant's asset allocation. Second the projection would be incomplete without substantial additional disclosures about the risks inherent in stock market projections. There should also be internal consistency among all assumptions. For example, a projection of future contributions to the accounts requires a projection of future compensation.

If the compensation is projected to stay level rather than increase, implicitly that means that both inflation and productivity growth are expected to be zero. So that assumed investment return would need to be ratcheted down accordingly. An alternative assumption for future compensation growth would be a standardized rate of anticipated long term inflation plus productivity growth. Any projection of annuity conversion rates should reflect anticipated future mortality improvement because guaranteed lifetime income will continue to become more expensive as longevity continues to increase. Finally, assumptions should be disclosed along with caveats about the uncertainty inherent in projecting into the future. I will now turn the remainder of the academy's statement over to my colleague Noel Abkemeier.

Noel Abkemeier:

The four set of questions relates to fiduciary safe harbors for selection of lifetime income issuer or product. We would like to make two points here. First safe harbors should be expanded in order to facilitate plan sponsors offering a broader range of options, thereby broadening consumer choice. Second, safe harbors should be extended to other lifetime income options besides annuities, again for the purpose of broadening consumer choice. The fifth set of questions concerns alternative types of lifetime income arrangements. Many solutions exist but the challenge is to raise awareness of them and educate consumers and plan sponsors of their value in addressing longevity risks. Having both in plan and outside of plan solutions is essential so that participants in all situations can have access to lifetime income arrangements.

Many options already exist outside of plans. It would be helpful to have more lifetime income options available within plans as well. We support a requirement that some form of guaranteed lifetime income be one of the investment or distribution options offered in tax qualified individual account plans provided that the requirement is accompanied by a clear set of regulations that will allow for effective implementation at a reasonable cost without subjecting plan sponsors to undue fiduciary risk. Individual plan sponsors should also be permitted to make an annuity the default option, having a variety of lifetime income options within plans to suit varying circumstances is critical to achieving greater use. Among many variations are A, partial annuitization to provide planning flexibility; B, deferrals to advanced ages to coordinate with structured withdrawal programs; C, inflation adjusted annuities to add inflation protection to longevity protection and D, death benefit options for those who are concerned about the lack of a death benefit.

Employers could also be encouraged to offer their retirees the option of purchasing an annuity from a defined benefit plan at the point of retirement. This would be a distribution option from the employers to find contribution plan. One potential stumbling block that would have to be addressed is the coverage by the PBGC of the annuities purchase from the defined benefit plan. In particular the PBGC priority category in which said purchases would be placed. Comments we submitted in May address this in further detail. Outside of plans there are many products to address longevity risks. It should be recognized that these are available not only for distributions from plans but also other personal savings. The potential scope of lifetime income should encompass not only tax qualified assets but also nonqualified assets. Various types of annuities are available in the market place. Single premium immediate annuities provide longevity protection and frequently include an option for inflation adjustments.

Deferred start income annuities, sometimes known as longevity insurance, are another way to insure against living too long. But required minimum distribution rules do not exclude deferred income annuities. One solution to encourage greater use would be to exclude deferred income annuities from required minimum distributions, perhaps up to some limit. There are also annuity-like lifetime income structures that also address longevity risk, albeit at a

lower level of guaranteed income. Guaranteed lifetime withdrawal benefits are available on various types of annuities. These provide longevity protection and certain principal protection while providing full access to the retiree's assets. Guaranteed minimum income benefits on variable annuities provide an annuitization floor while providing certain principal protection. A mutual fund structured withdrawal program is not guaranteed but it could be complemented with either a guaranteed lifetime withdrawal benefit or a deferred start income annuity to add longevity protection.

Disclosure of projected income under one of these guaranteed lifetime withdrawal structures could also be helpful information to plan participants. Another important issue in encouraging lifetime income is that standard annuities are poor investments for annuitants in poor health. Substandard annuities are offered by a few insurance companies. Although some allowances made for significantly impaired substandard annuities and statutory reserving, it may be appropriate to allow greater statutory reserving flexibility to encourage the offering of a full range of substandard annuities. In closing, we want reiterate our support for the agency's efforts to promote access to and use of lifetime income arrangements. Thank you for the opportunity to testify and we welcome your questions.

Larry Goldbrum:

Thank you, my name is Larry Goldbrum and I am General Counsel of the SPARK Institute. With me today also for the SPARK Institute is Sue Unvarsky, Senior Vice President with Prudential Retirement. We would like the Departments of Labor and Treasury for this opportunity to present our views. We will address two of the issues identified in the hearing announcement and we will briefly mention the SPARK Institutes lifetime income data standards project that is nearing completion. The SPARK Institute is an industry association that represents the interest of broad based, cross section of retirement plan service providers, including banks, mutual fund companies, insurance companies, third party administrators, and benefits consultants.

In order to encourage plan sponsors to voluntarily offer lifetime income solutions and to encourage participants to voluntarily use them is absolutely critical to create an

environment that supports this behavior. Although lifetime income solutions are well established in the retail market, the institutional market is still relatively new. There are several outstanding issues that will need to be addressed as this market matures. However all these issues are dependent on the level of comfort plan sponsors and participants feel about offering and using lifetime income solutions. Until this general level of comfort increases, many of the other issues are likely to be inconsequential. As has been mentioned by many of the earlier witnesses, some of the major challenges that plan sponsors are facing involve the application of risk rules. As such we believe that the Departments of Labor and Treasury can play an important role in making retirement income solutions more readily available and understandable.

The SPARK Institute believes that the keys to greater adoption and utilization of lifetime income solutions are simplification and certainty. Until plan sponsors have a simple and reliable safe harbor that allows them to offer lifetime income solutions in their plans without materially increasing their potential for fiduciary liability and litigation, many may conclude that the potential benefits for them as employers and business owners are outweighed by the potential risks. Plan sponsors are faced with the prospect of insuring due diligence in connection with the selection of a vendor as well as with administrative challenges if they later decide that an active vendor is no longer a prudent selection. In such a situation the cost incurred by the participant, for example the benefit guarantee cost, could be lost or forfeited before they receive the benefit that they paid for because switching providers does not constitute a distributable event. Participants would not have the option to retain the guaranteed by rolling their investments into another account with the affected insurer.

This could put sponsors in impossible position and potentially exposes them to litigation. And it is a good example of where the agencies can make a real impact. In order to improve its usefulness we recommend that the DOL confirm that when a fiduciary initially selects a provider to deliver a lifetime income contracts at future dates and when a fiduciary later abuses the continuing appropriateness of that decision, the fiduciaries actions will be judged based on the circumstances prevailing both at the time of the initial selection and upon the

subsequent review. Two, issue guidance that expressly authorizes a fiduciary to rely on public information at the time of the review unless the fiduciary has non-public information indicating that the provider's public information includes material misrepresentations. And three, clarify that a plan sponsor can make a decision to no longer offer a lifetime income solution for future contributions. This could be addressed by clarifying that as long as the decision to select a lifetime income investment was prudent at the time that it was made, the plan sponsor and other fiduciaries cannot be held liable by plan participants for discontinuing the option provided that participants are allowed to continue to keep previously invested amounts in the discontinued option. I am now going to turn over the balance of our time to Sue Unvarsky.

Susan Unvarsky:

Thank you, Larry. As it relates to plan participants, like other financial choices, making decisions about using a retirement income product or service can be intimidating and challenging. Plan sponsors with the knowledge and assistance of their service providers are more likely to help participants understand their choices and guide them in making their own decisions if they have reasonable certainty that by doing so they will not become an investment fiduciary to the participant. Without clear and permissive guidance plan sponsors, product providers and service providers will most likely be unwilling to provide participants with useful information, especially if doing so could cause any of them to assume additional fiduciary responsibility. The SPARK Institute requests that the DOL issue guidance that is comparable to interpretive bulletin 96-1 to explicitly cover educational materials related to lifetime income options and to expressly clarify that providing information about lifetime income options available both inside and outside of the plan, life expectancies, historic investment returns, the impact of various withdrawal rates, longevity risks, market sequence risks and other similar information is education, not advice.

Additionally a request that the DOL clarify that plan assets can be used to pay for providing information to help participants make decisions about in plan and out of plan options available to them upon separation from service or change in provider by the plan sponsor. While it is

generally understood that plan assets can be used for education regarding in plan options, there is considerable uncertainty with respect to out of plan options. In order for plan participants to fully understand their options and what may be most appropriate for them, plan sponsors should be permitted to educate them about both options and to use plan assets to pay for the educational costs. We would like to mention that the SPARK Institute is on target to complete an information sharing standards project by the end of this month.

We started this project almost one year ago and it now includes over 80 individuals from more than 35 different companies. The standards that we will release will make it more feasible and more cost effective for record keepers and insurance carriers to make retirement income solutions available to plan participants. And will resolve several issues that have been obstacles for record keepers, plan sponsors and participants. The standards will streamline the bills for record keepers to offer multiple products from unaffiliated insurance carriers, will facilitate portability of products when a plan sponsor changes plan record keepers and will support portability of guaranteed income when a participant has a distributable event in the form of a rollover to a rollover IRA or as a qualified plan distributed plan annuity. As yesterday's testimony, as I am sure today's will also indicate, the retirement income market is still in its early stages. We are seeing a great deal of interest from plan sponsors and plan participants. And the industry is responding with a variety of product structures and services.

As a whole the industry is keenly aware of the need for solutions that can provide lifetime retirement income options. And while the agencies can have a tremendous impact in making retirement income solutions more readily available and understandable to millions of working Americans, it is vital that the innovation that is propelling this emerging market be preserved. The SPARK Institutes members recognize that retirement income is a critical component of financial planning. And their various business models create a broad spectrum of ideas and solutions to the issue. Just as employers have different objectives as plan sponsors, individuals have different retirement planning needs. Some will look for flexibility whereas others will be willing to give up greater control of their assets in exchange for a greater

guarantee. We do not advocate any particular product or service. And urge the agencies to maintain a competitive environment where a diverse mix of solutions are available with plan sponsors and participants retaining the discretion to voluntarily utilize the options that best meet their needs.

On behalf of the SPARK Institute, we thank the panel for the opportunity to share our views on these important issues and we welcome the opportunity to respond to your questions.

Drew Carrington:

On behalf of the Defined Contribution Institutional Investment Association, which I will hereafter refer to as DCIIA, thank you for the opportunity to offer our views on lifetime income solutions for qualified plan participants. I am here today as the Chair of DCIIA's Retirement Income Committee representing the association and its objectives. We applaud the agencies for evaluating how to improve the retirement security of American workers. I should also add here that the views expressed do not necessarily reflect those of my employer. DCIIA is a broad based organization with members from the asset management, investment consulting, record keeping, insurance, plan sponsor and other vendor communities. In fact over a dozen of the organizations speaking at these hearings are members of DCIIA. As an industry association with a diverse membership, DCIIA is by design product agnostic. We are not however neutral.

Among our five core beliefs, which we submitted with our response to the RR 5 [spelled phonetically], one is to define contribution plans we should take a full lifetime approach to providing retirement income adequacy. DCIIA fundamentally views the conversion of accumulated balances to a stream of lifetime income payments as the point of retirement of retirement plans. And the system should make that simpler and easier for sponsors and ultimately participants. Additionally another of our core beliefs is in the nudge principals of behavioral finance and economics, which we define as improved default programs are the most effective path to realizing successful retirement outcomes. If you want to move the needle on any of these topics, automation is demonstrably the best way to do it. Education alone will not affect enough participants in a meaningful enough way.

DCIIA is a new organization formed earlier this year to advance the notion that the existing employer based define contribution system can create comfortable, secure retirements for American workers. In order to achieve this we need to more fully utilize the techniques that address participant behaviors, such as automation. But in addition the define contribution system should more fully take advantage of the scope of institutional investment skills and knowledge accumulated over the years of managing and overseeing define benefit plans to improve participant retirement outcomes.

Based on yesterday's testimony, I would like to add a few comments. Frequently the discussions on the topics of lifetime income are framed in "either/or" binary terms, in plan versus out of plan, annuities versus not annuitizing, and so on. This is not helpful and will be increasingly less so. New products and solutions can and will blur many of these artificial distinctions. At DCIIA we always bring the discussion back to, "Does the product or design help improve retirement outcomes for participants?" If the answer is yes, then the distinction shouldn't matter. I would also add while there are early adopters, organizations willing to communicate accumulated balances as a lifetime income stream or early adopters even in offering lifetime income solutions, those willing to act in the presence of uncertainty will not be sufficient to affect enough participants. My remaining remarks today will primarily address two of the five questions raised by the agencies. These two questions have immediate, practical consequences and agency action in the form of guidance or safe harbors can quickly and dramatically alter the retirement plan landscape for the benefit of participants.

First in order for plan sponsors to incorporate lifetime income options and plans, we must design a fiduciary safe harbor for them. And second, in order to change the framing context in DCIIA plans, we must agree to display accumulated balances as a stream of lifetime income for participants. As a starting point, DCIIA view is making lifetime income solutions broadly available in tax qualified plans is an important policy goal and legislation and regulation should encourage plan sponsors to adopt these options and plans up to and including using them or incorporating them as a default options for participants.

Unless a safe harbor for selection is offered we believe that plan sponsors will not adopt in plan solutions at a rate sufficient for participants to meet their retirement income needs. DCIIA views in plan offerings important for five key reasons.

In plan solutions offer participants valuable scale pricing and fiduciary oversight benefits which are not available in a retail setting. Second, in plan solutions can allow participants to dollar cost average into a distribution option helping them avoid critical point in time risks associated with both equity market levels and interest rates. Third, dollar cost averaging allows for smaller incremental purchases of lifetime income which can offset - - help offset the widely documented behavioral objections individuals have when faced with the binary decision of fully annuitizing or taking a lump sum. Fourth, in plan solutions facilitate the use of pretax dollars to purchase lifetime income solutions. And fifth, in plan solutions can be more liquid than retail purchases particularly in the traditional fixed annuity space. In light of these important benefits, DCIIA believes it should be simpler and easier for plan sponsors to incorporate these solutions in their plans. But plan sponsors have been reluctant to adopt them, often due to concerns regarding new forms of fiduciary reliability and regulatory uncertainty.

One of the central sources of concern is related to the selection of lifetime income solutions. Today in managing 401(k) plans, plan sponsors and their advisors have clear guidance regarding how to select investment options for a plan line up. There are regulations such as 404(c) or the Pension Protection Act of 2006 but more fundamentally the principals of a prudent process, well documented in both the selection of and ongoing oversight of investment options in a plan, are clear and well understood and more importantly, widely applied. Plan sponsors are deeply concerned that attempting to offer lifetime income solutions will introduce new, unfamiliar and potentially heightened fiduciary responsibilities. Unfamiliarity combined with the perception of higher risk becomes the formula for the negativity that the plan sponsors have regarding their recurrent reluctance to utilize lifetime income options.

This need not be the case regulatory clarification could allow sponsors to employ the same principals of a well-

documented process in the selection and monitoring of lifetime income solutions in a qualified plan, which they currently use for the monitoring and selection of investment options. More important with that regulatory clarity many plan sponsors will be more likely to offer these innovations in their plans. This is no fairy tale of wide eyed optimism. Regulatory guidance has already helped make a remarkable difference in 401(k) plans. The simplicity and clarity offered under PPA 2006 has led to wide spread and rapid adoption of automatic enrollment, auto escalation and diversified default investment options. Plans that have adopted these features demonstrate large improvements in participation rates, deferral rates and portfolio diversification metrics and many of these benefits accrued to lower paid employees. Similar improvements in retirement security are available if the regulatory and fiduciary context regarding lifetime income solutions can be similarly clarified.

The other key item DCIIA would like to comment on is the display of accumulated balances in 401(k) plans as lifetime income streams. The sooner we can change the conversation regarding defined contribution plans away from a number, which emphasizes wealth accumulation to a series of numbers; such as this is the amount of income you can expect to sustainably withdraw from your plan and retirement, the better. The behavioral finance literature including studies by a number of professors, including Shlomo Benartzi who will be speaking here later today, is clearly demonstrated that the choice of taking a lump sum versus an annuity is largely a function of how the decision is framed and that for many participants if they are accustomed to viewing their retirement plan assets in a monthly income format as opposed to a single value, they are more likely to select at least partial annuitization over a lump sum. I think the TIAA-CREF testimony on this point was compelling yesterday.

It is true that any approach to converting current balances to a projected income level will require a host of assumptions. However Americans are already familiar with the symbiotic [spelled phonetically] complexity in their Social Security statement. For example, they can already see on the statement the impact of retiring early or taking benefits early versus delaying those withdrawals. There are a variety of assumptions that go into creating any projection and those different assumptions can lead to

different projected outcomes. But plan sponsors and their vendors should not be in a position where the fear of fiduciary liability if they offer such projections prevents them from doing so. Many of my fellow panelists and other panelists who have spoken here have specific insights -- very specific insights -- as to how to construct these projections or how to provide guidance to plan sponsors on specific variables.

Our view is that simple projections with a clear emphasis on the assumptions used without fear of incremental fiduciary liability represents a huge improvement over the current state of affairs and we urge the agencies to provide clear guidance and encouragement to sponsors and vendors in providing this. In closing, I would again like to sincerely thank the agencies for the opportunity to testify on this critically important set of issues and your interest in this set of issues. We would like to, again, point out that as the guidance surrounding PPA 2006 is demonstrated, regulatory changes can make a difference. At DCIIA we believe that we have the tools available in the current private employer based retirement system to create meaningful, secure, comfortable retirements for millions of Americans, but to be most effective we need guidance that it is safe for us to use all of those tools. Thank you.

Robert Doyle:
Thank you. Questions?

Zenaida Samaniego:
I have a question for well, the American Academy if I may? Part of your testimony shows the relative difference among different risk protection products, I would just would like to inquire in terms of the discussion of in plan versus out plan, your estimate of the difference in costs due to, say, the mortality table, like group versus individual, the gender difference -- I don't know -- fees, commissions. Just to get an idea, you know, in terms of what you are looking at.

Noel Abkemeier:
We provided a couple of estimates that are in our May commentary, for example, that the cost of adverse selection that is priced into the retail market but would have to be priced into any kind of compulsory annuitization scheme is about a 10 percent extra cost for the fact that when it is voluntary just healthy people will take annuities. So that

is about 10 percent. For the gender difference, roughly 7 percent difference in cost or so where in the retail market which uses gender distinct mortality assumptions, the costs for women is about 7 percent more than men because they live longer. And of course in the in plan market gender neutral rates have to be used, so the costs is the same.

Zenaida Samaniego:

How about fees? Have any of the other panelists an idea?

Larry Goldbrum:

I guess when you have products outside of plans you do have sales commissions which lead to an extra cost and that might be a 4 percent cost or something or that level of magnitude. Within plans you could conceivably narrow that a lot or eliminate it.

Frank Todisco:

I would say that the scale benefits in group purchases I think you could probably get up to a 10 percent improvement, at least a 10 percent improvement, versus the retail market for a comparable product at a comparable point in time.

Zenaida Samaniego:

Thank you.

Jeffrey Turner:

I have one question for SPARK and it relates to the information sharing initiative that you mentioned. I am trying to put some context around it in my mind. And this is how I see it fitting; a plan has an arrangement with an issuer and there is a product -- an in plan, an accumulation type annuity. The plan for one reason or another decides it needs a new record keeper but the problem is the incoming record keeper is unable to maintain the data set for the existing in plan product. Is that the gap that is being address with the information sharing?

Larry Goldbrum:

Let me give you the context. When you have a record keeper that is not an insurance provider and that record keeper has a plan customer that wants an in plan option, there has to be a way for that record keeper to interface with an insurance provider. So the primary function of the data standards is to create different data standards and

protocols for that customer facing record keeper that is not an insurance company to be able to offer an in plan product to its plan customers by working with various insurance carriers. So that is the primary function of the data standards, making it easier for customer facing record keepers that are not insurance providers to offer those products to their plans and to be able to program their systems following a defined set of standards.

One of the impediments is that record keepers don't want to go ahead and start programming their systems to accommodate every different insurance product out there because it is expensive to do so. But by creating some standards around that, it becomes more cost effective to do that. So that's the basic premise for why we did what we did. But also by defining all those data standards, it does make it easier for a plan that is changing record keepers to move their product from record keeper A to record keeper B if they decide to make that shift because all the data is defined and the standards are defined, so you can easily move from point A to point B, including the same thing for rollover.

Jeffrey Turner:
I see.

Susan Unvarsky:
If I could just elaborate on that a tiny bit, what is happening today, Mr. Turner is that each record keeper is being driven its largest clients to add specific lifetime income in plan options and they are going through a fairly significant build to offer just that one option. Then the next client who comes along wants a different option, they are reopening those same programs and going through some very expensive additional builds to offer another product that might have different features. So what the standards are doing is making it easier for the record keepers to build one platform that might support different types of products at the point in time when they chose to offer multiple different products on their platform.

Jeffrey Turner:
I see and I am wondering if ultimately, uniformity is achieved if that if sort of indirectly addresses DCIIA's -- the concern that Drew mentioned about the employers concern about the permanence of these types of products that if an employer knows that it isn't stuck with a particular arrangement at the outset it may be less worried about

incorporating an in plan option. Is that a connection that --?

Drew Carrington:

That is absolutely true. A number of DCIIA members are also members of the SPARK Institute and have contributed to this effort. That is absolutely the case. As I mentioned to you yesterday, I think that if plan sponsors know that they have a possible way out, that they can make on an ongoing basis appropriate fiduciary decisions or plan management decisions whether it is regarding the record keeper or the investment or lifetime income option. If the, as long as they know that there is a way out, they are much more likely to start in the first place.

Robert Doyle:

That's an interesting point. I mean I have thought about that in the context of kind of framing a safe harbor when we looked at the current safe harbor for selection of annuity providers in the context of DC plans. There was an argument, "Hey these are the same as making decisions with regard to any investment option that might otherwise be available under the plan." But one of the things that troubled us was this long time commitment of funds and the inability, essentially of participants, to liquidate those investments. So just by virtue of that kind of lack of liquidity, the lack of, the inability to essentially to move out of that decision suggests that a different type of analysis and perhaps the more troubling or challenging analysis for fiduciaries in terms of speculating or analyzing or reaching conclusions as to the long term liability of the solvency of the annuity provider.

So how we approach, kind of stepping back and looking at the annuity selection standards from a fiduciary stand point may well turn or be different depending on the type of product that we are talking about and the circumstances under which there is an ability to liquidate or move from that investment. Because it seems to me the greater the ability or flexibility on the part of the participant to move or similarly the fiduciary to change products upon the determination that that's no longer the appropriate or best product for their particular participants changes the analysis in my mind. And that's not to say that there aren't issues with the termination abilities and I think we need to think about those as well and kind of what factors need to be considered if that current framework, at least

what I am hearing, doesn't seem to be providing the certainty and comfort that a safe harbor is intended to do. So you have any reaction or comment on?

Frank Todisco:

Yeah. You know what we try to address is sort of the practical limitations that our members, record keepers, insurance carriers were facing in trying to make these products available and facilitating the portability. So we were able to do that but we view this as a partnership as you have already alluded to as you know there are some legal limitations and hurdles that need to be addressed. And hopefully through what we have done in addressing the practical limitations, it will make it easier and open up more options for you in loosening up a safe harbor or defining a more definitive safe harbor.

Drew Carrington:

I think that point about the flexibility of participants or plan sponsors to make changes is relevant in the safe harbor description. So to the extent that the lifetime income option behaves like other investment options in the plan, participants have the ability to make changes, which by the way we think is important even if you think about it in a default option context. So if participants are defaulted into a lifetime income option then we believe that they have to have the ability to exit without fear of surrender charges or minimum required holding periods. Otherwise it is, again, not viable as a default option. But if it has those characteristics then the application of the traditional prudent process guidelines, you know, a well-documented ongoing product process of both selection and monitoring should apply. And I think plan sponsors, if they had clarity that it did that they would feel a lot more comfortable incorporating these into their plans and incorporating them as part of a default option.

Robert Doyle:

SPARK have any views on incorporation of default options and --?

Larry Goldbrum:

Well because of the diversity of our membership, we had some difficulty reaching a consensus so-- [Laughter]

Robert Doyle:

What about the academy?

Frank Todisco:

We think that employers should be allowed to have a lifetime income default option and should have appropriate safe harbor to allow them to do that.

Robert Doyle:

Do you believe that encouraging that is -- my sense from your testimony is that you know is encouraging more opportunities to have safe lifetime income options in the plan is the better approach.

Frank Todisco:

Without question, yes and we concur with the things that Drew is saying about the behavioral finance aspects. And there is no question that using a default tool can really change the dynamics of what people go with.

Robert Doyle:

I guess lastly I have one question on the conversion of account balances to lifetime income streams. We heard some discussion yesterday about a very basic conversion approach to kind of a more complicated, more aggressive type of projection based. And I think that is an issue that we do want to come to terms with so again, I would like to get your views as to -- does it help, is it informative to start with a basic account balance and here is what that lifetime income stream would like. Simply taking that balance in and projecting to, let's say, retirement age and Social Security retirement age.

Larry Goldbrum:

I think that is quite helpful and it puts everything in perspective for the participant. And even in that picture -- we have been talking about annuitization, which is fully committing your funds to a lifetime income. But even another path of the guaranteed withdrawal benefits, which can be applied in various circumstances, that is an important thing to present to people. Because I think it is an important decision for people, do I want to look up my funds or do I want to have liquidity? So in that context in what is presented annually, there is value at actually looking at both of those. One may have priority over another such as the annuitization, that's the more clearly understood. But the second one actually fits in there too perhaps in a little bit subsidiary fashion. But

at any rate, having all that presented I think helps give a frame of reference for the participant.

Drew Carrington:

I might add that I think the primary question is whether or not to show some lifetime income amount and [unintelligible] to that is yes, it's very important to do so. The secondary question then becomes, how do you come up with that number? What exactly does it represent? And then there are tradeoffs there between getting more sophisticated or providing more variations versus providing something very simple which could be over simplified to some extent. But we think that the most important thing is to start to show something in the form of lifetime income.

Jeffrey Turner:

And do you recommend the more sophisticated approach or the simpler approach? As I understood what you said earlier, you were recommending a two tiered approach. You would say take somebody's current account balance as of this date, \$300,000, a 40 year old person, 25 years to retirement and you take that current account balance and you express it as a stream beginning in 25 years. However, whatever assumptions that you use to get there, that's option A. Option B would be to take that same account balance and assume a continued contribution rate for the next 25 years, to assume a return on the contributions made and then a conversion to a stream 25 years later. That's the more sophisticated, that's more sophisticated model, that's B. And I understood you to say at a minimum, A is a good idea, B is more complex, but you support both.

Frank Todisco:

At a minimum show either A or B or C or some form of lifetime income. There are different ways to do it. But we do like the idea of a tiered approach in principal of maybe starting with some basic information and then there could be secondary model information that's voluntary, that gets more sophisticated. In terms of how you would actually do it, because a plan sponsor can't do this calculation necessarily, so it would be probably up to vendors to do it. But I think the department might have to put forth a table of factors to do the calculations so that they are uniform. And if you just taking a current account balance and projecting it forward without future contributions, you can do that with a table of factors based on age but when you throw in adding in future

contributions, you are adding another dimension to the calculation. So you have another step in the calculation and that gets a little bit more difficult.

Patricia McDermott:
Is there time for me to --?

Robert Doyle:
Absolutely.

Patricia McDermott:
Thank you. I just want to clarify about the standardized data set. It's -- that takes care of the issue of A, there is a plan where there is an in plan lifetime income option and the plan sponsor changes record keepers. But it doesn't resolve the situation where the plan sponsor either in conjunction with a change in record keepers or not, no longer wants to provide that particular in plan option and instead -- so he is sort of going to discontinue that and provide another one. And that situation the points that you made about surrender charges and failure to hold for a particular period of time can still come into play.

Larry Goldbrum:
That's right. I mean it doesn't deal with insurer portability. It deals with record keeper portability and participant portability and also the basic maintenance of the products on the record keeping platforms.

Drew Carrington:
This goes to the question that came up yesterday about a new type of distributable, in service distributable event to take the discontinued option so that participants can maintain it.

Larry Goldbrum:
And would facilitate that and that becomes a portability issue.

Robert Doyle:
Just before I let you go, I do want to follow up on the fiduciary safe harbor. I'll just -- we won't get into it anymore but I would invite you if you have thoughts or suggestions in terms of, again, approaching this from the perspective of "certainty is always a good thing" but with it brings certain restrictions. And evaluating, for lack of a better term, portability features or liquidity

features that might be attendant to a lifetime income product, what should a fiduciary be taking into account?

Frank Todisco:

Yeah, we would be glad to follow up.

Robert Doyle:

Thank you very much.

Panelists:

Thank you.

[simultaneous speaking]

Panel Two

Eric Levy:

Members of the joint panel, good morning. My name is Eric Levy and I am Vice President and Head of Defined Contribution Products for Lincoln Financial Group. Lincoln Financial has participated in the retirement plan marketplace for over 50 years and today serves more than 24 thousand plan sponsors and their 1.4 million plan participants in corporate health care, education and non-profit sectors. We are a leader in developing lifetime income solutions for both individual products and defined contribution plans, including a product called I for Life Advantage [spelled phonetically] that was subject of a private letter ruling issued in September of 2009. I appreciate the opportunity to appear before you today to share our views about the importance of insuring that plan sponsors have the guidance they need to offer appropriate income options to help their employees face their futures with confidence.

Plan participants face a number of risks when they begin to take contributions from their defined contribution plan including longevity risks and inflation risks. Only insurance companies have the ability to assume those risks and are able to offer product solutions, specifically annuities, to provide guaranteed benefits. Lifetime annuity payments from insurance company can be an excellent solution for providing an income stream that plan participants cannot outlive. While variable annuities and fixed annuities with inflation adjusted payments can be chosen to combat inflation risks insurance company annuities have some perceived disadvantages. They are sometimes viewed as inflexible, irrevocable, inaccessible and costly relative to other options. A new generation of annuity products designs, however, addresses these perceived disadvantages.

One such design is Lincoln Financial's "I for Life Advantage Rider" [spelled phonetically] which is administered through a patented method which provides a lifetime income stream with substantial flexibility and complete accessibility during an access period of the participant's choosing. Newer product designs also include reasonable and simplified fee structures and cost can be lowered appreciably when purchasing an annuity inside a defined contribution plan. We believe that clearer

guidance on incorporating lifetime income products in defined contribution plans would significantly benefit plan sponsors and plan participants. Such guidance would also help to insure these products are prudent and sound from a fiduciary perspective. And if employers were simultaneously encouraged to provide more education about available choices, cost and features, and to provide clear illustrations showing how much income participants account balances will convert to in retirement more plan participants would understand the very real threat to their long term financial security posed by longevity and inflation.

Additionally they will also have the opportunity to see the impact of the decisions that they are making today regarding contribution rates, asset allocations and, in too many cases, hardship withdrawal and or loans. Further, participants would understand that there are solutions and resources available to help them plan to minimize those threats. Turning to fiduciary obligations in our opinion only annuities with their lifetime income option guarantees backed by the full faith and credit of the issuing company should be the subject of a safe harbor. Any lifetime income option that does not provide such guarantees should be subject to standard fiduciary determination. The size of the plan should not come into play in these guidelines since a fiduciary obligation owed to participants by a plan sponsor is the same no matter the size of the plan. And the criteria required in the selection of the provider should be objective and easily determined.

While current safe harbor regulation is an improvement over safest available annuity rules, it is still not practical. The requirement to evaluate an insurer's future solvency means that all but a very narrow segment of plan sponsors must hire an outside expert to make that determination since it requires detailed review of an insurer's financial records and investments and current and future obligations. In addition it is unclear how such an independent expert would obtain access to this information, making the requirement not only difficult but impossible to meet. Information on the financial strength of insurance companies is readily available from state insurance regulators and from private industry rating agencies which routinely have access to the detailed information needed to make these determinations. State insurance regulators can be encouraged to coordinate access to basic insurer

financial information, licensing, and standing with the State Department of Insurance.

Safe harbor rules can and should be expanded to cover the selection of an annuity provider for an in plan option as described in the RFI and should not be limited to a selection for benefit distribution from defined contribution plans as is currently the case. However since many plans are already funded with a group and individual annuities that incidentally provide for distribution in the form of an annuity, the safe harbor should not be modified to inadvertently include the selection of the annuity to fund the plan as act contemplated by the safe harbor. And therefore subject to a fiduciary standard beyond the normal fiduciary requirement where plan sponsor selects a plan funding vehicle, whether that be a funding vehicle, a mutual fund, a bank financial product or an annuity contract. Ultimately there is no single, simple solution to address the multiple concerns about best option for including lifetime income and retirement plans.

We believe that it will take a joint effort between; one, insurance companies who have the regulatory structure and risk management expertise to offer guarantees; two, asset managers who are skilled at developing products to maximize savings and accumulation; and three, record keepers who provide the statements, web experience, call centers, and in person service to deliver solutions. Such partnerships could result in pricing efficiencies, clearer delivery and diversification of other risks from the plan sponsors point of view. These partnerships along with new concepts of plan design are being widely explored today. Turning to plan design how retirement income products are integrated into a retirement plan and how plan sponsors and service providers describe and communicate the benefits of these options can have an effect on their usage by plan participants.

One seldom discussed but significant barrier to more widespread adoption is the requirement for unisex rates and in plan annuity. Advisors generally educate plan sponsors and plan participants to the fact that males can receive higher lifetime income benefits through gender-distinct rates in an individual retirement annuity rather than through the in-plan. In-plan unisex lifetime annuity payouts in a defined contribution plan are usually based on 100 percent female and/or 50-50 blended rate due to the

expectation of most or all males will roll out of the plan to receive a higher gender-distinct male payout. This leaves only female participants who will receive no less of a benefit in the plan versus out of the plan. By comparison, annual income from males is 7.3 percent higher than for the unisex rates.

Planned fiduciaries are reluctant to encourage their male retirees to access in-plan annuities if they know that they would be better off in out-of-plan retirement income annuity options. As long as unisex rates for an in-plan annuity pay out are required by law, it will be unsuitable for male participants with shorter life expectancies to stay in the plan. There is positive news of how plan design innovation has led to more favorable participation and retirement plans. Behavioral economic studies earlier this decade show that the typical DC plan with automatic enrollment features dramatically increase participation rates. Further, automatic step-ups and automatic investing in a QDIA prove to increase retirement security for many participants, especially rank and file employees.

This same concept could be leveraged to encourage the appropriate use of retirement income products for participants. Specifically, guidance that explicitly states the prudence of automatically providing downside protections of retirement income products into already chosen or defaulted investments, such as target date funds, as participants enter a period of 10 to 15 years prior to retirement would provide plan sponsors the comfort they seek in offering such products and ultimately improve outcomes.

As more and more individuals rely on savings built up in employer-sponsored defined contribution plans for their financial security and retirement, the more critical it becomes for plan sponsors to have clear and simple guidance in terms of fiduciary responsibility and incorporation of income options to improve outcomes for plan participants. Thank you for your time and your attention to this very important topic.

Charles Nelson:

Good morning. My name is Charlie Nelson. I'm president of Great West Return Services, a division of Great West Life and Annuity and Insurance Company and part of the Great West Lifeco Group, one of North America's largest insurance

complexes. Great West is the fourth largest defined contribution provider and record keeper. We serve over 24,000 plans and 4.4 million participants. Our clients comprise a variety of DC plans, including 401(k), 403(b), 457, as well as define benefit. In 2008, the rollover total from DC plans to IRAs was an estimated 270 billion industry-wide. That same year, total variable annuity sales were almost 155 billion, of which 65 percent were IRA rollovers. Seventy-nine percent of participants purchasing an IRA in a variable annuity went into a guaranteed lifetime income product. Clearly, there is a demand.

However, we don't think participants should have to leave their DC plan to access these products. That's why we introduced an in-plan option often referred to as a guaranteed lifetime withdrawal benefit, or GLWB, for our DC clients this past April. Our goal was to create a guaranteed lifetime income product designed for the unique characteristics of the DC plan. Guaranteed lifetime income products inside DC plans need to take into consideration vesting loan hardship, multiple money types, and many other plan and code rules. Our GLWB product called Secure Foundation is designed to accommodate both these unique DC plans characteristics and to provide the benefits of a GLWB product.

While you may hear differencing opinions about participant interest in these products, our research and experience indicates their significant growing demand. For example, in the short 100 business days since we introduced our guaranteed lifetime income product, almost three plans a day have added it. And we're seeing increasing demand and acceptance by additional plan sponsors. This is consistent with the popularity experienced in the individual variable annuity and IRA markets.

Our results have been encouraging; however, we believe by addressing a few concerns, even more plan sponsors will make guaranteed lifetime income products available to participants. With that as background, there are four points I would like to make. First, the agencies can help resolve key fiduciary concerns that employers face when selecting these products. Second, the agencies can clarify application of the qualified joint and survivor annuity rules to guarantee lifetime income investments. Third, the agencies can help change the mindsets of plan participants by requiring participant statements to display benefits as

a month to lifetime income payment. And fourth, the agencies can create default mechanisms that will increase the number of participants who retire with guaranteed lifetime income benefits while protecting participants who don't want or need this option.

Let's start with resolving fiduciary concerns. Thirty-nine percent of our 401(k) plans have selected our guaranteed lifetime income products as their default investment option. The remaining 61 percent who don't select it mentioned unease about their responsibility to sort out portability and insurance company solvency -- this despite Great West Life and Annuity being one of the highest-rated insurance companies in North America. You've heard representatives from SPARK testify regarding the record-keeping portability solution that Great West and 34 other SPARK members are creating.

We believe this industry-generated solution is a practical response and it will go a long way to resolving record-keeping portability concerns. We believe fiduciary concerns with insurance company solvency can be addressed by amending the DOL safe harbor rule for selecting annuities or by creating a new safe harbor specifically intended for in-plan guaranteed lifetime income products. We urge the agency to allow plan fiduciaries to rely on their traditional sources of help -- DC plan advisors, consultants, or third-party administrators -- and not require them to seek the help of an insurance company solvency expert in applying the safe harbor.

My next point: clarifying application of qualified joint and survivor annuity rules. The qualified joint and survivor annuity rules are designed to ensure that employee spouses have access to retirement plan benefits. While the goal is laudable, a review of our business showed 77 percent of plan sponsors and DC plans opt out of the QJSA requirement due to the cost and complexity of compliance. For example, any time there is a loan, hardship withdrawal, or other distribution from the plan, a special notice must be provided, the spouse's consent to the transaction must be obtained, and the consent must be notarized or witnessed by a plan representative. The QPSA rules also require plan administrators to track down when participants turn age 35 and obtain new beneficiary designations from those participants.

All this involves cost and time for a benefit that's not appreciated or used by the majority of participants or their spouses. For instance, our records show that even in plans where the QJSA must be made available, only about one-half of one percent, or only a few thousand participants out of our 4.4 million, take advantage of this distribution election. We've heard from plan sponsors and third-party administrators that the risk of triggering QJSA requirements is a deterrent to adoption of guaranteed lifetime income products by plans that have chosen not to support QJSA benefits in their plan.

The purpose of the triggering rule is to provide protection to spouses where the 100 percent death benefit alternative has been rendered moot because a participant has converted their account balance into an annuity so there is no longer any death benefit available to a surviving spouse. This protection isn't appropriate in guaranteed lifetime income products or the participant's account balance remains available as a death benefit to the spouse until the account's been depleted through withdrawals. Therefore, we recommend the QJSA rules be amended to clarify that a QJSA isn't triggered by the virtue of a participant receiving lifetime payments as long as the participant's account balance remains available as a death benefit to the surviving spouse until depleted through withdrawals.

Next, the agency should require participant statements to include account balances expressed as monthly lifetime income payments. We recommend the participant statement rules be amended to require that at least annually, participant account balances be displayed as a monthly lifetime income benefit. We also encourage the agencies to facilitate discussions between participants, advisors, and consultants about the need for guaranteed lifetime income and the features of guaranteed lifetime income products that are available to them by clarifying that these discussions don't constitute fiduciary advice.

We also encourage the agencies to promote effective participant communication by working with FINRA and the FCC to eliminate regulatory barriers, such as prohibitions against using certain phrases. We believe part of our success in getting plan sponsors and participants to choose a guaranteed lifetime income product comes from incorporating lessons topped by behavioral finance research. For example, Professor Jeffrey Brown from the

University of Illinois did research on framing annuities. Notably, his research showed the importance of word selection when describing investment decisions. Keeping this in mind, we need the agencies help in letting us "speak the language of participants" so they can make more informed decisions. Today, regulations limit how we can communicate these products, making them more complex and confusing than they are. For example, we wanted to use the term "retirement paycheck" to describe lifetime income in a manner that participants could easily understand but FINRA told us we couldn't use "paycheck" and had to use "retirement income" instead. This nuance may seem minor, but presenting concepts in a language that speaks to participants is important if we're going to help them make informed decisions.

Lastly, default strategy should be encouraged to mitigate the risk that employees will outlive their retirement savings. Behavioral scientists have produced volumes of studies validating what we've seen and experienced in DC plans over the years. Congress and the agencies have listened to scientific evidence and addressed participant inertia by promoting automatic enrollment, automatic deferral increases, as well as by sanctioning qualified default investment alternatives. We encourage the agencies to deploy these same default strategies to guaranteed lifetime income products. As mentioned earlier, since we introduced our guaranteed lifetime income product, 39 percent of our new plans have selected it as a default but only 9 percent of plans have mapped their participants to guaranteed lifetime income products.

We know we still must address a few issues when plan sponsors change providers if default strategies are to be more widely used to encourage the use of a guaranteed lifetime income product as a default and mapping alternative. We also believe these strategies allow participants to opt out. For example, we recommend the agencies use the same "three strike rule" despite our concept that DC plans use for other auto-plan features. This initiative provides three notices to participants; if after the third notice a participant takes no action to opt out of the feature, then he or she is automatically enrolled in it.

That concludes my prepared remarks. Thank you again for the opportunity to testify on this important topic. We

support the agency's efforts to improve retirement income security and remain available to assist with information or other support at your request. Thank you.

Thomas Roberts:

Good morning. My name is Tom Roberts and I am chief counsel at ING Insurance U.S. testing [sic] on behalf of the American Council of Life Insurers. On behalf of the ACLI, we'd like to express our appreciation of a concerted effort by the Department of Labor, EBSA, the Treasury, and IRS to bring strong focus to the importance of guaranteed lifetime income.

ACLI member companies represent more than 90 percent of the assets in premiums of the United States life insurance and annuity industry and offer insurance contracts and other investment products and services to qualified retirement plans, including defined benefit pension and 401(k) arrangements and to individuals through individual retirement arrangements or on a nonqualified basis. ACLI member companies also are employer sponsors of retirement plans for their own employees. As both providers and as employers, we agree with you that saving for retirement and managing assets throughout retirement are critical economic issues facing Americans and our nation.

The life insurance industry protects individuals and families against the risk of adverse financial consequences due to premature death, long-term care needs and disability, as well as the risk of outliving one's financial assets or living at a substantially reduced standard. ACLI members have many years of experience providing the only financial products that feature guaranteed income for life. Employers have a long history of helping employees understand and obtain the insurance and financial protections provided by life insurers. For many years, employers have been choosing life insurance companies in making life insurance, disability insurance, and retirement plans available through the workplace. When employers have provided education and information about these insurance products, employees have been able to understand the products and the workplace has become an important place for individuals to learn about insurance products and to obtain them. Employers can and should provide this same kind of information and education about lifetime income. With some additional guidance, employers

will find it easier to provide education and information and to choose an annuity provider.

We support efforts to make it easier for plan sponsors to provide information and education about annuities, including the illustration of an individual account balance as lifetime income. My comments today highlight some of the issues and recommendations that the industry submitted in response to the request for information. Accordingly, I would like to spend this time discussing two specific items: first, the disclosure or illustration of account balances as guaranteed monthly income for life, and secondly, the fiduciary safe harbor for the selection of lifetime income issuers or products.

Turning first to the disclosure of account balance as monthly income streams. Academics write of the wealth illusion, the effect of workers seeing their savings as a large single sum without understanding its true potential as a source of lifetime income throughout retirement. Current law and common plan design encourage participants to consider their account balances as single sums available as payment upon retirement. This can and often does create a false sense of wealth and one major step forward would be to reframe retirement savings as a source of lifetime income. The Department of Labor can issue guidance to make it easier for employers to appropriately illustrate or demonstrate the guaranteed lifetime monthly income that could be provided by a participant's defined contribution plan account.

ACLI supports the legislative proposals introduced by Senators Bingham, Isaacson, and Kohl, as well as Representative Kind to include these illustrations on benefits statements. ACLI suggests that the illustration be based on a participant's current account balance and the assumption that the participant has already reached age 65. With this key piece of information, workers can understand the value of their savings, decide whether they need to increase their contributions, adjust their 401(k) investments, or reconsider their retirement date if necessary to help achieve the quality of life they expect in retirement. Our RFI response included a survey that shows most workers felt it would be valuable to see how much guaranteed lifetime income they could obtain using their retirement plan savings and that seeing an illustration may prompt them to save more.

More specifically, the survey showed that nearly all -- nine in ten -- respondents said it would be valuable to have their employers show them an illustration of how much monthly income they could get guaranteed for life based on the value of their retirement plan account. A majority -- three out of five -- said that if an illustration showed the monthly income generated would not be enough to meet their needs they would start saving more immediately. Separately, 85 percent expressed an interest in having this information available in their regular retirement statement or on a secure website hosted by either their employer or their plan provider.

To make this work, a lifetime income illustration would be based on either a plan's existing guaranteed lifetime income product or an illustration rate table prepared by the departments. Yesterday, we heard much discussion about arriving at appropriate illustration factors, and, Mr. Turner, I must tell you, I went home last night and studied up on 417(e) of the code --

[laughter]

-- in preparation for today. We are confident --

Jeffrey Turner:
Thank you.

[laughter]

Thomas Roberts:
-- we are confident at the ACLI that we can come up with a table that embeds --

Jeffrey Turner:
Did you say can or cannot?

Thomas Roberts:
We can.

Jeffrey Turner:
Okay.

Thomas Roberts:
-- it embeds publically available mortality rates and interest rates, and we are going to work on that and

pleased to visit with the department on it. Illustrations will help educate participants by translating their account value into retirement income potential. This information will assist them in evaluating such factors as their income needs, their savings adequacy, and the amount of income currently devoted to retirement savings. It reframes the defined contribution plan as a vehicle that not only helps accumulate savings but also can generate retirement income. But for this to work, it is critical that plan fiduciaries have no liability to provide payments in the amount illustrated under the rules. The Department of Labor should provide model language the plans may include on statements to make clear that the payment amount is illustrative.

I'd like to turn next to the fiduciary safe harbor for the selection of the lifetime income issuer or product. ACLI believes that the agency should adopt rules and regulations to make it easier for employers to select and administer guaranteed lifetime income products. The 2008 safe harbor for individual account plans was a significant improvement in the rules for the selection of annuity providers; however, it has been the experience of our member companies that it is not broadly used. ACLI believes that the regulation should be revised to modify or eliminate the requirement that fiduciaries make a determination as to whether "an annuity provider is financially able to make all future payments under an annuity contract." This standard is difficult to meet in part because it is hard to know how to draw this conclusion. A determination regarding future performance is not a requirement applied to the selection of any other financial protection product. Changes can be made to these rules which will make it easier for employers to meet their duties while at the same time ensuring a prudent selection.

The safe harbor should continue to include the following important criteria: one, that the fiduciary engage in an objective, thorough, and analytical search for the purpose of identifying and selecting providers from which to purchase annuities; two, the fiduciary should appropriately consider and conclude at the time of the selection that the cost, including fees and commissions of the annuity contract, is reasonable in relation to the benefits and administration services to be provided; thirdly, if necessary, the fiduciary should consult with an appropriate expert or experts for purposes of compliance with the safe

harbor provisions. However, instead of a determination about the financial ability to make all future payments, the safe harbor should require the fiduciary to give consideration to the current financial strength and other quality aspects of the provider.

We know the department has given serious thought to this issue, and as you consider our request, we believe it is important to recognize the unique roll of state insurance departments in overseeing life insurance companies, including the imposition of any IC uniform rules for the establishment of reserves, the valuation of assets and liabilities, risk-based capital requirements, and required capital. Insurance departments conduct routine reviews of the financial strength of each insurer and its ability to meet its commitments and they have a number of powers to intervene and protect policy holders. The primary focus of our state-based system of life insurer regulation is all about seeing that insurers keep their promises to consumers under any scenario.

Fiduciaries need clear and effective guidance concerning their plan duties when selecting guaranteed lifetime income products. ACLI believes the safe harbor should address all such products and it is critical that the safe harbor be revised to become a more effective tool. We expect to submit additional commentary and suggestions concerning financial strength and quality of the provider. Thank you.

Zenaida Samaniego:

Question for Mr. Nelson. You mentioned something about the relative success of your GLWB in terms of acceptance or demand by plan sponsors. Was there some kind of education or information that got provided that drives this? And what is the experience in turn among participants who are in fact subscribing to this product availability in-plan?

Charles Nelson:

Yes. There was a tremendous amount of education, and the first place where we started was in the intermediaries market, working with advisors, consultants, third-party administrators, educating them on the product features, benefits, et cetera. And then when you sit down with a plan sponsor, it does extend the length of time it takes, to you know, to communicate a 401(k) benefit or, you know, to sell a plan, if you will. We saw an increase in a length of time just for the communication parts of it in

explaining the benefits and features. So, we've done a fair bit of work there and I think the intermediary market has really got up to speed so they can be able to effectively communicate these programs. Relative to participants and participant demands, we're seeing very strong interest as well. So, you know, it really is broad based, not just with plan sponsors, but also within the participant sector.

Zenaida Samaniego:
Interest in terms of how?

Charles Nelson:
Of participation.

Zenaida Samaniego:
Okay.

Charles Nelson:
You know, selecting it as the investment, as an investment vehicle.

Zenaida Samaniego:
Any percent, percentage?

Charles Nelson:
I can get you some of those percentages.

Zenaida Samaniego:
Okay.

Michael Davis:
Mr. Nelson, could I ask -- I mean, one of the issues that you had raised was the spousal protection rules as applied to the purchase of lifetime income streams. You've -- apparently been dealing with those issues since you're selling the product in-plan. How have you been dealing with those spousal protection issues kind of currently and maybe talk a little bit more about what you'd like to see different about -- that would make it easier for you to deal with spousal protection?

Charles Nelson:
Well -- [coughs] excuse me -- a number of -- as I indicated, 77 percent of our plans don't -- you know, haven't elected that, so it's really a smaller percentage. And the plans that have are already abiding by the QJSA and

have elected that: Those are the ones that tend to select the lifetime income products in some ways because they are already subject to that, so it's not an additional. But the people that are -- the plans that are not subject to it don't necessarily want to purchase the retirement income products because that is a concern, that it will increase their overall cost of administration and record-keeping.

Michael Davis:

So, if I'm understanding what you're saying, so the -- a lot of the plans currently comply with the rules for having exception to the --

Charles Nelson:

[assent] right.

Michael Davis:

-- the profit -- call it "profit sharing exception" to the QJSA equips and rules. So those folks are not so interested in [unintelligible] --

Charles Nelson:

Doing anything that will potentially draw them into having to do more around the QJSA and all the documentation.

Michael Davis:

So for those who are willing to go through it, how is that working currently? Like, when are people getting options and elect -- making elections and notices being provided? I mean, I guess --

Charles Nelson:

Just as they would normally -- you know. It's nothing different than how the plan has operated. If they've already been part of -- and -- you know, in getting the notices and doing things.

Male Speaker:

Mr. Nelson, you're very popular today. This question actually can go to you, but more on the panel, but I do recall that Great West, a significant portion of your business is governmental, so non-Orissa. So do you see differences between those plans and Orissa plans in terms of adoption rates, usage; they're obviously not inhibited or controlled by Orissa. Do you see any differences across different types of plans?

Charles Nelson:

There are some differences just in terms of the cycle. Governmental employers typically have a bidding cycle and three-five, year time periods, so, you know, they can't necessarily add new programs. So they're a little slower to adopt because of those processes. However, we have seen and we have a large state plan that has selected our Secure Foundation product and made it available to their employees and are -- is using that as a default option in their plan. So, you know, we're seeing it both at the large plan in the governmental sector as well as some of the smaller plans as well.

Zenaida Samaniego:

This is a question for Mr. Roberts. You had alluded to the state insurance departments I think guarantee protection, and this was a question raised or discussed yesterday at the -- at the hearing yesterday, concerning what is and what is not covered by state guaranteed protection. In this particular case, there was some reference to possibly in-plan options not being covered, and I thought that, perhaps incorrectly, that the businesses -- that's written by insurance companies, the standard guaranteed are in fact covered by a state guaranteed protection. Can you address that, please?

Thomas Roberts:

I -- certainly. I did not talk about guaranteed association coverage in my remarks today, but I do recall yesterday's discussion and I know the rules concerning the coverage that is accorded by guarantee associations to products with in-plans of varies somewhat state to state. But in general, my understanding is that in-plan products are covered as are out-of-plan products.

In my remarks today, what I was emphasizing is that guarantee associations aside, life insurance companies would not be in business, would not be allowed to be in business unless they could demonstrate to the satisfaction of their state regulators that they were adequately reserved and had sufficient capital to provide for all future financial commitments.

Zenaida Samaniego:

Thank you.

Patricia McDermott:

I have a question for Mr. Levy. You mentioned as a fiduciary issue that the use of unisex tables and annuities under retirement plans make -- is less favorable for males, and so I guess I'm wondering sort of what's that -- are you currently comparing -- are you comparing currently what it costs for a man to get an annuity from a defined contribution plan compared to the -- just purchasing it individually on the retail market and how would you see that changing if there were -- I mean, the earlier panel talked about reduced costs if the offering of annuities under defined contribution plans are more widespread?

Eric Levy:

You're referring to the number that I put there [unintelligible] --

Patricia McDermott:

I think you said 7.3 percent.

Eric Levy:

-- [unintelligible] above 7 percent differential in the benefit payout under a male only versus the unisex or 50-50 over the unisex were they all female. And that was comparing to a retail annuity, because they can't get that within the defined contribution plan. We would propose if there were sex-distinct rates that are available to those participants within the plan. So therefore, they would -- the males would have the opportunity to have a higher payout and with the focus -- I probably focused less on the cost per se but more on the payout with the focus being on how much income can an individual obtain through the annuity?

Patricia McDermott:

Personally, I think it sort of -- you know, you either pay more to get the same amount, or you get less for same what get less for the same what you pay. And I assume you know that there are -- that raises legal issues, federal law issues that go beyond any.

Eric Levy:

Understood, understood.

Female speaker:

These agencies do.

Eric Levy:

And we are raising it to know that there are other agencies that would need to deal with that. But it is an impediment which we view within this market.

Male speaker:

A couple of you talked about plan options and the value of them. Can you talk about portability? And that's obviously been a challenge that a lot of people have talked about in previous panels. How have you from a product standpoint dealt with the issue of portability across plans?

Charles Nelson:

You know, I can maybe start off on that. As the previous panel discussed and we participated in as well as the SPARK Institute kind of information sharing, which is really just for record keeping of the product. You know, as pointed out it is not necessarily moving from one provider -- from provider A to provider B of the actual retirement income product. So it is just the record keeping. But that has been a major obstacle inside the market place, just dealing with the record keeping component. And I think that we have made tremendous progress as an industry with the SPARK Institute solution. And I believe that will go a long ways to solve the record keeping component. I don't see much or I don't see much opportunity for provider portability, going from provider A to provider B because if you think about the risk provider A has hedged their risk of the market. They have purchased hedge to support that benefit. You go to provider B; they haven't purchased those for that specific individual. So it's really not a practical solution necessarily to think about provider portability from our perspective.

Male speaker:

But do you think that portability issue is a -- inhibits in some respects some portions of the market from opting to elect an annuity option?

Eric Levy:

I would say that it does, the number of plan sponsors that I have you know talked to over the years about this, they are hesitant because they either could change their record keeper. They are concerned about participants having paid in to the system and not getting the benefit if they were to make a change. So the portability issue is a real inhibitor to plan sponsors taking that next step forward.

I think we have you know discussed a lot issues here and that's one of them that comes up in the top two or three.

Thomas Roberts:

So portability seems to be the three holed monster than there is the fact pattern that Trish referred to earlier which is a provider is discontinued and the participant would then have to take the maybe the -- not the cash value so much as the instrument itself and move it into an IRA. That is one possibility but then there may very well be constraints under the code. Then there is the second portability issue which is the change in record keeper and the extent to which the new record keeper is able to keep the data. And the SPARK initiative is designed in part to address that. And then there is the change from the provider to the provider and Great West just said that I think that because of the way in which risks are hedged that that's a problem that is very difficult to address.

Eric Levy:

Yeah, we agree with all three of those as being impediments.

Robert Doyle:

And again kind of following up on my invitation to the last panel to the extent that you can have thoughts in terms of how one encompasses criteria within a fiduciary safe harbor to take that into account. Now what I heard from this panel was state or -- the financial solvency of an insurer was an issue and fiduciaries are going to be hard pressed in most instances without engaging an expert to make those determinations. And perhaps there should be more reliance on the state regulatory regime that is in place. And I guess in that regard, would it be enough in your view if the company was licensed in one state? Should they be licensed in multiple states? What kind of standard might one construct that the average plan fiduciary could take some comfort in knowing that they satisfied that regard? Or if you want to think about it, that is fine too. But again in stepping back and looking at you know the fiduciary safe harbor as it is and what can we do to provide a higher degree of certainty without kind of compromising on some of these issues. You know I think that would be very helpful.

Thomas Roberts:

We think -- the state insurance regulation has been under appreciated and we really would very, very much advocate for taking a second look at the good job that the state insurance regulators do in protecting the public by making sure that life insurance company commitments are adequately reserved. We think our industry has an admirable record of satisfying its obligations.

Charles Nelson:
We would agree, yes.

Robert Doyle:
And I guess the kind of along the same lines, I think it was like in Briton [spelled phonetically] testimony in any event, encouraged the department to perhaps engage state guarantee associations to do more in terms of considering certain lifetime income products. And I guess in that regard is there anything you can add more specificity as to what kind of products we are talking about? What are the issues that state guarantee associations are struggling with in this regard? Are there issues, has the NAIC been engaged in these discussions?

Eric Levy:
Look to Tom also but you know to the extent that they are not included or covered we would look to the encouragement to have these products and you know the annuity income options or withdrawal benefits be able to be part of the guarantee. And allow for plan sponsors to have that comfort that there would be a backup for any issues of insolvency related to the insurer that they chose.

Robert Doyle:
And do you -- are these issues that are currently under consideration? Are they tend to be considered by the state on a state by state basis or -- I mean I know there is an association of --

Male speaker:
NAIC?

Robert Doyle:
-- of guaranteed fund.

[simultaneous speaking]

Male speaker:

I am not aware of, specifically I don't know.

Robert Doyle:

I guess I would invite you again if this is kind of an area of interest and there is something that we should be thinking about in terms of facilitating or encouraging a little more specificity in that area as to kind of what types of products are under consideration or should be considered in that regard that would be helpful.

Zenaida Samaniego:

If I may one last request if possible. To the extent that there is a range of products out there, if anyone of you could provide some data on take up rates and experience with those products, we would appreciate it. Thank you.

Robert Doyle:

Okay, thank you very much.

[break]

Panel Three

Robert Doyle:
Welcome.

Male speaker:
Thank you.

Robert Doyle:
Shall we start with you Mr. Utkus?

Stephen Utkus:
Okay, great shall we begin?

Robert Doyle:
We should.

Stephen Utkus:
Okay, thanks. Thanks very much for the opportunity to speak today. I would just like to highlight a few points from my written testimony. First on sort of item number one before us, the question of participant concerns regarding annuitization: The conventional view of this topic I think it's been expressed in this hearing and some forums and in other forums dedicated to this issue is really focused on this question of guaranteed annuity income. And from this perspective households face important risks, market and longevity risks in retirement. Annuities offer protection against such risks and thus households -- American households ought to optimally annuitize a great portion of their assets. And the fact that if you look in the U.S. economy annuitization rates are low, that is either taken as evidence of market failure by the annuity market itself or evidence of poor decision making by U.S. households.

And as you can see from our written testimony, we take a very different view of this issue. We recognize that most households already attain some significant level of risk protection through Social Security. More over and I think that this is a point that Bill Gale made -- Bill Gale from Brookings -- at a recent retirement income summit here in Washington. He emphasized that households have other quasi annuitized wealth like Medicare and for many a primary residence. So given this sort of floor of protection we believe it's actually perfectly reasonable for most households to prefer a portfolio savings as a reserve

against future risks in retirement. Retirement from this perspective is fraught with a great deal of uncertainty particularly with respect to some of the issues that have already been raised in this session, things like long term healthcare costs, end of life or late in life housing decisions, and indeed the general uncertainty of fear of life that can last over such a long horizon.

And it is for this reason, really, that we see that a portfolio of savings can, in effect, be a form of financial security that we believe withdrawal strategies rather than annuitization will be the dominant retirement income strategy for most plan participants and beneficiaries. Liquidity and flexibility are very powerful motivations. And given this safety net that exists already in the U.S. retirement system, they will often trump the demand for private annuities. Now that said, if you did want to purchase additional annuity income, it is also fair to say that the market is fraught with certain inefficiencies. For example if I wanted to compare five annuity providers today, it would involve contacting five distinct sales people and then engaging in sort of a technical analysis of these contract features that really only experts can understand. And as you may know under state law transparency of commissions, paid under annuity contracts is very weak, in fact non-existent.

And so for these reasons and for those investors who are looking for guaranteed income we recently entered into collaboration with the Hueler Companies to offer their income solution platform to Vanguard investors. As you may know from this service with this program, which at Vanguard we call Vanguard Annuity Access, allows individuals to compare annuity quotes on an apples to apples basis for multiple providers. And we believe that it will improve information for consumers, heighten market place competition and lower fees. And interestingly enough we actually think it will expand the annuity market place for the benefit of both the issuing insurers and for the individuals as well who are participating as the Vanguard program is really expected to reach the self-directed market place, typically not served today by the annuity market. So we continue to believe that at the heart of this decision making round retirement income and the question around annuities is their fundamental, irreversibility of an annuity contract makes it very costly to consider annuitization. And households therefore will

prefer, given existing sources of guaranteed income a portfolio savings over annuity.

But that doesn't mean that we can't do more to improve the efficiency and attractiveness of the annuity marketplace as it exists today. And we think that programs like Vanguard Annuity Access will do so. So that's on really the first issue and my main comment. On the other two issues that we want to comment on, the second one is regarding participant education. I know that you have heard a great deal about that. We actually took the time to itemize what we thought would be a comprehensive set of issues that a revised interpretive bulletin might deal on this issue. So I would sort of welcome your review of our written testimony in that regard. I would just like to make one additional point on this whole question of participant education. And it's driven by the following statistic; our research shows that within three years most of the Vanguard record keeping participants -- we are a major 401k record keeper -- leave their employer plan upon retirement.

So within three years they have effectively exited the qualified plan system, virtually all the participants. Now we can talk about the variety of reasons that why this is occurring. There is lots of dynamics driving that. But fundamentally most retirement income decisions we believe by households will be made outside the plan in an IRA rollover arrangement, not within a qualified DC plan. So for this reason alone we think it is very imperative as we think about revisions to the interpretive bulletin to draw a very clear guideline for planned fiduciaries about what constitutes describing and educating about beyond the plan solutions versus endorsement. Sponsors are looking for some clear guidance between how they can educate people when they leave the plan to make informed choices without appearing to endorse or recommend specific options outside the plan, which would lead to fiduciary liability.

And then finally, just one last comment on alternative arrangements in retirement income or alternative designs. I have already talked about the question of IRA rollovers and most decisions being made outside of qualified plans. The other issue that we are sort of very interested in this question of default annuitization or trial annuitization. But our interest in it is to encourage everyone to distinguish between the success of automatic enrollment and accumulation phase versus the prospects for trial

annuitization at retirement. We actually find them from a behavioral perspective to be quite different. The financial consequences are quite different, if I have been automatically enrolled and I decide to stop, the consequences are or I continue the cost is a weekly or bi weekly payroll contribution whereas default annuitization leads to a fundamentally irreversible position for a large portion of my savings.

And also one of the clear things from my research is that participants are quite different in terms of motivation when they are young and uninterested in retirement savings versus they are at the end of their working career and thinking about the disposition of their retirement savings. The level of motivation, the active level of decision making is quite different. Now ideally if there were to be a default in federal law, we would prefer one that preserves liquidity and flexibility for participants, for example something like a three or four percent withdrawal plan would be a default and a perfect way to get some income from an account. And then participants would have the option then of considering on a proactive basis, on a fully informed basis whether or not to make sort of the daunting decision to annuitize a portion of their savings. Even if there were such a default, we actually don't think it should be a designated default because of the tax consequences of any sort of default arrangement.

In the end, because of tax consequences and irreversibility of certain decisions in the payout phase, it is really difficult to design a system in which there is a default arrangement. People actually do have to make active choices. So in the end when we think about the distribution phase compared to automatic enrollment and accumulation fees, we see quite different decision making dynamic. And we would intend to -- we would, our approach would be in thinking about the payout phase to focus on choice and education as the main driver because the default arrangements have such particularly onerous consequences. So thank you very much for the opportunity to give those comments.

Kelli Hueller:

Are we ready? I apologize up front for my allergy cough going on here. So I am going to clear my throat as much as I need to. I apologize up front for that. It is great really to be here with all of you today. It is a pleasure

for me to be here and I sincerely want to thank you for the efforts that you have undertaken through the RFI process as well as now these ongoing testimonies and hearings that you are offering and affording everyone the opportunity to participate in. Hueler submitted our background through our RFI response, so I won't focus on that. And it is available to you at written submission. It worth noting that Hueler is an independent organization, we don't manufacture any products, either insurance or investment products. And we don't provide any form of advice. We are neutral actually to the type of structure that could be utilized to produce lifetime income for participants.

However it's been our interest and in fairness, it is our experience in terms of working with the guaranteed insured product structures that offer lifetime income that lend themselves to transparent comparison and can be selected on a competitive results basis and delivered at low cost. So that would be something that could consider our bias. In efforts to develop our independent, non-exclusive delivery platform, Hueler has collaborated with multiple organizations across the private and public sector as well as worked with not for profit and for profit organizations. I am going to focus on three questions today. Your first question that was raised dealt with specific participant concerns, affecting the lifetime income choice relative to other options. When annuities are offered to participants in plans or a plan distribution, they are offered really typically in an all or nothing format.

They have additional constraints associated with them that are not associated with other alternatives. Basically participants are given the option of only utilizing one hundred percent of their balance or everything that they have saved in their retirement plan to purchase an annuity versus flexibility. So they have a single point in time decision and typically a single provider decision that they make. That is also an irrevocable decision. Based on our experience, participants are far more receptive to having the option of using a portion of their resources and an amount that is reflective of their own personal interests and circumstances. It's really the last thing that they want to do when they are making retirement decisions, to make a decision about all of their resources and that it involves all of their hard earned savings. That is irrevocable.

They want to be able to select from a limited list of features. It doesn't need to be extensive but it needs to be enough that they can create some customization and create an annuity payment stream that fits their needs. They typically feel more comfortable being able to see some price comparisons; a single number is a very difficult thing to trust. And they want to be able to choose from multiple providers. Trust, we see, is a big issue in this process and we believe that one of the very powerful things that can be done -- should I move this over? Is that helpful? One of the powerful things that could be done to create a higher degree of trust in the entire process of offering annuities to participants would be to require full fee disclosure, no exceptions. Finally what we have learned in working through this process over the last ten years is that 85 - 90 percent of people when they are in the process of trying to make an annuity decision; they want to speak to someone.

They want to speak to someone knowledgeable, trustworthy and unbiased to determine which annuity features might be right for them or even if they need an annuity. Your second question relates to the type of information that participants could utilize in regarding the pay down phase and how they might be able to make choices about paying out over time their retirement resources. As much as we would love to be able to tell you all you really need is a great platform designed with new technology and competitive, it's just not that simple. We really believe based on what we have seen that participants are able to make an annuity decision -- they're more likely to make an annuity decision when we have given them flexibility like we have outlined above but they also have got access to professionals who can help them.

Calculators can be very useful and we have found that to be, you know, simple straight forward calculators are the most useful. We have a calculator tool we call basically the income yap calculator and people use it all the time. It is simple and straight forward. They can go in and get a start on thinking about, "How much do I need to annuitize?" It is utilized, like I said, all the time. It helps people think about what amount and then it helps them estimate, "How much would I need to set aside to create that amount?" But that's just an example of many calculators that are available. There are many new calculators coming out. There are lots of tools available

on the web and throughout a lot of different organizations. I have heard that the testimony has included some suggestions to the group about the Department of Labor having a web site where there would be a centralized way of calculating the theoretical annuity values. And we are all for having those kind of values included in participant education and communication as they move through the accumulation phase.

It makes it more normal for them to think about their money in relationship to an income payment and when they get to retirement, it won't be foreign. But the folks who are retiring now haven't had that opportunity. And theoretical values, what we see, is they move away from the calculator and move to the real time quote capabilities once they get into a phase of needing to make a decision. So we would really encourage and we would be -- we would encourage you to focus on, not moving to theoretical values and creating more opportunity for theoretical value creation but to look at real market information. We have developed that technology. It is available at our web site. We have collaborated with all the insurance companies that participate on the platform to create real time market information. And we are more than willing to collaborate with the Department of Labor or any other agency the way we have with other organizations to offer access to market based information that can truly help those folks who are in the process of trying to transition get a realistic value for their resources.

We don't think that you can answer this question of offering values by looking in the rear view mirror and creating more theoretical technology. We think you need to look to the future and leverage technology that exists in the market place, to engage participants and to encourage them. And Hueler is very much committed to being a part of that and doing whatever we need to do to facilitate the increased access and meaningful competition. And if it is in the public interest, we are happy to be part of that. Your third question asks about the safe harbor as it relates to the selection of issuers and products. The number one issue that we talk about with plan sponsors is fiduciary liability. And that is whether they are considering an in plan option for distribution or an IRA rollover program, whether it is direct fiduciary liability or it's the issue of endorsement. Plan sponsors have a

significant concern and don't believe they can burden their companies with additional liability.

We talk with them weekly and it is very difficult for them to justify that. We have over 1200 plans that participate in our program right now but that's a small fraction of the plans that need and want to provide access to their participants and understand that it is in their interest. So we need to take the handcuffs from our perspective off reasonable plan sponsors and allow them to offer access to lifetime income annuities without the fear of liability. We can do this, we think, in a very prudent, simple way for the distribution phase. And we recommend that the Department of Labor offer guidance to plan participants about lifetime income annuity offerings by outlining a practical, straight forward process with a simple multi-step road map.

Based on our experience we believe the following, the process should include the following steps; allow for partial distributions so participants can use any portion of their retirement savings. Make multiple issuers available to promote price competition. Encourage diversification to address concerns over single provider risks. Provide standardized features to reduce confusion and allow individual customization. Require institutional pricing with fee disclosure -- no exceptions -- that maximizes monthly income amounts, promotes transparency, and improves trust. Utilize an issuer due diligence process that is based on pre-established objective criteria. And if assistance is provided, it should be through noncommissioned professionals that can offer unbiased assistance. That would be it for my comments. Thanks very much for the time. Thanks.

Patricia Harris:

Good morning. My name is Patricia Harris. I am Assistant Vice President in actuary income solutions at the Hartford. I am appearing today on behalf of the Insured Retirement Institute and its members. Thanks very much for the opportunity to testify today. The membership of IRI is diverse and includes all segments of the annuity insured retirement product and retirement planning industries with over 300 member organizations. As Americans are living longer and facing greater obstacles to retirement security, the role of guaranteed lifetime income products is in helping investors achieve financially secure retirement has

never been more important. And annuities are the only financial products that guarantee lifetime income throughout retirement.

We applaud the President's focus on retirement security and his promotion of the benefits of annuities and other guaranteed lifetime income strategies. At the Hartford and at IRI, we have been very engaged as the Obama administration has undertaken a comprehensive evaluation of the federal rules and regulations surrounding the use of guaranteed lifetime income options in retirement plans. I will focus on just a few of the most significant issues in my testimony this morning and a more detailed discussion of these and other issues is included in my written testimony. The first issue that I would like to discuss, which has already been talked about a great deal so far in the testimony, is the selection and monitoring of lifetime income providers and products. We view this as a threshold issue, one that must be adequately addressed in order to achieve the administration's goals.

If it is not adequately addressed the effectiveness of any of the other actions that the DOL or Treasury will make could be severely limited. Potential fiduciary liability under section 404 of ERISA is of paramount concern to plan sponsors with respect to their operation and maintenance of retirement plans on behalf of their participants and beneficiaries. A violation of ERISA's fiduciary duties potentially results in personal liability for client sponsors. To assist plan sponsors in fulfilling their fiduciary obligations, the Department of Labor has issued regulations, rulings, releases, interpretive guidance and other pronouncements that do help to clarify who is a fiduciary under ERISA and how to fulfill these duties. Unfortunately plan sponsors have not found enough certainty and comfort in these pronouncements as they relate to guaranteed lifetime income products. And therefore the vast majority have been unwilling to include guaranteed lifetime options in their retirement plans.

The most significant obstacle to increased offerings of guaranteed lifetime income options is the potential fiduciary liability associated with the selection and monitoring of the providers and products. Under ERISA plan sponsors have a fiduciary duty to prudently select and monitor the investment options under the plan as well as the providers of such options. Plan sponsors are fairly

familiar with the selection and monitoring rules with respect to traditional accumulation products, such as mutual funds. But for the most part, they do not fully understand what is required to fulfill their fiduciary duty in the context of guaranteed lifetime income products. The DOL attempted to address this issue when it created the safe harbor under regulations section 404 A-4 for the selection of distribution annuities in such plans. Unfortunately this safe harbor has not been widely utilized.

Our IRI's member companies have heard from many sponsors that the requirements of the safe harbor are just too confusing and too burdensome. Specifically plan sponsors are troubled by the safe harbor's requirement that they assess the ability of the annuity provider to make all future payments under the annuity contract and conclude that the annuity provider is financially able to make all future payments under the annuity contract. This is an onerous task and the average plan sponsor is not well equipped to perform it. Furthermore it is inefficient and possibly inequitable to require multiple plan sponsors to conduct this analysis of a single provider, possibly reaching different conclusions. We believe that the DOL should revise the safe harbor to modify or eliminate the requirement that fiduciaries make the determination of whether an annuity provider is able to make all future payments under an annuity contract. To be clear, we do believe that plan sponsors should have to consider the providers financial condition. However we do not think it is necessary, appropriate or effective to require plan sponsors to reach definitive conclusions about the future of the provider.

On a similar note we believe that the DOL should clarify that plan sponsors are not subject to fiduciary liability for changes in circumstances with respect to the provider's financial stability in the future if the plan sponsor fulfills the requirements under a revised safe harbor at the time of the selection. In considering how to proceed we urge the DOL to consider as a factor in its deliberations on this issue that insurance companies are subject to a comprehensive state insurance regulatory system which includes numerous mechanisms designed to protect consumers from the risk that a particular insurer may be unable to satisfy its financial obligations. DOL guidance would also be helpful with respect to the

obligations of plan sponsors in the selection of guaranteed lifetime income products other than distribution annuities. IRI's position is that rule 404 A-4 safe harbor protections are just as appropriate for other guaranteed lifetime income products as they are for distribution annuities.

The lack of clarity of the safe harbor might discourage plan sponsors from making a guaranteed lifetime income option available because they are concerned about the risk of liability. Plan sponsors need a clear explanation of their duties when selecting guaranteed lifetime income solutions for their plans. And the safe harbor should be modified to provide fiduciaries with an unambiguous way forward. As you might expect and as you have heard with other testimony there are differing views on what the requirements should be in terms of imposing unplanned sponsors in this context. My company, for example, believes that the DOL should clarify that a plan sponsor can satisfy its fiduciary obligation with respect to the selection of an in plan, incremental annuity that provides a meaningful redemption feature by complying with 404C regulations. Our view is that such in plan annuities, which allow participants to reallocate their investments from the guaranteed income benefit to other plan investment options very much resemble traditional plan options such as mutual funds and should therefore be held to the same standard.

My company believes that since most employers seem very comfortable with the process for selecting investment options under 404C bringing in plan incremental annuities under the same standard would greatly increase plan sponsors willingness to offer such products. Before moving to the next subject I want to summarize our views on selection and monitoring. Most plan sponsors are not currently willing to confront the annuity selection process due to the complexity and uncertainty and the nature of the safe harbor. The lack of clarity of the requirements might discourage a plan sponsor from making an annuity or guaranteed lifetime income option available because they are concerned about their own personal liability risk. If the DOL can address these concerns with a revised safe harbor that provides the clarity and certainty to plan sponsors, we believe the availability of these options will greatly increase.

The next subject that I would like to discuss is the education and communication around guaranteed lifetime income strategies. This is critical to the growth and acceptance of guaranteed lifetime income as a fundamental component of a comprehensive, well considered retirement plan. It is extremely important that plan sponsors and participants are provided with straight forward, clear and effective communication and education about their retirement plans. Hartford and IRI are committed to education. And in the retirement plan business and continually looking for ways to enhance the educational process in an effort to insure participants have the tools that they need to make informed decisions. Unfortunately despite the intentions and efforts, participants are still not receiving adequate education and information about guaranteed lifetime income strategies.

Plan sponsors are concerned that due to the perceived complexity of guaranteed lifetime income products, any attempt by plan sponsors to educate participants about these products and give relevant information could result in potential fiduciary liability if the information provided is deemed to be investment advice under ERISA. We believe this potential liability is a significant factor in limiting the use of these products in the plans. Interpretive bulletin 96-1 does create a safe harbor and it does lay out four different categories of education that can be provided without stepping over the line into ERISA investment advice. And these include plan information, general information investment performance, asset allocation models and interactive investment materials.

Plan sponsors may be able to rely on a number of these, particularly plan information to provide participants and beneficiaries with information about a specific option that may be available. But the DOL has not provided any specific guidance for plan sponsors about how to meet the requirements of the safe harbor for lifetime income products. Okay. In conclusion I would like to emphasize that IRI and its members strongly support your efforts to break down the barriers to the use of guaranteed lifetime income strategies for participants and beneficiaries. At the Hartford and at IRI, we stand ready to assist your efforts as you continue to contemplate changes to the rules and regulations. I welcome any questions that you may have at this time and would also be glad to provide additional information in writing. Thank you.

Male speaker:
Go ahead.

Zenaida Samaniego:

To the extent that we can educate plan participants in what you are calling an unbiased manner -- I think this is the question for all participants -- and I think you started to recite the kind of information that you would like to be able to provide. In your view -- I mean which of this information -- I mean in an ideal situation where there is no fear of fiduciary liability -- would you like to be able to provide that you think would be effective to participants?

Stephen Utkus:

So in our written testimony we have enumerated a number of things, I think it is -- one very clear issue is that there are categories of retirement income solutions so you can use how to set up a systematic withdrawal plan as a source of income. How do you use minimum required distribution rules, which are actually tax rules but an interesting way to generate income if you are 70 and a half and older. How to use new structures like payout funds or how to use annuities in financing retirement income, there are a variety of strategies. And it seems to me that you can describe those in terms of features, benefits, risks, and costs without endorsing specific products as part of the plan. So in the same way for example in the interpretive bulletin today under the 401(k) plan sponsors talk about stocks and bonds and cash investments and asset allocation without endorsing specific product offerings within the plan.

Patricia Harris:

I think we would add to that offering education along the demographic spectrum. So that education is targeted to a need base versus just openly sort of, you know, feature specific or solution based. More for the phases of retirement, we break it down into four phases. We look at early retirement or early accumulators, mid-range to late stage accumulators, folks that are about reaching retirement, and then those that are transitioning or in retirement. And we think that income annuities and other lifetime income alternatives, they meet different needs. And so being able to speak, as Steve, said generically about a type of solution but have it framed in a way that

it's delivered to the folks that have the need. And recognizing that there are different needs, that people who are right now either in retirement or at the point of having to make a decision, they have some immediate burning needs. They have a different, you know, problem set to solve. So I do think that one of the things with education is being able to look at it in terms of the demographic groups within the plan and offer lifetime income information about either building or utilizing.

Kelli Hueler:

I would just add too I think that many participants and plans really don't know anything about annuities. So just some general, basic information about what an annuity can do in terms of your retirement planning and how that can give you enough money, you know, to cover basic expenses that you are going to have in retirement. And to get people with that mindset to start thinking about, "How am I going to cover my retirement expenses and how should I be thinking about that and planning?" I think just general information isn't available to participants, so they don't even know how to consider an annuity today. And I think that would be very helpful, it doesn't have to be -- as everyone has said, it doesn't have to be product specific. It just has to be some general education that should be available. And then once somebody is interested, if they think, "Well, based on my circumstances that makes a lot of sense for me. I do need to learn more. Do I want to buy an annuity that is incremental annuity along the way? Do I want to wait and buy an annuity at the end as a partial annuitization strategy or something else?" They can investigate that further.

Stephen Utkus:

I was just going to add one more thing, we do actually have samples. Part of the issue is some of this education is already occurring today, so in retirement seminars, pre-retirement seminars, web information, so we actually do have samples of what we do provide today. I think what people are looking for is an extension of IB 96-1 to say, "Oh that is a good idea," and to encourage more -- the provision of more information. So we have basic information on how to set up withdrawal plans, how to do -- how to think about the present kinds of annuitization and whether to annuitize and at what age. So that is some of the information we want to see expanded.

Patricia Harris:

I think just on that point I want to mention that we had actually one plan sponsor so concerned that if they did a special webinar or a special retirement session just on annuities it would be viewed as though they were favoring that option over other options in their plan. So that's where you get into the dilemma of how much information you can provide before it's looking like it is investment advice.

Robert Doyle:

So what I am hearing, it's more clarify -- there are materials out there and I know that there is a lot of innovation and the like going on and communication in the private sector. So it is more facilitating that process than perhaps the government assuming a role of preparing those materials, is that?

Stephen Utkus:

That would be my view. I think it is as simple as conservative ERISA council would like to see an expanded bulletin that has examples using retirement income. So I have provided some examples. For example in my written testimony -- case -- when you talk about case studies as an example of what you can and cannot say, for example the existing interpretive bulletin talks about sample portfolios. Well you could have sample retirement income strategies, and just incorporating those concepts and saying this interpretive bulletin has to apply to accumulation based strategies as well as draw down based strategies. I think that is what people are looking for, wouldn't you say?

Kelli Hueler:

Yes and I think that what's important about your question is that those educational efforts are sort of occurring but they are over on the side. They are not integrated with all of the other information so it is not -- annuities are not talked about as a normal part of the process. So if plan sponsors have a comfort level and some guidance with -- lifetime income can be part of the conversation that employees are -- that you can provide to your employees relative to their defined contribution plan and their retirement assets. So it sort of makes it a normal part of the process, just like seeing your income amounts on statements and understanding how that could convert their assets into income. Well they right now make all decisions

about annuities in isolation. It's really not a workable prospect for them.

Robert Doyle:

Maybe I should do the follow up, is there a role for us in the development of calculators and educational materials that we should be fulfilling perhaps that we are not at this time?

Stephen Utkus:
[unintelligible]

Robert Doyle:

[unintelligible] I mean maybe the answer is no, which is fine.

Stephen Utkus:

[unintelligible] which extends to public education. I do think the issue -- the broader issue, is less about DOL's role, which could be supplemental and useful as it's done in the past on other retirement issues. I think it is more a question of making sure that existing guidance is interpreted broadly by industry.

Patricia Harris:

I think it is about getting to the point where people are confident that they are allowed to and that it would be a responsible thing to integrate that information.

Robert Doyle:

Okay. In that regard the more specificity you can provide us in terms of areas that should address that would be helpful that when you are talking to clients you can point to as the department has addressed that would be I think helpful to us.

Patricia Harris:

One of the comments that I would make is simplicity and starting with the base line, creating a baseline income in retirement. And just very simple, straight forward concepts that people can start applying to their real lives in a practical way.

Robert Doyle:

Well it is always helpful to engage in these discussions because of just terminology alone. We are not always in sync, so if there are words that have some magic in terms

of communicating a concept again, that's the kind of thing I would find helpful.

Patricia Harris:
[Inaudible]

Stephen Utkus:

Yeah and we made a rather detailed list in our written testimony in terms of, as Kelli mentioned, in the sources of income that you expect to rely on and how to think about them and whether there is a deficit or surplus. The issues of the types of instruments that exist, annuities and other types of strategies, systematic withdrawal plans to spend down assets and the tradeoffs and the costs, work sheets that help you do that, so I think the issue is in today's interpretive bulletin. People read it narrowly and say, "Oh you can do a worksheet on calculating your retirement needs." But whether that applies to a worksheet on retirement income is somehow questioned. So by actually modifying it with an example and saying one example is your -- someone doing a worksheet to estimate retirement income needs in the future versus someone who is in retirement thinking about how to draw down their assets and using a worksheet to do that. It's that simple context that people are looking for.

Zenaida Samaniego:

Just a follow up comment and a question in regard to the generic information that you are talking about, I think Patricia was talking about this question about a webinar say that is addressed, focused on annuities. In terms -- in generic terms you could provide a webinar in fact that discusses all those possible options including annuities and how you might contrast these different options. In that case perhaps the question would be less then. Just a thought. And this is a question for Kelli, I guess. In terms of your platform, how do providers get on your platform? Do you select them or do you they?

Kelli:

Insurance companies? Yes, we do.

Zenaida Samaniego:

And what is the basis for their getting on?

Kelli Hueler:

It is Hueler has -- as I probably could mention, it would be helpful. We have been in the business for over 20 years. We have built our reputation on the stable value side. We are very familiar. We have extensive experience in reviewing insurance companies as financial institutions and doing due diligence on them and on their products. So we use our own internal due diligence process that has a set of objective criteria that is put in place in advance. We also utilize industry data and external modeling and quantitative modeling and research on insurance company balance sheets. We compile that and we have an ongoing oversight process that occurs on a quarterly basis. So that is something that we have created and utilized over the course of 20 years. And we feel very confident in its, you know, strength. And the other thing that I would say is this is not a pay to play platform, we are completely independent of the decision to select an insurer or remove an issuer. And we believe that independence is critically important for plan sponsors, so when an issuer comes on the platform, they have qualified to be on the platform. But they also have to price institutionally and be willing to have fee transparency, so there are some barriers.

Zenaida Samaniego:

Do you think any of that objective criteria could be shared or used to address the concerns about the selection of providers?

Kelli Hueler:

I think so.

Zenaida Samaniego:

In the safe harbor.

Kelli Hueler:

I do think so. I think it's something that you can give a lot of thought to. We are certainly willing to have more dialogue about that and look at, you know, the specific objective criteria that we set, and why we don't rely solely on rating agency information and data. And we don't view that as a reliable, you know, single source that is a part of the process. So we would be happy to have more conversation about that and try to outline how we have developed the process.

Male speaker:

Ms. Hueler, you talk passionately, I thought, about fee disclosure and the need to have more transparency and even maybe a push to require that transparency. Is it your view that that transparency would make a significant difference in the participant's comfort level with annuities and the adoption around them?

Kelli Hueler:

You know I think it is two things. I think what it does insure that when participants are presented with alternatives, they have the ability to look at an apples to apples -- you know, when we talk about standardized features that is a part of this. So the standardization of features combined with fee transparency lets people be certain that they are buying only what they need. They are not getting features or add ons that they are paying for but they don't need. They are not confused, it is very straight forward. And when there is fee disclosure, there is no opportunity to be encouraged to look at another product and assume that there are no fees associated with that.

We have that happen on a fairly regular basis because we were, you know, the odd man out ten years ago. We said we are going to require fee disclosure and nobody does that. So the other alternative programs they may look at, they don't offer the information about fees. And we think that it is very important because people ask about it all the time. Individuals want to know, "What am I paying and how does this compare to another product?" So we think that this is part in parcel, not simply stand alone by itself but it's a critical component of elevating the comfort level of meeting consumers and participants and retirees where they are, which is trying to make a very important decision. And that is a big part of developing trust and comfort.

Male speaker:

I just wanted to --

Stephen Utkus:

Can I add something?

Male speaker:

I wanted to know if that, I just want to make sure, I did want to hear from the entire panel as to whether you guys agree with that view.

Stephen Utkus:

Well I was just going to say that remember with all net yield products, in other words bank and annuity contracts. What Kelli is speaking about is commission income paid to a distributor. And if you go to annuity markets around the United States and you ask, "Do you pay commissions to the annuity distributor?" they go, "No."

Kelli Hueler:

Or are there any fees?

Stephen Utkus:

Or are there any fees?

Kelli Hueler:

No.

Stephen Utkus:

So there is that commission income revenue and then within the product -- you know, within the financial institution itself, the banker or insurance company there is actually obviously a fee for running. There is a profit to make a profit at the business. That information itself is virtually, it is quite difficult to disclose but it is not disclosed today because the state's regulatory approach is that you compete on the price you get for your annuity, how much income it is going to pay. And all the fees are incorporated into that. So you look at annuity one, it is going to pay your 500 a month. Annuity two is going to pay you 510 a month and you say that is the net net [spelled phonetically] of all the fees. But the actual underlying fees for the insurance company to run that product are A, very difficult to calculate and B, not reported. But Kelli is talking about the fee to distribute that.

Kelli Hueler:

Right.

Stephen Utkus:

Through a sales person.

Kelli Hueler:

But it is also an issue of transparency when you talk about standardization. The only way to get at the costs, the underlying costs and how that product is being delivered and whether its value is being able to compare an apple and an apple, and not to be caught up in this apples and

oranges comparison where you are confused and not certain what you are buying. So that's really why transparency at the fee level is so important but so is the standardization of presentation.

Male speaker:

I am just curious Miss Harris, would you agree with that perspective?

Patricia Harris:

I do. I mean, I certainly support fee transparency in the disclosure and I think that makes sense. But I also agree that on certain products it is very difficult, for example, with a fixed annuity type product where you don't have an accumulation annuity. You are not taking certain fees off of say a credited rate in order to get it to, you know, a net rate. It's very difficult to put it in an apples to apples comparison. And there you really are left with, "Okay what am I paying? What is the purchase price and what's the benefit that I am getting?"

Kelli Hueler:

It's a very important point.

Patricia Harris:

And that's really -- what's important is what is that guarantee that is being provided.

Kelli Hueler:

And I think the difference is, as I said earlier, my comments are really about the distribution phase when an individual goes to convert assets into income. This straight forward comparative process is critical. And your point is extremely important, products in the accumulation phase have different characteristics and you can't look at all the same products the same way.

Male speaker:

[unintelligible] Mr. Utkus I would be interested to hear your point of view. To me it seems kind of an alternative view or kind of a unique view as compared to some of the other folks who have testified. Let's see if I've got kind of the basic idea. As I understand what you have said, you can do all the promotion or all of it and the rule changes that we can think of to encourage a guaranteed annuity products in plans and it would be your point of view that still most defined contribution plan participants are not

going to be interested in those kinds of products. And so you would, I think I am hearing you say that you would want us to look at kind of other kinds of issues like you know is there any kind of help that we can provide with respect to systematic withdrawals that aren't really related to guaranteed income products. Is that a fair description of what you have --?

Stephen Utkus:

I think you have captured the spirit of the, you know, our view which is that the principal, you know, the annuity puzzle that people talk about, is not a puzzle. As research has shown people are concerned about health costs and about housing transitions and about other factors. So they want to preserve liquid savings. So absolutely that is an emerging view and in the research literature and it is one that we have embraced at Vanguard because it is some of the work that my colleague, John Amerts [spelled phonetically] has done in this area. So that's our view that households will -- even if we make for example, if we make qualified joint survivor annuities the default rule -- and you have to -- all defined contribution plans, we think substantially most people will opt out of them for the reasons that we have talked about.

Now that said, I don't actually think there is much other than promoting education and better -- a full array of choices in our view, systemic withdrawal plans to guaranteed annuities -- I don't know that we need more to encourage systematic withdrawal plans per se. I mean, I think it is relatively easy to communicate and educate people about how to set them up and the risks both in the plan and outside the plan. So it doesn't require any particular issue. I think it is difficult to talk about other types of more complex financial instruments and maybe some clarifying language would help with some of those. But I think actually today you can talk about systematic withdrawal plans and many, it is the default advice of the financial planning industry in the United States today.

Male speaker:

So I guess that is kind of the [unintelligible], if you had your druthers, there is not really that much that you would be asking for as far as changes maybe --

Stephen Utkus:

Other than with respect to education about a full range of options, I think that is the key. I mean I think that if you had the focal point is making sure that everyone understands all the choices that are available. I think the general assumption is that you have to immediately -- if you are going to have an education seminar about income it has to start with guaranteed income. To me it starts with a series of different types of ways to generate income in retirement and the pros and cons of each. And if that is the policy position that we gravitate toward, that would be -- I am in favor of that.

Robert Doyle:
Thank you.

Panel Four

Robert Doyle:
Good morning.

Pamela Perun:
Good morning. My name is Pamela Perun, and I'm the policy director of the Aspen Institute Initiative on Financial Security. At Aspen IFS, our focus is on the ordinary saver, those with modest to medium-sized nest eggs, and our perspective on life-long income products is intended to keep their interests in mind. I'm here today to testify on the topic of a fiduciary safe harbor. In 2007 I published a paper on this topic titled "Putting Annuities Back Into Savings Plans," which elaborates on the comments I will make today. I will be submitting this paper for the public record along with my comments.

I am also an ERISA attorney, and my special interest is in keeping the private pension system a hospitable place for small employers. It is important to remember that 90 percent -- that's 90 percent -- of defined contribution plans have less than 100 participants. These plans cover about 15 percent of all planned participants, and they represent an important constituency that we need to keep within the private pension system. I believe that we're not asking the right question here. The question is really not how can we get a better fiduciary safe harbor for employers. The relevant question is what happens when something goes wrong with a lifetime income product? There is no fiduciary liability until something goes wrong. So we should be asking, when something does go wrong, what should be the extent of the protection available to participants, both inside and outside a plan, and who should provide such protection?

Current ERISA regulations make the employer a potential final backstop for participant protection. The rationale for this stems from the Pension Annuity Protection Act of 1993. In the early 1990s, a number of insurance companies failed, including the Executive Life Company of California. This put into jeopardy the benefit payments to former plan participants and terminated defined benefit plans whose pension obligations had been transferred to insurance companies. Subsequent investigations revealed that a number of these plan sponsors had chosen very low bids from Executive Life and other companies to pay

promised plan benefits rather than those of higher-rated companies. Choosing a lower bidder enabled these sponsors to increase the amount of plan assets they would recapture after annuities had been purchased.

Two court cases, *Mertens vs. Hewitt Associates* and *Kayes vs. Pacific Lumber*, seemed to block former plan participants from either suing their employer for putting its own interest ahead of theirs or receiving monetary damages to make their pension promise whole. The legislative history of the Pension Annuity Protection Act reveals that Congress merely intended to reaffirm the original intent of ERISA to provide these remedies and its primary concern was with defined benefit plans. But since then, in reaction to the abuses observed in the Executive Life case, regulatory guidance has morphed the fiduciary duties of employers with respect to distribution annuities in extraordinary ways, and I believe that guidance fails to distinguish between the risks posed to participants in a DB plan versus a DC plan.

In a DC plan, there is no such thing as a reversion, so there's no need to protect against this potential conflict of interest between employers and participants. In a DC plan, there is no promise of a guaranteed accrued plan benefit that purchased annuities must provide. In a DC plan, the accrued benefit is merely the dollar amount in the account at a particular point in time, and how a participant chooses to invest that account balance in an investment product is primarily that participant's responsibility. Merely providing a softer safe harbor will not encourage many more employers to offer lifetime income products. Frankly, ERISA lawyers, like myself, will continue to advise our clients not to include them in their plans because of the expense and potential long tail of fiduciary risk involved.

So I urge you as regulators to go back to basics and think through what makes sense from an ERISA perspective in a DC context and, particularly, what makes sense to require of small employers -- what are the risks? Who should bear them? And should protection differ depending on the type of investment product available in a DC plan? We don't need a softer safe harbor. We need a reasonable process that enables employers to choose good lifetime income products without fear of long-term liability while it enables participants to purchase the investment product

that meets their needs. When something does go wrong, the primary responsibility rests with state guarantee associations standing behind these products. I understand that the Government Accountability Office is analyzing and evaluating the current strengths of these funds, and I look forward to that report.

I would like to point out, though, that the private pension system had its first extensive experience with these funds as part of the Executive Life crisis. I had just started to practice law at that time, and the firm where I worked, as well as many other large firms, were hired by employers, primarily large employers, to obtain redress, not just for annuitants, but for participants in GICs and other investment products from these funds. I think it's fair to say that this was an expensive time-consuming and not wholly satisfactory experience. Seeking redress for participants required a lot of individual fact-finding, as well as preparing complicated regulatory filings. Large employers have the resources and the will to pursue these avenues for relief when necessary, but it is not likely that small employers will.

We also learned that there were significant gaps and differences in coverage across states that led to uneven outcomes. This seems to me to be unacceptable for a private pension system that is governed by federal law and that provides the same protections to participants no matter where they live or work. If we are going to continue to rely on a state-based backup for lifetime income products, we need to call for changes at the state level, whether it's uniform contracts, higher guarantee amounts, or special status under state insurance codes for qualified plan investors. Many have also called for federal regulation and guarantees instead, and that is something to be considered, although that would require the federal government to have a much larger footprint in regulating the insurance industry than it has ever had.

My final point is, as we move forward, we have to be mindful to balance the costs and benefits of new regulations under ERISA to secure the promise of lifetime income products. Every new regulation that requires a planned sponsor to hire an expert, every new requirement for additional participant education and disclosure, every increase in state or federal protection will have its costs. A DC plan has no unallocated pool of funds to pick

up these expenses. In a DC plan context, it is participants who will pay this cost, whether or not they, themselves, invest in such products. And these are dollars that will not be available to build retirement income.

Thank you, very much.

Ross Bremen:

Good morning and thank you for your time today. My name is Ross Bremen and I'm a partner in NEPC's defined contribution practice. NEPC is one of the largest investment consulting firms in the country. We work with over 100 defined contribution plans, representing over a million participants, and we've done considerable work on lifetime income products. We're independent and represent plan sponsors and participants. We're not an investment manager, and we don't offer investment products. The agencies have asked whether and how regulation might enhance the retirement security of participants and employer-sponsored retirement plans. There's a real concern that many people will outlive their assets. The focus on this issue has intensified in the wake of the wealth-destroying market events of 2008. As evidenced by these hearings, lifetime income products, as a defined contribution investment choice, are a solution. It's our view that plan sponsors lack incentive to pursue such solutions when it's unclear what protections are available to them as fiduciaries, particularly when the products have notable shortcomings.

According to NEPC's annual plan and fee survey, a third of the sponsors have expressed interest in in-plan income solutions. However, not a single sponsor in the survey offers such a product today. We submit that there are three things the agencies can do that would encourage sponsors to consider lifetime income solutions. First, clarify the role of income solutions within the QDIA context and/or encourage sponsors to use employer-match to purchase a guaranteed stream of income for participants. Second, clarify safe harbor provisions around the selection and monitoring of income solution products. Third, backstop the products with a government agency. Income solutions represent a means to achieve income certainty for individuals in retirement. The term is a catchall for a range of products; they're typically based on insurance concepts. I should point out that while there's a wide range of products, I'm going to focus more on the insurance

and insurance-like products, as opposed to some of the other types of payout funds.

They're not a new idea, and there are advantages and disadvantages. Their shortcomings have been well documented, and they've been impacted by legislation. Out of plan annuities or fixed annuities purchased at retirement, were not uncommon as a distribution mechanism prior to the enactment of EGTRRA. Post EGTRRA, many plan sponsors dropped out of plan annuities as a distribution vehicle due to administrative challenges, cost concerns, and participant behavioral biases. During the 2000s, we've witnessed the emergence of the in-plan solutions. At a high level of these products might be broadly described as core investment options that have an insurance component that creates an income floor or level of guaranteed benefit for participants in retirement. As I mentioned, plan sponsors are not offering these vehicles. Sponsor concerns include single insurance company default risk, lack of fee transparency, lack of vest in class investments, lack of portability and oversight challenges, and lack of clarity around safe harbor provisions. Given these problems, how do you get sponsors to consider income solution products?

First, clarify the role of income solutions within the QDIA context. Plan sponsors want to meet their fiduciary obligation and do the right thing for participants. Doing this is not easy when staff is limited and clear choices do not present themselves. The final QDIA regulations name three offerings that meet the standard, including target date funds, balance funds, and managed accounts. The regulations state that products that meet the QDIA regulations shall not fail to meet the standard solely because they're offered through an annuity contract. This is not a ringing endorsement for income solutions. They're not precluded, but they're not explicitly one of the three. Clarification of the QDIA regulations could encourage sponsors to revisit the merits of lifetime income solutions and even foster innovation amongst the service and product providers. Consider the evolution of target date funds for example.

Target date funds, which are clearly one of the named three, have been broadly adopted. According to our survey, 89 percent of plans offer target date funds. Interestingly, around half or more of these products have been rolled out post PPA. The focus on target date funds

is also encouraging innovations. While most plans already offer target date funds according to our data, 14 percent of plans conducted a target date fund search in 2009. The majority of plans now offer non-proprietary target date funds. A study by Casey Quirk indicates that 38 percent of all plan assets could be in custom solutions by 2018. We're not suggesting that target date funds and income solutions are completely analogous. We're merely pointing out that regulation of supported target date funds, they've been widely adopted and innovation is leading to better products for participants. Clear regulatory backing could do the same thing for income solutions.

Independent of the QDIA, but in a similar vein a stipulation that it is a prudent approach to invest the employer-match in an income-solution product, would also be of tremendous benefit. We believe an in-plan income solution funded by employer-match dollars could replicate the traditional defined benefit plan income benefit without the behavioral challenges of getting participants to self-select the income solution and without having to default them. Second, we would support clarification of the regulations that pertain to the selection and monitoring of income-solution products. The regulations, as written, present the high hurdle for the products. Moreover, plan sponsors are unclear of the process they must follow to select and monitor the products on an ongoing basis. The safest available annuity regulations require that a sponsor do five things -- avoid conflicts, consider information sufficient to assess the provider's ability to make all future payments, consider fees, conclude that the provider can make future payments, and that the cost is reasonable in relation to the benefit, hire an expert to assist with the analysis if necessary. These conditions are not easily met.

Income-solution products can be complex to begin with, and who has the ability to determine if an insurance company will meet obligations 40 years from now? How can a sponsor know if fees are reasonable if hedging costs are unknown and regularly changing? Which products do these safest available annuity regulations even apply to? Income products, such as guaranteed minimum withdrawal benefit vehicles, for example, do not require annuitization. If prudence is typically dictated by process, sponsors need assistance understanding what process and what matrix they must consider. We recommend that the agencies provide

guidelines for income-solution selection and monitoring like you did last year with Interpretative Bulletin 951, which relates the fiduciary standards when selecting an annuity provider for a defined benefit plan.

The bulletin states that reliance on ratings is insufficient in evaluating claims-paying ability. A number of other factors should be considered, including the quality and diversification of the annuity provider's portfolio, the size of the insurer relative to the size of the contract, as well as the level of the insurer's capital and surplus. We would suggest that these types of considerations would be helpful when evaluating income-solution products. In addition to claims-paying ability, other issues, such as portability, or lack thereof, and fee evaluation must also be addressed. On the point of portability, it's come up a couple of times, both yesterday and then this morning. I would -- I would suggest that you ask DCEA to potentially come back and comment on a go-forward basis on the public policy chair of DCEA, and I would submit that we would be more than happy to do that. So thank you for the opportunity.

Third, create an agency to backstop income-solution products. The safest available annuity regulations and the language from 951 that I've mentioned, relate largely to claims-paying ability. A recent study by PIMCO also indicates that insurance company default risk is the primary reason income products are not offered. What if these products did not rely on the strength of a single insurance company? There are currently providers of product that have looked for ways to offer multi-insurance company constructs. Perhaps, there are ways that federal backing could be established for income-solution products. While the PBGC model might not be the right solution, perhaps an organization could be established to back the lifetime income guarantees made by insurance companies? A government backstop would provide protection and comfort to both sponsors and participants. Sponsors would feel more comfortable offering the products, and participants would not need to worry that a lifetime of savings would be left in the hands of a single insurance company.

In conclusion, a great deal of attention has been placed on retirement income adequacy in the periods both pre- and post-enactment of the Pension Protection Act. Most of the conversation is focused on the accumulation phase of an

individual's life. As a greater number of participants approach retirement, it's logical that greater attention will be paid to the distribution phase of an individual's life. Sponsors are interested in lifetime income solutions, but they don't currently offer them. Clarification of the QDIA regulations, clarification of selection and monitoring provisions, and a government backstop would bring about significant progress. Such efforts would prompt plan sponsors to revisit income solutions and act as a catalyst for the improvement of such products and development of new innovative products for the marketplace. Such efforts could lead to solutions that it will help Americans meet their retirement goals and not outlive their assets.

Thank you, again, for your time today.

Tamara Burden:

Good afternoon. My name is Tamara Burden, and I'm a principal and consulting actuary with Milliman. Milliman is a leading actuarial and consulting firm, and we spend a lot of time working with insurance companies and plan sponsors and retirement savings products. I'm also the managing director at the Retirement Guarantee Network, and that's devoted to bringing guaranteed lifetime retirement income solutions to 401(k) plans, so I really appreciate the opportunity to speak with you today.

The Department of Labor is at a key juncture. You're looking now at ways to provide American workers access to and encouragement to buy cost-effective lifetime retirement income. You're aware that many of us here today believe that a key reason that current products aren't being widely adopted inside of employer-sponsored plans is because of uncertainty regarding the fiduciary safe harbor for retirement income products. A number of speakers have discussed this issue in detail and have asked the Department of Labor to consider extending and modifying that safe harbor. So today, what I'd like to talk about is extending that safe harbor to stand-alone living benefit products. These are also in the variable annuity world known as "Guaranteed Lifetime Withdrawal Benefits." And I've got three points to make.

First, these products are good for American workers. Second, these products require insurance companies to prudently manage the risk, and third, in order to protect

the interest of plan sponsors and the American worker, the safe harbor should only be extended in the presence of certain safeguards. So remember that the beneficiaries of sound public policy in this instance are Americans who are either saving for retirement or planning their transition from their working to their retirement years. So with the welfare of those beneficiaries firmly in your minds, I ask you to carefully consider my remarks today.

So what makes stand-alone living benefits a good product? Well, in today's world, Americans are facing retirement with too little savings, with recent large losses in their retirement accounts, and with interest rates at record lows. We don't have the luxury of conservative investment portfolios focused on protecting principal. For many, the best hope they have for secure retirement is to tap into the upside potential of equity investments, but, on the other hand, we can't withstand another collapse of the market that wipes out a big chunk of retirement savings. So Americans need investment strategies and products that enable them to prudently invest in equities while protecting their retirement income against market declines.

When people don't have a lot saved for retirement, it becomes difficult to partition assets into a recurring income stream meant to pay regular bills and expenses and money for unexpected events -- say, a sudden medical emergency. So even while people are trying to maximize their income stream, they need to maintain control of and access to their underlying assets. And Americans also need longevity protection. They need to be able to draw retirement income without having to worry about what might happen if they live longer than the average lifespans. Now, products that offer all of these benefits in one package exist in the marketplace today, and these are stand-alone living benefit products. These products enable participants to take advantage of a guaranteed lifetime retirement income with equity participation before and throughout retirement with full control of and access to their underlying assets. So how does stand-alone living benefits work?

Well, say, it's the beginning of 2008 and you're 65 years old and you're going to retire at the end of the year. You've got \$400,000 in your 401(k) account, and that's going to support a pre-tax income of about \$2,000 a month. Now, at the end of the year, your \$400,000 has gone down to

\$250,000, and that's only enough to support an income of \$1,200 a month. If you had a stand-alone living benefit guarantee, you'd be able to withdraw the \$2,000 a month that you had originally planned on, and when you ran out of money, the insurance company would pick up the payments as long as either you or your spouse are still alive. So that sounds pretty great. And you might be wondering, "What's the catch? How does that work?"

Well, retirement income guarantees are terrific, but every dollar that a participant doesn't lose has to come from somewhere. Now, in practice, it comes from the insurance companies who provide the guarantees, but the insurance company themselves get this money from the marketplace, and they do this by using derivatives -- not the complex, ill-liquid kind that caused the financial crisis, but rather the simplest, most-liquid and transparent hedge assets available. Now, I want to stop here for just a moment and emphasize that today, I'm not talking about new risk management strategies. I'm describing for you how insurance companies who sell these products today, many of whom are represented at this hearing, in fact, manage this risk right now. So insurance companies use derivatives, and derivatives have a pretty ugly connotation these days. I'm going to take just a minute to address that.

Derivatives can be used in two ways -- one, is to leverage risk in the hope of a higher return. That would be similar to AIG and their credit default swaps, and the other, is to lay off risks that already exists in a portfolio, winding up with a smaller net risk position. And that's the use of derivatives that applies here. Now, in general, in managing this kind of business, life insurance companies have avoided complex financial instruments. They have emphasized transparency and reliability in their operational processes. This emphasis on simplicity has helped the life insurance industry to avoid the pitfalls encountered by the banking industry. In fact, in 2009, Milliman completed a study of insurance companies offering guaranteed retirement income products and determined that hedging programs had been 94 percent effective in achieving their designed goals during the financial crisis from September 2008 to March 2009. In September and October of 2008 alone, these hedging programs saved the insurance industry an estimated \$40 billion dollars. So imagine where we'd be today without those hedging programs.

To look at the value of the guarantees in another way, I took half a dozen publically traded insurance companies and looked in their annual filings with the Securities and Exchange Commission where they have to report the value of their living benefit guarantees. At the beginning of 2008, these six companies had an average liability of \$275 million. By the end of the year, that liability had ballooned to \$3 billion. Now, that's an increase of almost eleven times. You can look at this number in two ways. And one is to think whoa, these are risky products, and the other is to think, wow, look at how much money that guarantee saved the American worker. So now that you have a better picture of not just how stand-alone living benefits work but also how companies manage the risk exposure, I want to talk about the concerns of plan sponsors.

It isn't that they doubt hedging programs work, they do. They have. But these guarantees are just backed by the general account of a single life insurance company. Now, even though insurance companies have significant regulation governing the reserves and capital that must be held to support each of their lines of business, including these products, the failure of an insurance company means that in some area of their business, these reserves and capital prove to be insufficient. To make matters worse -- oh, I'm sorry -- once an insurance company is in receivership, the participants in such a plan just end up in a line of creditors. And to make matters worse, the circumstances that would lead to the failure of a large highly-rated insurance company are just the circumstances that create huge guarantee liability, and these are the same times when participants need most to be able to rely on their guarantees. We saw exactly this perfect storm of events in the recent financial crisis.

So one approach that's been proposed is to extend the existing safe harbor to cover other lifetime income products. It's a recommendation that Milliman agrees with. However, it's important to realize that extending the safe harbor; it's a protection of last resort for plan sponsors. Sure, they don't want to be held liable themselves if the insurance company fails to make good on their promises, but what plan sponsors really want is assurance that the guarantees will be paid even if the insurance company gets into financial trouble. So what is the solution? I want to draw your focus to a very key aspect of these products

and their risk management. These liabilities develop and are funded over time as the market moves. They're not funded by insurance company capital and surplus. They're funded by gains and the assets being held to defense the liabilities. So the solution is straightforward. Take those assets, the hedge instruments, and any payoffs they've generated, and segregate them in a collateral trust account that accrues to the benefit of the plan sponsor in the event of an insurance company failure.

Now, segregating the assets is no hardship to insurance companies, who all manage hedging programs to fund their guarantee liabilities anyway. So companies are already holding these reserves. They're already holding these hedge assets. This simply draws the line in the sand, clarifying that these assets are specifically earmarked to support this guarantee and, thereby, clarifies the place in the creditor chain where the participants sit in the event of an insurance company default. Now the plan sponsor has a viable option for replacing a defaulting insurer or simply continuing to manage the risk on their own. Such a collateral account removes the vast majority of the risk associated with the potential insurer failure and puts the power to secure the guarantee back in the hands of the retiree and the plan sponsor.

So in summary, I've talked today about stand-alone living benefits because these products have some fundamental features that are very attractive in today's market. They allow Americans, those saving for and entering retirement, to maintain significant equity allocation while maintaining control of and access to their assets. They provide downside protection against adverse financial markets and protection against outliving assets. However, the size of the market and the huge value of these guarantees can have, means that the Department of Labor needs to look carefully at how these guarantees are supported. So specifically, we encourage the Department of Labor to consider extending the fiduciary safe harbor only in the presence of certain safeguards, the presence of a basic, transparent industry-standard hedge program, and the existence of a collateralized separate account that holds the hedge assets and the payoffs from those assets.

Thank you.

Sheldon Smith:

Good afternoon. Thank you, very much, for the opportunity to address you on these exceedingly complex and important issues that affect the retirements, ultimately of all Americans. I'm Sheldon Smith. I'm a partner in the Compensation and Benefits Practice Group at the Denver-based international law firm of Holme Roberts & Owen. I've been an ERISA attorney for more than three decades. I'm appearing today, however, on behalf of the American Society of Pension Professionals and Actuaries, where I have the privilege of currently serving as its president. ASPPA is national organization of more than 7,200 members representing virtually all disciplines of consultants and advisors to retirement plans, including accountants, actuaries, administrators, attorneys, consultants, and investment professionals. Our large and broad-based membership has unique insight into the current practical and complex issues that pertain to these retirement plans, and we look at them with particular focus on the small to medium size employer marketplace.

ASPPA's membership is diverse. But as I'm sure you all appreciate, we're heavily devoted to the maintenance, support, and continuation of the employer-based retirement plan system. ASPPA, and its members, are particularly interested in the issues that you are all hearing about today and that you heard about yesterday. We did, in fact, submit a detailed response to your request for information, and we would commend you to look at it, as it contains information clearly beyond what I'm going to present in this discussion today. In addition, ASPPA, along with WISER and AARP, as many of you are aware, hosted a lifetime income summit last spring. Some of you participated on the panels, and many of the people who have provided you with information yesterday and today, were also on panels. And one of the interesting things that I'm sure you appreciate came out of it, if you were fortunate enough to attend, is the fact that this deaccumulation phase of retirement is at least as complicated and probably more so than the accumulation phase that we have now dealt with since the promulgation of ERISA in 1974.

There are three areas in particular that I want to address without terribly belaboring some of the points that you've already heard. I want to talk about the fiduciary issues and the selection of providers that you have obviously heard significant presentations about. I want to talk about the 404(c) impact, and I would also like to talk

about the investment education component of bringing these lifetime income structures into the mainstream of what we're doing with our defined contribution plans today. The ASPPA membership generally believes, as you've heard from many of the people providing information, that a primary hindrance to the availability of lifetime income options and defined contribution plans results from the prospect of fiduciary liability attendant to both the selection and monitoring of the options themselves and, certainly, the providers. Notwithstanding the existing fiduciary safe harbor for selection of annuity providers, it appears that that safe harbor in the defined contribution context is rarely used. It is the exception when an annuity is a form of distribution contained in one of the plans that our members are responsible to oversee. And in those plans, those limited plans where they do exist, it is apparent that very few participants would ever select one based upon the existing culture.

There are many avenues from which fiduciary liability might arise in selecting options and providers under current rules. It might arise from the selection of the options themselves, the selection of the providers of these options, general dissatisfaction by participants, which could result from many market conditions, chatter in the coffee room, and a particular employer situation, and many other circumstances that give rise to that discontent and ultimately, the failure to meet statutory and regulatory guidelines, all of which we know are exceedingly complicated. We have two concepts that we would like to present to you for creating a safe harbor that deals with the fiduciary role. First, what we would like to do is focus on the insurance structures that exist in the state regulatory processes, and I'd like to take you back to the debate on ERISA that pre-dated its promulgation on Labor Day in 1974. One of the critical aspects of the debate that went on at that time had to do with preemption that is now well-engrained in Section 514 of ERISA.

It was clear that insurance would get special treatment under the preemption rules in no small measure because the insurance industry generally was already back down in the '70s heavily regulated, and it continues to be heavily regulated on a state basis today. It is our expectation that the rules that pertain at the state level can be used as a guideline to supplant and potentially enhance the existing safe harbor for selection of providers and

ultimately, to take that to the selection of annuity options themselves. We would like to propose a meaningful safe harbor that would protect the plan fiduciaries -- and, again, I'm focusing especially on small plan fiduciaries where the ability to have the funds available in order to meet the complexities of existing regulations may not be available with solvency determinations that are created by government. So we would focus in no small measure on EBSA and the Treasury Department and potentially the new bureau that is created under the financial services bill that was recently passed, to evaluate the purveyors of the various types of products that would be available in the marketplace and to make sure that those providers are solvent on a listed basis at the time that the fiduciaries are put in the position of having to evaluate which ones would properly be the ones for a particular plan.

We think that is a role that the federal government, through its agencies, can fulfill with the assistance of reliance upon what the state regulatory agencies are doing right now. And I did hear a question posited earlier this morning with respect to multi-state structures. And we believe that that can also be addressed by taking into account the determinations that are made by the insurance commissioners generally in all of the 50 states, to make a decision based on which of those purveyors are the most suitable for various types of plans using the same methodologies that you see utilized on average among the 50 state insurance commissioners. The second thing that we would like to see as an alternative is the possibility that the annuity safe harbor itself would be expanded as it currently exists. What we're looking at are the four basic components, not including the expertise component, which, for small plans, certainly gives rise to an additional expense that they may not be able to afford, but the ability to engage in an objective throw and analytical search for the purpose of identifying the appropriate providers. Appropriately determining what the cost and service is that would be available under the plan, must still, to some extent, remain a fiduciary obligation.

We don't have a problem with that. But in concert with the notion of providing some form of portability in these benefits, we believe that the current structure of requiring the fiduciaries to monitor the performance of the providers themselves consonant with what the government is providing, would make a world of sense. With respect to

404(c), we have under the law today what we consider to be an exceptional structure -- to allow participant directed arrangements to exist with sufficient protections that make sure participants and beneficiaries get the kind of information potentially that they would need to make educated decisions. And with respect to allowing QDIAs in these plans, we believe that we have pretty much closed many of the loophole areas that were there. And I think we have seen that participants have gravitated quite significantly to making the appropriate choices for themselves, certainly on a far greater basis than they had before the Department of Labor particularly had regulated in this arena.

We would add, however, or ask you to add as an additional fiduciary protection once lifetime income options are added, the following three -- I'm sorry, four items that 404(c) might include a simple written explanation of each of these options, a description of the impact on diversification of the selection of a lifetime income option as part of someone's investment portfolio, should they assume to do it whether it is a piece of it or the totality of it, relevant information concerning each provider of an option, which would be available culled from information that would be publicly obtained, and the extent to which guaranteed income is available under each of the lifetime income options. We believe that with that additional information, 404(c) should be fully complied with and the plans should be able to continue on what appears to be a positive path at this time.

And, finally, with respect to IB 96-1 that you've heard plenty about, it is our expectation that should it be modified in order to take lifetime income options into account, that it be modified in such a way as to make certain that the information that is provided to the participants and beneficiaries falls into the category of education and not into the category of advice in order to provide the necessary protections that will allow the fiduciaries and, in fact, encourage them to make that available.

Thank you, very much, for your time today, and I hope that that was helpful to you.

Robert Doyle:

Thank you, very much. Okay, we'll start down at this end.

Female Speaker:

Okay. I have a question for Ms. Perun. With respect to your testimony and talking about small employers, and obviously, everyone understands that small employers have particular challenges, but I just wanted some clarification with respect to whether you see any kind of responsibility on the part of small employers in choosing the options that would be available to participants because you were talking about the primary responsibility going to the state organizations, but you also indicated that there is a lot of discrepancy between the way that the different state standards operate?

Pamela Perun:

I think I was making a distinction between who chooses the plan options versus who provides the first line of defense when something goes wrong. And, you know, under ERISA there is no flexibility about who is the first line of defense for actually choosing the investment options, and that remains the employer under current law. And, you know, I think we have to be realistic about what actually happens out there. I was both impressed and distressed to read a paper by AllianceBernstein that was written several years ago about how few small employers actually know what a fiduciary is or that they are one under these plans. So I think there's a real mismatch between the regulatory structure we think is operating in these plans and what these plans actually do. So I think small employers, particularly as we move into a complicated area, like lifetime income products, we'll need a lot of assistance and backup and guidance from agencies like yourselves if, you know, if we're going to continue to give them the primary responsibility for choosing.

Female Speaker:

I just wanted to ask Mr. Bremen -- correct me if I'm wrong -- I think you made some allusion to picking up some of the criteria that is in IB 95-1, and my understanding is that we have purposefully gotten away from 95-1 as it applies to the DC plans. And is that -- I just wanted to confirm that you were essentially trying to say get back to some of that?

Ross Bremen:

So that you have the safest available -- safest available annuity regs, which I think to your point, replace the old

regulation. And then there was a subsequent bulletin for pension plans that included a list, if you will, of items that pension plans might consider when selecting an annuity. And so my comments are not to suggest that everything's moving in the wrong direction. It's more that I thought that you put forth a valuable piece of work that provided the type of checklist, which would be extremely valuable to plan sponsors.

Male Speaker:

I have a question for Ms. Burden from Milliman, and it has to do with the extension of the -- of a current -- of the current fiduciary safe harbor to guaranteed lifetime withdrawal benefits. And the idea that this extension could occur where there are hedging strategies and where there is partitioning, or what did you call it? You called it a --

Tamara Burden:
Segregation.

Male Speaker:

-- the creation of an account. Is that something that would -- could be accomplished without the intervention of state legislators? I mean, is that insurance law?

Tamara Burden:

Yeah. It's not a -- there's no real economic or operational reason why segregating assets -- it's really just accounting treatment. The key thing that this creates is the need for a very high degree of transparency into the hedging program and how it's performing. And what we found in looking at, you know, how hedging programs performed during the financial crisis, is the companies that had the highest degree of transparency also had the best performing hedge programs. Companies that didn't have as much transparency, often ended up -- well, had holes in their hedging programs. They ended up losing money. And so, you know, we see this as helpful in a number of ways.

But the, you know, the accounting treatment is a separate account versus general account. There are certainly precedents in the 401(k) market if we look at get contracts and stable value funds. All of those are separate account assets, but they're wrapped with an insurance contract. So they're certainly precedent.

Male Speaker:

But so you don't -- you don't see any limitations under state law, state insurance law that would preclude an insurer necessarily from this type of segregation, is that right?

Tamara Burden:

That's right. That's right. And when I think of, you know, exactly how would this be implemented, there's a guarantee fee charged to the participant for the guarantee. So that guarantee fee would go into a separate account. The hedge assets would be in that separate account. Any payoffs they generate stay in the account. And there'd be a mechanism for removing profit over time to pay back the insurance company. But what we probably would not recommend enforcing is if the hedge program under-performs, not to have money come back from the insurance company into the account because that's something that creates -- that creates a call on general account assets. And so what we really want to do is focus on funding the guarantee with the fee and with the hedge asset payoffs and returns, and over time, those monies should, you know -- in more than 99 percent of the case, there should be sufficient to fund the whole program.

Male Speaker:

Is it feasible, though, to ask a plan fiduciary to assess the hedging strategies of an insurer in the context of these products?

Tamara Burden:

There's -- you know, insurance companies have been steadily increasing their role in providing retirement savings programs that offer both equity protection and longevity protection. So there's a lot of attention paid to insurance companies and their hedging programs. And rating agencies, for example, you know, look at hedging programs and analyze them for their effectiveness. U.S. Reserve and capital requirements have been revamped to specifically address retirement income guarantees and the hedging requirements that back them. So there's a lot of context already in the industry for, you know, analyzing a hedging program.

The transparency that's created by this kind of system really benefits from having an independent third party opinion of the adequacy of the hedging program, the

performance of the hedging program. But these are -- these are all -- you know, the insurance companies who provide these products, are all very large companies. They all run hedging programs today. And so it's -- you know, although there's definitely a role for, you know, independent third party person to analyze it, it's not, I don't think, necessary as long as the structure exists. There's enough opinion around the hedging programs being run by insurance companies that that might be enough, you know, protection right there.

Male Speaker:

And, again, just kind of getting back to what we heard in a lot of the testimony is, you know, you really need to look to what the state insurance regulators are doing and be more accepting of their contribution to this process. And assuming, you know, there was such a construct or requirement for such segregating of assets, is that something that would necessarily be reviewed or audited in the context of state regulatory oversight?

Tamara Burden:

Yes. Generally, if you have a separate account guarantee, the key difference is that the separate account assets are generally not covered under the state guarantee fund. But that certainly doesn't mean that those separate account assets and liabilities are not monitored and reviewed by the State Department of Insurance.

Male Speaker:

But it raises other state-guarantee fund issues, perhaps -- ?

Tamara Burden:

That's right, that's right. And but, you know, when we look at the tradeoff between having this obligation just a general account liability of the insurance company, knowing that it can be, I mean, literally, billions of dollars if the insurance company fails. And not for this reason, but just for some other reason. Like AIG did not fail because of their variable annuity business. It was their credit default swap program that brought them down. So we look at a trade-off between if you just have that as a general account liability with no recourse and the plan sponsors have no ability to access even the -- even though reserves have been built up, these guarantees exist, plan sponsors have no ability to access that directly in the event of an

insurance company failure. So they don't really have an option if the insurance company goes under. They can't replace them with someone else who takes over the guarantee.

So you look at one option where that's the structure and you wind up with a state guarantee fund in many years trying to work the insurance company through a receivership versus having this kind of structure where you might not have the state backdrop, but you have, you know, probably 100 percent of the assets needed to support the guarantee specifically earmarked immediately available to the insurance -- to the plan sponsor. So in that case, an insurance company goes into receivership, the plan sponsor can actually take those assets and go find another insurance company to back the guarantee.

And it's attractive because the -- all the money needed to fund the guarantee is right there available for someone else stepping in. So it provides a protection for the plan sponsors and participant's options for the plan sponsors and participants in the event, you know, as pointed out. I mean, that -- the purpose of the fiduciary safe harbor, you know, it's that the key -- the key thing that you really need to look at is what happens if an insurance company fails? What happens? And that's what we think this addresses.

Female Speaker:

I think what you're saying, I mean, to the extent that you segregated true enough. I mean, like if the insurance company goes bankrupt, goes into default or something, I mean, you know, all the funds needed to back that guarantee is in the segregated account -- I mean, whatever is in there, I mean, to the extent that your funds are inadequate, I mean, that's all you get?

Tamara Burden:

That's right. Yeah.

Female Speaker:

Okay.

Tamara Burden:

Yeah. And, I mean, generally speaking, you know there are possibilities for hedge programs to underperform, you know, and so you could have on a temporary basis, you could have

funds that slightly less than say the market value, but you've got ongoing fee revenue coming into that account. So and these are very long-term benefits. I mean, these aren't -- these are not benefits that say, you know, a person has \$100,000 in their account, and next week it drops by 10 percent, so you give them \$10,000. That's not how it works. These are long-term guarantee payments that say, when you start withdrawing your funds and you run out of money, we're going to pick up the difference. And so it's that long term protection that you want to have this account to, when people run out of assets, you can pay them out of that account.

Female Speaker:
Yeah. So --

Tamara Burden:
And so that should help.

Female Speaker:
-- just to clarify -- I mean, this was a question raised with prior witnesses, you know -- so to the extent that the product is -- guarantees are in the general account then that distinguishes what's covered in the state guarantee protection versus if you decide to keep your GWLB -- GLWB in the general account, then it stays there protected, you know, whereas, whether it's GLWB or some other product, you know, if it's segregated, it's not? That's kind of distinction?

Tamara Burden:
That's my understanding, yeah.

Female Speaker:
Okay.

Tamara Burden:
Yeah. Yeah.

Male Speaker:
Just a question for Sheldon. And you mentioned 404(c) and your four recommendations for 404(c) reg. And your recommendations with respect to that reg all appeared to be enhancements or augmenting the current disclosure requirements. Is it -- but I didn't get from you the sense that the regulation itself currently acts as an impediment to the inclusion of lifetime options in 404(c) plans.

Sheldon Smith:
It may --

Male Speaker:
Is that fair?

Sheldon Smith:
-- or may not. It depends upon the perspective of the fiduciaries in the context of adding this kind of an option in a 404(c) plan that is more significant than otherwise might exist in the typical mutual fund arena. So it will implicate those other issues that you've heard discussed over and over regarding the solvency of the carrier and so on. In order to bring these types of options into the 404(c) environment, we're looking at protecting the participants by providing this additional educational information.

So to some extent, yes, there is a 404(c) impediment today because the fiduciaries are paranoid, and rightfully so. But we believe that by enhancing the information that is given to the participants and providing this in effect as a safe harbor to the fiduciaries, we can accomplish that objective of limiting the paranoia.

Male Speaker:
Do we agree, and I guess I would go to Mr. Bremen's reference to QDIA, which sounds to me almost like a defaulted annuitization approach, that we still struggle with these same issues that we're talking about in an investment, which has long-term implications in the absence of total ability to liquidate that investment, right? So the analysis, at least in my mind, as to be a little different. And then the question is, what is that analysis that's appropriate? Because even in a QDIA context, you still have the fiduciary making a determination as to the prudence of the particular options. So, while there may be relief for putting a participant into it, the ultimate choice of what they're put into is going to be governed by whatever the applicable fiduciary standard is.

Ross Bremen:
That's right. I think that whether we're talking about 404(c) or some other regulation, we're talking about adding products that we know are not perfect. In fact, we knew that when target date funds were added that they weren't

perfect either, but these are in some ways imperfect in different ways. We talked about portability, we've talked about fees were knowingly were potentially going to default people into something that we know had some challenges. And so I think we would absolutely agree with you that it does require some other type of analysis.

There were, in another panel, there was a conversation that there are at least three challenges as it relates to portability. And so knowing that those three challenges exist, what is reasonable? And so I made the point that maybe you could make it easier for sponsors to use their match dollars with the QDIA -- I'm sorry, with the income solution product. Today, a lot of plan sponsors will -- or I shouldn't say a lot -- but, historically, some plan sponsors have separated employee dollars from the employer dollars, and the employer dollars might be in some diversified portfolio that they manage. There's got to be some way, knowing that you have these challenges, to manage the process. So you either maybe make it safer for sponsors to make a decision and go one way, or you make it easier for participants -- or easier for sponsors to give these options to participants where they could run into some challenges [chuckles] knowing that they're on the hook for those decisions.

Male Speaker:

Well, we're essentially asking the participant to assume the challenges of the employer or plan sponsors now, either complicated -- decided they're too complicated or better decided at the participant level. But, again, any suggestions you have for specific considerations that would be relevant to these -- the fiduciary process of selecting these products would be appreciated. Ms. Perun, I look forward to receiving your paper. The challenges of striking a balance and making, you know, a fairly complicated system work for small employers is not without its difficulties. And I'd like to think we try to work through those balances, and maybe sometimes we succeed and sometimes we don't succeed as well. But certainly the -- these types of conversations are helpful.

Tamara Burden:

I'm sorry to break in. I realize that I might have given an answer that was a little bit misleading. I wasn't quite expecting the question to be phrased in that way. Let me explain separate account versus general account. The thing

about separate account assets is they don't pay the premiums that go to the state guarantee fund. So the real concern is just that if you have separate account assets that have some call on the general account, that they're not paying premiums for that. So insurance liability is an insurance liability, and all of them, to some extent, covered by the guarantee fund, you know, up to certain limits. So I guess I don't mean to say that if the separate account really does run out of money and the insurance liability still has something to carry on, that that doesn't revert to the guarantee fund that it is in, but it's just that the separate account asset doesn't actually pay a premium. And so whenever you have a guarantee that actually has a call on the general account it's necessary that some premium goes into it to go the state guarantee fund. So that's a better distinction.

Male Speaker:
Gotcha.

Female Speaker:
Okay.

Robert Doyle:
Thank you, very much. And with the conclusion of this panel, we're going to take a break. I'd like to reconvene at --

[lunch]

Panel Five

Male Speaker:

Joint agency hearing. Turn it over to first panel this afternoon.

Mark J. Warshawsky:

Okay, I'll get started. I'm Mark Warshawsky, director of retirement research at Towers Watson. And I very much appreciate the opportunity to speak before you. My topic is products and strategies for lifelong retirement distributions. In this testimony I'll describe some products and strategies. I first describe the futures of the insurance product most like the traditional defined benefit pension in its distribution phase [spelled phonetically], and that is the immediate fixed life annuity. I'll list some of its advantages and disadvantages. Then I'll review several other products and strategies, the inflation indexed immediate annuity, the immediate variable annuity, the variable annuity with a guaranteed minimum withdrawal benefit, systematic withdrawals from a portfolio of mutual funds, and combinations of immediate fixed life annuities and systematic withdrawals, and I'll also very briefly compare their advantages and disadvantages.

For the most part, I'll rely on my statement on past resource. The co-authors and I have conducted both empirical investigations and stochastic stimulation studies. The studies generally describe what is available in the retail market, although with the exception of fee levels, many of the features and characteristics carry over to the institutional market. My fellow panelists will focus more on the institutional market and some other products that are available.

Research shows that the uncertainty about the remaining length of life during retirement is large and reduces welfare. Full use of immediate straight life annuity at the point of retirement resolves this uncertainty and gives a substantial lift to the welfare of the household. The full use of fixed annuities also has the virtue of simplicity for investment strategy where that responsibility and risk falls entirely on the insurer who guarantees the payment flows. But this product and simply strategy has several disadvantages as well. A steady, fixed flow of income can easily turn into an impediment if

a large legitimate need for a significant amount of assets rises suddenly, such as a family emergency. A fixed annuity also does not hedge other extent economic risk, in particular inflation and the possibility of insured solvency. In our research, this inflation risk is found to be significant and can produce real income shortfalls, even though a fixed life annuity gives the highest income flow of all the products and strategies at the point of retirement.

Two other disadvantages arise from the nature of the fixed annuity pricing, which depend in turn, mainly, on three factors: marketing and administrative expenses, interest rates at the time of issuance, and mortality expectations. Because interest rates are volatile, the prices charged fixed annuities are also volatile. This can be called timing risk. Two otherwise identical people retiring with the same account balance could receive significantly higher or lower income simply because one retired just one year or even one quarter earlier. For example, my research found that retiring in March 1986 instead of March 1985 would have caused a loss of 27 percent of income if the full annuitization strategy were pursued. With regard to mortality, insurers must price their life annuities based on the expected mortality rates of those who purchased the product.

In a voluntary market, those with impaired health and shorter expected longevity are likely to avoid the purchase of annuities. The insurer must therefore consider the resulting downward bias to mortality rates and pricing the annuity. Our research has found that the impact of this adverse selection adds about 10 percent of the annuity price. And inflation index [spelled phonetically] immediate annuity reduces the exposure and maybe even close to eliminates the exposure to inflation risk. This product is the same as the fixed annuity except that the payments increase with consumer price inflation. It has the same advantages of hedging longevity risk and simplicity, but suffers from the same disadvantages of ill liquidity, the risk of insolvency, timing risk, and adverse selection.

My research found that the expense load on an inflation index annuity was about five percentage points higher than on the fixed annuity, perhaps owing to the more limited investment portfolio available to insurers to back inflation index products. And, of course, to pay for the

cost of indexing the initial and some subsequent payments from an inflation index annuity will pay less than the nominal fixed annuity. An immediate variable annuity delivers variable income for life. At the time of purchase, the investor selects an assumed interest rate, the AIR. This AIR together with the insurers mortality guarantee determines how many annuity units the investor gets for his premium. The annual payment to the insured, conditional on surviving, is equal to the number of annuity units, multiply the value of each unit. The unit value evolves with the net investment performance of the underlying funds chosen by the insured relative to the AIR. The net performance is the gross investment returns, net of fund and management insurance fees. These average in the retail market about 200 basis points.

The main advantage of an immediate variable annuity is it eliminates timing risk. For the same AIR, every investor starts out with the same initial payment. Because it is a life annuity, it also covers mortality risks. Payments will continue for life. Depending on the funds chosen, the investment performance and the AIR used, payments might increase, perhaps even substantially over the life of the insured. The disadvantages are the same as for other annuities. They like liquidity, they have the insurance solvency risk, and they suffer from adverse selection. There is also for this product, some added complexity, which arise from the need to make the investment and choose the AIR. Finally, by definition, the income flow is uncertain and makes financial planning during retirement more difficult. Our research shows that the volatility of inflation adjusted income for a variable annuity invested 50-50 in stocks and bonds is among the highest of the products and combinations that we have modeled, and the risk of real income shortfalls is higher than for fixed annuities.

A relatively new product that has been developed which adds a guaranteed minimal withdrawal benefit rider to a conventional deferred variable annuity. The deferred variable annuity acts as an investment account, while the rider guarantees that regardless of investment performance and length of the life, nominal income will not fall below a certain percentage, and this is generally five percent of the income base, and it could increase investment performance is good. The account value is the actual market value in the investment portfolio and it fluctuates

with investment performance. The account value can go to zero after the subtraction of the income payments and fees. The fees usually come to about 300 basis points on average.

We've modeled several portfolio choices for this product. What I am going to say now is based on a 70-30 stock-bond mix. The advantage of this product is that the account provides liquidity at least until the account is used up. There's no timing risk, and the lifelong payments can increase, but will not decrease in nominal terms with investment performance. The disadvantages -- this is a quite complex product, and, of course, you still have the investment solvency risk. Our research shows that the variable annuity with this minimum guaranteed benefit has a reasonable expectation of a significant account balance and low volatility around the income flows, but the initial income is relatively modest and is highly likely to fall short of the minimum, real income targets over the lifetime of a retired person. A completely non-insured strategy is to take systematic withdrawals from a portfolio of mutual funds.

We modeled our research, the withdrawal of a constant percentage of the mutual fund balance of each period, and we used five percent. We assume a 50-50 allocation, and that the investment fees are 120 basis points. This distribution strategy produces the highest account balances throughout retirement with a good possibility of a significant residual upon death. Hence, the liquidity is excellent and there is also of course, no insurer's solvency risk and no timing risk. There is some complexity, but there are products in the market place that ought to make this process both on the investment and withdrawal functions. The main disadvantage of this strategy comes on the income side. It produces the highest probability of not meeting the minimum real income targets and averages the lowest real income flow.

Finally, we have considered some combination strategies using a fixed annuity and systematic withdrawals, and we've modeled two. One is a onetime purchase of a fixed annuity using 30 percent of the value while the remainder of the account is distributed through the systematic withdrawals. A second strategy is a gradual annuitization until age 75 which this combined with systematic withdrawals, and then at age 76 and beyond we have full annuitization. The research results show that there are actually some nice

characteristics for these combinations. The first combination produces quite a bit of liquidity with account balances nearly as high as those produced by the variable annuity with the guarantee of withdrawal benefit and less volatility. It also gives a higher average real income flow with some upside potential than some of the other products and strategies. The second combination by definition only gives liquidity for the first 10 years of retirement, but its income characteristics are the best of all the products and strategies that we have modeled.

In particular, mean real income flows are the highest and the risks of shortfall is the lowest. There is substantial upside potential and the downside is protected. The timing risk of annuitization is hedged by the gradual laddering of the annuities, and postponing annuitization increases income flows because of the positive impact of the mortality premium; that is the exit return gathered from the pooling of mortality risks becomes greater at older ages. Unfortunately, because to my knowledge these combination strategies have not been automated in the market place, they unfortunately appear to be complex for a household to pursue. So it has a disadvantage on the complexity side.

I hope my testimony has depicted part of the rich menu of products and strategies that can be used to provide lifelong income to retirees. They all have advantages and disadvantages which plan sponsors and retiring participants have to consider and weigh. More technical research and experimentation is needed, and I hope that any guidance coming from the government in this area will be encouraging rather than constraining.

Male Speaker:
Thank you.

Dan Campbell:
Good afternoon. My name is Dan Campbell, and I am the practice leader for Hewitt Associates defined contribution administration business. We're the largest independent provider of retirement services to retirement plans, serving over 11 million participants. We're honored to present comments to the panel today on this important topic of lifetime income options. We would like to address a couple of topics, first of all, the need for full fee transparency as it applies to lifetime income products, the

advantages of implant solutions, and then address a number of points with regard to alternative designs.

As we've heard, there are many reasons for the lack of adoption of lifetime income products. We believe that a lack of full fee transparency is one of those reasons. While the interim final rules recently released by the department will improve upon this issue by providing plan sponsors with greater information of all compensation received by service providers as well as the cost of these programs. We also expect the future rules on participant fee disclosures will help individuals in the same manner, hopefully increasing the likelihood of usage of these programs. However, we believe that certain modifications to the interim rules are necessary. These modifications should also be included in the upcoming rules.

Modification one, because these programs tend to be very complicated, the department should clarify that rules and fee disclosure should apply to all fees that arise through all phases of these programs, all phases of planned participation, particularly all throughout accumulation as well as a decumulation phase. For example, if a lifetime income product provides participants with choices and fees may vary based on the choices those participants make throughout their lifetime, then these additional fees should be disclosed to planned sponsors and participants upfront. These disclosures will help planned sponsors and participants make more meaningful comparisons between lifetime income and non-lifetime income products as well as whether to invest in the lifetime income product inside or outside of the plan.

Modification two, we believe it's important to separate the fees for lifetime income products from the underlying investment management fees. This unbundling of fees will give fiduciaries and participants a better picture of the true cost of the program. This transparency will enable a comparison which should facilitate competition ultimately lowering costs.

Modification three, fee transparency should also apply where service providers earn compensation from cross-selling to participant's lifetime options that are outside of the plan. This will allow participants to compare the costs of options offered within the plan to those offered outside of the plan that are being marketed to them. These

fee disclosers for lifetime income options are necessary to ensure their future success. Without them, parties will not have a true picture of the fees related to such products, and the lack of interest in them will likely continue. We also believe that there is an important advantage to offering lifetime income products within plans primarily as participants would benefit from lower priced programs. Today, many large employers leverage the size of their retirement plans and choose low-cost, non-mutual fund alternatives such as collective trusts and separate accounts, or institutional shares of mutual funds which are not available in the retail market. Similarly, we see much lower prices emerging for institutional lifetime income products compared to retail products. Participants will be able to benefit from these lower prices if income options are offered within the plan.

As we've heard, there are some products available in retirement plans today that include a guaranteed stream of payment over the retiree's lifetime, with the potential of increases based on investment performance. Generally, prices for these types of insured income products, enlarged plans range between 50 and 150 basis points, depending on the product and the underlying investments. However, if an individual went strictly to a retail product upon retirement, this pricing would not be available. Many retail products range in cost between 300 and 350 basis points, significantly routing the possibility of receiving higher payments in the future. It's this combination of leveraging institutional investments and in-plan solutions that could make a real difference in participant savings levels. We urge the department to encourage adoption of income solutions within plans to be able to reduce these fees increasing financial security for plan participants.

Regarding the issue of alternative designs, according to our research, overwhelming majority of participants choose to move their money out of the retirement plan rather than converting their balance to a lifetime stream of income directly from the plan. Within our survey, 100 percent of the 401k plans that we studied offer lump sum payments as a final distribution option and 84 percent of [unintelligible] participants take this lump sum option. Just 14 percent of plans today offer a traditional annuity form of payment and just one percent of participants in those plans elect this option. Our data shows a similar lump sum preference among defined benefit pension plans

where traditionally this is the place where participants were able to receive lifetime income streams. Today, 57 percent of pension plans offer a lump sum payment between 65 percent and 90 percent of participants elect this option when it is available. Clearly, today's plan structures are not encouraging participants to protect themselves against post retirement risks.

In recent years a variety of lifetime income options for defined contribution plans have been introduced offering guaranteed payments from within the plan their designed to eliminate some of the barriers associated with traditional annuities. However, few plan sponsors have implemented these options. Hewitt research shows that just seven percent of 401k plans currently offer an insurance annuity solution within the construct of the plan. We believe that one of the main issues behind this lack of adoption by plan sponsors are their fiduciary concerns, particularly with selecting annuity providers. Plan sponsors need clarity, as we've heard, and safe harbors on how to choose plan lifetime income solutions, how to communicate them without overselling or under representing what they have, and how to monitor them. They need appropriate direction so that what they are offering won't get them sued by the participants. Clarifying fiduciary requirements and encouraging plan sponsors to implement lifetime income solutions will help spur their adoption.

Finally, we encourage the department to support flexibility in the design of the options. We do not believe there is a single silver bullet solution that's right for every plan or participant. To maximize adoption, we believe a spectrum of solutions should be made possible. Many of these have been mentioned throughout this last day and a half of testimony. These include guaranteed lifetime income, potential increases and guaranteed payments based on investment performance, level payments calculated through asset allocation methods, deferred annuities, guaranteed structure within target date funds, and even rollovers into pension plans for annuitization. In closing, Hewitt recommends the agencies for their ongoing efforts to help Americans achieve income adequacy. We appreciate the opportunity to share our ideas with the council and volunteer our data and expertise to continue conversations about improving retirement security for all Americans. Thank you.

Martin A. Schmidt:

Good afternoon. My name is Martin Schmidt. I am a principal with HS II Solutions [spelled phonetically] and a retirement plan consultant with over 25 years experience in the institutional retirement space. I am here today in my capacity as chair of the Institutional Retirement Income Council. IRIC is a non-partisan, tax-exempt, volunteer organization whose members consist of retirement plan advisors, consultants, and attorneys. IRIC's goal is to facilitate the culture shift of defined contribution plans from supplemental savings plans to programs that provide retirement security. I will share with you today our experiences in working with planned sponsors who have considered adding lifetime income options to their DC plans. Over the next few minutes I will provide the agencies with some background on the new types of income solutions that are emerging in the market, what is hindering the adoption of these solutions, and offer recommendations which the agencies may wish to consider.

IRIC considers a product institutional as opposed to retail if the product is purchased through the plan-sponsor participant relationship. When compared to similar retail products, an institutionally priced product will likely have lower fees, which will translate into higher retirement income and larger amounts of lifetime wealth. Institutional lifetime income products may be offered either in plan, through the DC plan, or out of plan as an IRA rollover. Lifetime income products may also be offered as an insurance-based solution which provides a guarantee of lifetime income or an investment-based solution which provides retirement income but without the lifetime guarantee. Both solutions are becoming more common.

A new type of insured solution in the DC plan is a deferred fixed income annuity. This solution allows the participant to invest in guaranteed income over time while the participant is building their retirement savings which we referred to as the accumulation phase. The product can be a standalone investment in the DC plan or an asset class within an investment fund, typically a target-date fund. These products are liquid during the accumulation phase and require annuitization by the participant to receive guaranteed income payments. A second type of insured solution is the guaranteed minimum income benefit. Similar to the deferred fixed income annuity, the participant purchases guaranteed income over time during the

accumulation phase. The difference is the guaranteed income component is wrapped around an equity investment, typically a balanced fund.

If the equity investment appreciates over time, the amount of guaranteed income available to the participant will be higher at retirement. Similar to the deferred fixed income annuity, these products are liquid during the accumulation phase and require annuitization by the participant to receive guaranteed income payments. A third type of insured solution is the guaranteed minimum withdrawal benefit. This solution allows the participant to purchase an equity investment, typically a target date or balanced fund that is wrapped with insurance. The market value is tracked and a high water mark is used for the benefit base. At retirement, the participant has the right to guaranteed withdrawal based on the percent of the benefit base, typically five percent. The guaranteed withdrawal is paid for the rest of the participant's life, even if the market value falls to zero. Unlike the other two solutions, a participant does not annuitize their balance and the amount they can withdrawal may vary. However, if the participant takes more than the guaranteed withdrawal, the future payments will decrease.

We are also starting to see other retirement income solutions that are not insurance based, but investment based. For example, there are managed payout funds that are designed to distribute balances over a certain period of time, such as 20 years after retirement. We also expect to see more development investment-based solutions that offer balance protection during the accumulation phase and distribute income over time. Development of these solutions includes derivative based and other hedging strategies similar to those found in other insurance products. Some early innovations in this area include structured notes offering principle protection as well as structured income payments. These notes become dead to the insurer and are subject to the debt hierarchy. While we expect to see continued innovation leveraging investment-based concepts, at this time, none of the available solutions protect a retiree from out living their assets while maintaining a fixed level of income.

These are the newer solutions that have been or will be introduced to the market. I emphasize newer because the immediate income annuity has been available as a planned

distribution option to participants for decades. However, very few participants choose this option. Recent surveys by Hewitt Associate show when participants are offered annuities by a planned distribution option, the percent of participants annuitizing has dropped from six percent in 2005 to one percent in 2009. Because of this annuity puzzle, we have seen the emergence of these newer options which are built to be more attractive to participants due to their added flexibility. While planned sponsors have expressed interest in the newer solutions to help participants with their retirement planning, the current regulation and guidance for the retirement income and DC plans is based on an old one-time annuitization election model. As a result, planned sponsors have been slow to embrace these new solutions.

One concern was about the increased fiduciary exposure associated with adding a lifetime income product that requires a relationship between the plan and an insurance company over several decades, often referred to as counter-party risk. If a planned sponsor wants to change an investment option in their DC plan, they can easily do so. But the process is much harder with an income solution. Even though some industry experts feel the fiduciary issues have been addressed, the perception among most plan sponsors and their advisors is the counter-party issue still exists. A safe harbor here will help.

Plan sponsors are also confused as to the applicability to the current safe harbor roles when selecting an annuity provider for a DC plan since the current safe harbor roles apply to distribution annuities. There is a question as to whether the same rules apply for lifetime income products which are acquired during the participant's accumulation phase. We ask that the DOL all consider providing more direction about the process for selecting an insurer. The DOL may also wish to clarify when and how ERISA fiduciary duties apply to participant communications for lifetime income products. It is our belief that these products are often needed to be sold to participants, and clear education and communication is critical. Interpretive bulletin in 96-1 could possibly be expanded or separate guidance could be provided.

Another way to get participants to invest in lifetime income products is through defaults. The use of defaults has worked well to increase planned participation and

improve asset allocation. However, there is still confusion as to whether lifetime income products can or should be embraced as QDIAs, especially since the products have higher fees for income guarantees that may not be utilized by the participants. Clarification and guidance in this regard would be helpful. There is also a problem with how in-plan lifetime income products are covered by state insurance guarantees. Coverage varies by state, but even when coverage exists, insurers are restricted as to how much information they can disclose. Unlike bank products, which can easily be liquidated and refer to FDIC protection in their marketing materials, lifetime income products require a much longer time commitment and state insurance coverage that will help participants gain peace of mind cannot be explained. Some guidance here would be helpful.

Finally, the long-term relationship between the plan and the provider of the lifetime income product creates a concern about plan level portability. The industry is in the process of developing record keeping data standards to help address this issue, but further work is required in this area. A common platform or a middleware solution needs to be developed to make the integration with insurers and record keepers more seamless. Until this happens, few record keepers will support multiple lifetime income products on their record keeping platforms. As a result, planned sponsors have been reluctant to add a lifetime income product which may limit their ability to change record keepers. To address this issue and other portability issues, it would be helpful if the agencies would consider allowing a distributable event to IRA for lifetime income products prior to plan participant termination. This would allow participants to maintain insurance guarantees for which they have paid fees.

In closing, I would like to say there is growing interest among many plan sponsors in adding lifetime income solutions to their DC plans to help mitigate the risk their employees will not outlive their assets. We are not in favor of mandates, but we do believe that plan sponsors, especially those without defined benefit plans should be encouraged to consider whether adding a lifetime income option is in the best interest of their participants. IRIC believes that the agencies can help in this regard by providing clarification, guidance, and safe harbors where possible. Having better ways for participants to manage

the income they received from their DC plans is critical to the future health of our nation's retirement system. And we thank the agencies for the honor of sharing our thoughts today.

Male Speaker:
Thank you. Questions?

Male Speaker:
Thank you for your testimony. Well, we have heard in this panel and some of the preceding panels about a lot of different kinds of products that are evolving in the marketplace. As I listen to this, I find myself thinking it must be daunting to know whether you're getting good value when you shop among these different products. The variety is such and the details are such that it's not necessarily always easy to compare one product with another. So I would invite anyone on the panel, Mark, from your perspective in terms of the possible outcomes, but also on the perspective of the details of the different product designs. How does one go about assessing the value and knowing either the pricing is good or not when looking at these different products?

Mark J. Warshawsky:
Well, I'll say that in conducting the research, the fee levels were extremely important in the results. So it is clearly a very important question when you get to the level of household making an actual purchase decision. It is critical. It was, I won't say, challenging for us, we're somewhat expert at this. We did find -- we believe we found all the relevant information. It is all disclosed. But it may not be as easy for somebody who doesn't spend as much time as it as we did.

Martin Schmidt:
I think one of the issues, and you are raising a very valuable point when you start talking about what the value is -- one of the things that IRIC has done is done an assessment of really all the products that are currently available in the market today. I think when you take a look at the variable products that are out there, the pricing that's associated with those products is more transparent and straight forward. The issue about the value associated to what that pricing is or what the fees are really gets down to what the richness of the benefits are. And as you said, what I attempted to describe were

really what the solutions were related to the market. Within a GMWB, you could have 10 different products that are out there, and within those products they all have different pricing, and that pricing is variable based on what the richness of the benefits are, what the underlying asset allocation is.

What becomes even a little more complex, and we talked about this a little bit in one of this morning's panels is the transparency of fees. And when you start to deal with a fixed annuity product, those fees really aren't as transparent. So it's really hard to create an apples to apples comparison. When you're looking at it from the perspective of a plan sponsor, I would say that given where the market is at today, it is almost impossible for a plan sponsor to assess what the value is of that, and that's really where the consultants or the advisors are coming in to help assess what the scope of the market is and how do you evaluate what the difference is with the products in the space today.

Dan Campbell:

I would agree with that and that is why we came out with our comments in regard to the real need for more mandated fee transparency. I think there are too many places where fees are not fully disclosed or certainly understood by the plan sponsors much less the participants. So having more mandated rules to make sure that disclosure is out there would help in that regard. But you're right, it is a daunting task for planned sponsors.

Male Speaker:

Thank you.

Male Speaker:

I just wanted to ask one question. I think it was Mr. Campbell mentioned in passing, about the various strategies that are out there with the possibilities of rollovers in the DB plans are one of the strategies that are available. I think in an earlier session someone had talked about having a number of clients who had that has an option. Did your results show that was a frequently used option or frequently available option?

Dan Campbell:

Actually, we put that more there -- again, something else that is a possibility. It would certainly depend on, while

it's available in a small to medium number of plans, it's not used a great deal. Obviously, the general shift is to move away from DB plans. But I think a lot of that still has to do with participants. Again, there is this infatuation with this lump sum payment. I mean, people see \$300,000, and that feels like a lot of money, and then they see the stream of income that may translate into and it doesn't feel like a lot of money. That goes back to many of the points that were made today; much more needs to be done to help educate near retirees to understand what they would be getting from that with the advantages of lifetime stream of income would be and how they would be much better off in a guaranteed stream of payments versus a lump sum that is subject to all the risks that we talked about.

Male Speaker:

I'm curious of the panel's views in terms of assuming there was very clear guidance in terms of fiduciary standards applicable to the selection of annuity providers, which is a big assumption, but assume that, do you think there would be a move toward default annuitization? Is that an attractive option for plan sponsors?

Dan Campbell:

We're in the assumption realm, so we can be a little speculative; I would say probably not. Because, I think -- we did a survey of DC plan sponsors last year, and we asked them a question of -- first we asked how many did offer annuity through the plan or associated with the plan. We had a little higher number than Hewitt, but not a lot. We had 16 percent of DC plans offering it. And then of those that asked remained, we asked why not, and they certainly did give the fiduciary concern reason, but the larger concern was they felt the participants weren't interested. So I think both are needed. And that relates both to education, which I understand has been widely discussed at this hearing, but it also relates to product design, to what actually the distribution mechanism is. And it has to satisfy these needs, these legitimate needs of plan participants, and I don't think we can or should ignore the need for flexibility and control, and perhaps even a little desire for upside potential. So, I mean, the industry has been responsive, but I think it's definitely -- I'll speak for our investment consultants in this area for Towers Watson, we feel as if there is a lot more that needs to be done.

Martin Schmidt:

I think a number of plan sponsors are interested in this program. Clearly everyone has shifted their point of view from accumulation to deaccumulation; that's been clearly stated. But now they're saying, "What can we do to help participants there." We've talked about all the barriers here, but I think the number one step in clearing those fiduciary concerns would open the door to allow planned sponsors to start introducing these, and I think that would allow to pick up some momentum.

Male Speaker:

So your sense is there is an interest on the part of the employers. There is recognition of potential value at least to some participants of this option, but part of its education and being comfortable that we can provide that education without assuming liability. And to some more clear articulation of what standards apply as I'm going through the selection process.

Mark J. Warshawsky:

Absolutely, the plan sponsors are asking us these questions. So there is definitely interest. I think these hearings and the RFI in part is responsible for those questions coming up.

Dan Campbell:

I was just going to add to the point. One of the things we were seeing from an IRIC perspective is really to get clarification right now as to whether these products are really QDA eligible. There is, I think, disagreement within some of the community. Some would say that they are eligible; others would say that they are not. I think the reality is that when you look at it from a plan sponsor, and it's not just a plan sponsor; a lot of it is as Mark was saying is from the advisors and consultants. When plan sponsors are working with their investment consultants, it's really having their comfort level to say they are QDA eligible. If anything, where you'll probably see more acceptance of something like this and might be driven from the small plan market, where there might be more acceptance to have this QDA eligible versus having the large plan market to say that's going to be defaulted. That has been one of the challenges, I think, overall with a lot of these products is having it be driven more from the small plan market, bottoms-up versus top-down, and how the large plan

sponsors and their reluctance to overall adopt, not just a QDA but the products in general.

Male Speaker:

Apart from the fiduciary comfort that you alluded to, you've each mentioned one or more possible measures that government might take. Could you circle back on that and give us a sense of what your list is of priorities in this area, specific things that might be done in addition to the fiduciary issue that you mentioned.

Mark J. Warshawsky:

I would say that because I think another issue is the knowledge and the education of the plan participant; it's that area that plan sponsors need the most comfort. They are nervous. So I'm not a legal expert, so I don't know. I can't formulate it in terms of how this comes out, safe harbors or whatever. But that's the issue I think I would put as the first priority because it's a chicken and an egg, but once we get some interest from the plan participants, then I think we can work our way down the list.

Male Speaker:

Mark, in terms of strategies apart from how the comfort or protection might be provided regarding permissibility of education beyond the existing Labor Department guidance, what do you see -- and open this to all of you -- what are the most promising ways that education might go forward. Let me reframe that a little bit. If the government were to give more comfort to the effect that plan sponsors can be more forward leaning in educating participants, what's the specific kind of activity that might be most effective?

Mark J. Warshawsky:

I'll briefly give a thought and that is not so much my research, but the research of other colleagues have shown that the way the choice is framed is extremely important. As was indicated, \$300,000 seems like a lot of money and in terms of annuity, it's modest. So it's hard to get over that if you're thinking in terms of lump sum. So the framing is extremely important and that's challenge. It will require a lot of experimentation to get it right. So even that sort of circles back to the comfort of plan sponsors, and those that would develop such education, they may not get it right the first time. So they don't want to

be sued for getting it wrong the first time. It's just that they need to figure out what's going to work.

Dan Campbell:

I would add to what Mark was saying. I think framing is critical from that standpoint because I have been calling it a lump sum based on what that will translate into in a value. The point was raised earlier with the question, what's the value that you're getting out of this -- they're complicated products in how you look at this. We make the point within our group is that, if you're not using QDA, they probably have to be sold. The participants by themselves probably will not intuitively just look to invest in them. So that's why we are saying that the communication and education to help framing it and help participants understand the products better will help with that overall utilization of the products.

Martin Schmidt:

Make to my earlier point. Part of this, I agree, there are a number of service providers coming out with new products and new ideas in this space. But because there is so much misunderstanding or lack of understanding of what fees are really in there, maybe it's through the different phases as we said to make different choices in the product that later on may trigger some fees. I know it's important to know about that up front. Also, really, just understanding the whole transparency aspect is critical.

Male Speaker:

As you know, the literature includes some analysis of alternative framing in terms of investment versus consumption or income stream and the like, very much at the kind of the hypothesis level and starting with experimentation. Is there something about that -- the framing issue -- that you see has precluded, that a plan sponsor is precluded from trying different legitimate and accurate, alternative ways of framing by the way the law stands today? In other words, in thinking about, helping the department of labor in particular -- this is really their issue, think about how to consider relaxing the constraints on education or clarifying what would be valid education. And this is something I invite you to think about afterward. It doesn't have to be off the top of your head right now. But is there something about the law now that could be changed to better accommodate alternative

framing given that obviously any alternative frame has to be accurate and defensible in its own right.

Martin Schmidt:

I appreciate the opportunity to get back to you on that.

Dan Campbell:

I would agree.

Male Speaker:

Thank you very much for your contribution today.

Panel Six

Trevor Oliver:

Hello, my name is Trevor Oliver, and I am the director of Research and Product Development for State Street Global Advisors Defined Contribution Team, and I am joined by Kristi Mitchem who is the global head of Defined Contributions. Both Kristi and I have spent the last several years designing and building income products for 401k investors, and we are really excited to be here and talk to you guys and hopefully shape some policy.

Defined contribution plans are now the predominate form of retirement savings in the United States. With the passage of the Pension Protection Act, these plans have been strengthened to include automatic enrollment and default investing. Despite the positive changes, we have witnessed over the last three to five years and the general move toward institutional management within 401k plans, we are missing one critical element which exists within the defined benefit construct which has not been fully replicated in the 401k world, which is lifetime income. The significance of this omission perhaps best communicated through an analogy: without annuitization, 401k savers are forced to plan or pack for a trip without knowing either the duration or the destination of their journey.

In order to enhance the probability that a majority of Americans achieve retirement security need to increase the access to and uptake of investment options that include lifetime income. Why is lifetime income a central component in a successful retirement portfolio? The answer is two-fold. The utilization, one, makes it possible to define with certainty a time for which retirement cash flows will need to last and through pooling allows participants to avoid the premium associated with self-insuring their own longevity; and, two, a decrease of the individual burden and risk, particularly for elderly Americans managing a large lump sum to generate a monthly cash flow, pooling all the participants to purchase income according to mean life expectancy, but receive it as long as they live.

Currently, if a couple wanted to have a 95 percent certainty that they would not outlive their retirement savings, they would be faced with -- well, they could be faced with two options. One would be to run a draw down

strategy and the other would be to purchase some form of annuity or income product. As it turns out, looking at actuarial pricing, the income product could probably be provided for somewhere in the neighborhood of 25 percent less and provide income for their entire lives, not just the 95 percent mortality. The importance of income products is further underscored by some recent research and behavioral economics which has identified some degree of financial mismanagement that occurs due, at least in some part, to cognitive decline with aging. One of the other advantages of using income products is it pushes the responsibility of management away from the individual and onto the insurance provider.

Despite the advantages of annuitization, practical challenges associated with lifetime income today have imperative option. In our testimony today, we'd like to comment on three major themes: first, the advisability of mandatory annuitization and alternative methods to driving up income utilization in participant populations; second, the importance of insuring competitive transparent pricing retaining liquidity and incorporating inflation protection; and finally, primary barriers to adoption from planned sponsors respective. We'll also have some suggestions for potential remedies.

The idea of mandatory annuitization has some appeal and is used internationally within the 401k retirement systems in the U.K. and Chile. While we believe there is a great deal of benefit to be had by individuals who put all or part of their 401k savings in lifetime income vehicles, we do not believe a system of compulsory annuitization fits with the 401k model. Because contributions are voluntary and belong to participants, any attempts to over engineer the acceptable investments might reduce participant participation and savings level. In our view, participants should have the final say in terms of how their balances are allocated. Giving participants the final say, however, does not prevent us from creating safeguards against participants who would otherwise not act in their own best interest. In our view, it would be advisable for the DOL to specifically include income as an acceptable investment within the GDI framework.

We believe defaulting participants in a strategy [spelled phonetically] that include lifetime income would most likely be highly effective and certainly more consistent

with the current practice of using opt out investment selections, which is why they accepted the 401k plans today. Targeted strategies, balance funds, and managed accounts that would use deferred annuities or income features in the form of a rapt contract can be created; the advantage of specifically encouraging this income as part of a QDA option, which is beyond the extension of lifetime income and benefits to defaulting participants. Not only could inertia be used effectively to increase the number of participants who benefit from lifetime guaranteed income, but, importantly, those guarantees would also be structured and managed by a fiduciary who would determine the level, pace, and pricing of annuity purchases.

It is critical to note here the relevance of framing for participants. While we believe illustrating monthly income conversion would potentially help participants in thinking about retirement in terms of a monthly flow rather than a lump sum, it is also our belief that seeing income is not experiencing income. The idea of reframing the conversation without simultaneously promoting access to income solutions could be problematic. Reporting a simple conversation of lump sum to monthly income number would not allow participants to experience the most important features of an annuity purchase, performance guarantees, term certainty and pooling. We recommend the DOL bare this in mind when considering any new reporting requirements. In our view, the best way to implement a lifetime income solution is within a QDA.

However, income solutions QDIA eligible or not should be structured in a way that preserves liquidity throughout the savings years, provides competitive pricing, and ensures protection against the erosive effects of inflation. We believe that liquidity is to be retained -- can be retained by structuring annuities as a fund rather than an individual investment or through the utilization of a RAP contract. Competitive pricing can be achieved by fiduciaries through the use of a model or through an auction mechanism in which multiple insurance providers participate. Inflation protection should be structured as a fully replicating CPI adjustment to the annual payout. If inflation is not fully hedged, participants face the problem that their income products will fail them when they need them most because the longer they live, the longer inflation will erode the purchasing power of their guaranteed fixed incomes.

Frequently in finance we find ourselves talking about correcting very small inefficiencies. We don't mean to trivialize these improvements. When a number of them are combined, their impact can be quite material, but what we are talking about here is far more substantial in its potential impact. We believe that income products offer the opportunity to reduce the amount of money people need for retirement by as much as 25 percent, and their incorporation can have an immediate impact. Participants need solutions that can be implemented today and will significantly improve their lives tomorrow. We can tell you from many recent conversations with our clients that plan sponsors are unanimously noting how important retirement income is to the future of their DC plans. However, they are waiting for some indication from Washington that they are going to be supported in this choice going forward. Three concerns we hear most often voiced are: unclear guidance and uncertainty around the fiduciary protection for incorporation of income and QDIA to the inability to mitigate potential risk and insurer default and the lack of portability in the current product set.

In support of planned sponsor's concerns, we specifically recommend the following be considered. One, the addition to the QDIA regulation to specifically allow the incorporation of annuities and insurance wraps while continuing to stress the importance of competitive pricing; two, establish a national program similar to that of PVGC for defined benefit plans to guarantee annuity purchases made and is part of a workforce savings plan; and three, the facilitation of plan to plan transfers and plan to IRA transfers to ease portability for participants. We hope you seriously consider these recommendations, and we once again thank you for the opportunity to be here today and we will be happy to answer any questions afterwards. Thank you.

Mark Fortier:

Good afternoon. I'm Mark Fortier. On behalf of AllianceBernstein, I appreciate the opportunity to testify today. We are a global asset management firm headquartered in New York with approximately \$500 billion in assets under management. We'd like to share our views on how to enhance retirement security participants and employer sponsored

retirement plans namely by facilitating arrangements that provide a lifetime stream of income after retirement.

A convergence of powerful forces has triggered the need to address this important issue. Defined benefit plans once the main source of retirement income from many workers becomes too expensive for all sponsors. Meanwhile DC plans have traditionally not been designed to deliver lifetime income to participants. This creates a potential retirement income gap for future generations. Of course, DC plans do have many excellent features of their own, most notably portability, participant control, and access to funds. And USDC sponsors have invested an enormous amount of time and effort to improve their plans in recent years. Mostly that was motivated by the desire to enhance employee benefits, but it was also encouraged by the protections and incentives afforded through safe harbor offered in the pension protection act of 2006. We believe the DC plans can preserve their beneficial aspects while also replicating the core benefits of DB plans, including widespread employee participation, expert investment design, low cost, and provisions for lifetime income. I'll briefly describe an alternative design for an inplan lifetime income option, outline some of the current obstacles to adoption, and then suggest policy changes to remove those obstacles.

A DC plan can achieve widespread employee participation by automatically enrolling new and existing employees and requiring they proactively opt out of the plan, rather than proactively opt in. Expert investment design can be provided by using target-date portfolios as the QDA. Of the available QDA choices, plan sponsors have already shown an overwhelming preference for target date portfolios, seeking greater flexibility, transparency, investment manager diversification, and lower cost. Sponsors of large DC plans are decreasingly adopting custom or open architecture target date portfolios. All of these recent enhancements are positively impacting participants. However, with so much being to help participants to save and invest until retirement, why has there been so little progress in helping them beyond retirement? While delivering secure retirement income to participants appeals to many DC sponsors, to date they have been reluctant to provide such products through the lack of adequate incentive protections. I'll discuss this further, but,

first, let's review what participants might want and need in terms of secure lifetime income plan.

Many academic papers make a persuasive case that a traditional annuity offers much higher income potential and security than giving participants a lump sum in retirement. But when DC plan sponsors offer participants the choice between a lump sum with complete control and income stream with virtually no control, virtually all participants choose the lump sum. Why? Academic papers on annuities typically assume that the soul motivation of retirees is to maximize their annual income for the rest of their life, but it is well documented that retiree's needs and circumstances are far from uniform. How much retirement income participants require, when they requirement, and whether they would like to leave money to their beneficiaries vary widely from participant to participant. It also varies widely for any one participant over time, since unexpected healthcare or other life events can radically alter a participant's finances.

As a result, most retirees or near retirees simply don't want to lose control of their investments or access to their cash. Buying a fix annuity requires participants to make an extremely complicated and difficult emotional decision to surrender lifelong savings. This is perhaps the most important financial decision of their lives and one that most are unwilling to make. And whether the annuity is purchased automatically or by choice, waiting to annuitize into retirement creates enormous timing risks. Participants who are unlucky and retire just after market drop or retirement interest rates are low would obtain much lower guaranteed income than participants with similar contribution and investment histories who are simply just lucky enough to retire after a period of strong market returns when rates are high.

Fortunately, it's not necessary to choose between giving participants full control with no income versus an irrevocable annuity with no liquidity or control. There's a range of annuity contracts that offer varying degrees of control, typically with some reduction, a level of guaranteed benefit. This would seem a sensible balance to meet the needs of DC plan participants who desire a baseline of secure retirement income, but also value control and cash access. We believe that one such benefit known as a guaranteed lifetime withdrawal benefit is

particularly appropriate for use in DC plans. Withdrawal benefit provides lifetime income, preserves participant control, and allows participant assets to remain invested in the capital markets providing the potential for capital appreciation. We believe that combining a target-date portfolio with a draw benefit can create an attractive QDA, one that provides secure lifetime income similarly what's offered by a traditional DB plan, but with the control and upside potential of a DC plan; I'll refer to this alternative design as a secure income target-date portfolio.

Here's how it works. In secure income target date portfolios, the guarantee is a component of the target date portfolio's asset allocation. Starting at around midlife, more and more of the portfolio's assets are automatically covered by guarantees, and the guarantees can be backed by multiple insurers. What this helps to do is promote price competition, but it also addressed the risk that anyone insured might default or run out of capacity to guarantee more assets. In our conversations with sponsors, they felt that having the guarantee [unintelligible] by multiple insurers was not nice; it was a necessity. Also quarterly statements for participants could include two other items along with their current account balance: the annual lifetime income they have accrued so far and estimates of annual income they might accrue by retirement.

DC plan investing and communications would move from a focus on account value alone to focusing on retirement income. This could help participants gain a sense of retirement security. We believe DC plan should consider automatically enrolling employees into a QDIA that incorporates lifetime income guarantees such as secure income target-date portfolios. We believe this can offer workers the best attributes of DB plans within a DC plan framework. Despite these potentially transformative advantages for DC participants, very few plans today offer investment strategies with lifetime income guarantees as their plan default option.

We believe there are two primary ways that they policy makers could help promote wider use of lifetime income strategies within DC plans. First, concerning safe harbor provisions, it is unlikely that plan sponsors will adopt inplan lifetime solutions without safe harbor protection should an insurer provider fail. Of course, the safe

harbor would require that the fiduciary who selects the annuity provider conduct appropriate due diligence in selecting the insurer. Right now, the safe harbor that protects fiduciaries who select annuity providers for DC plans only seems to apply to traditional annuities, and it doesn't clearly extend to the other types of guaranteed lifetime income products. We feel that the rule should be revised to explicitly incorporate a broader class of guarantees. Along with this, policy makers should clarify that QDIAs can include a broader class of guarantees. We recognize that current regulations contemplate the incorporation of guarantees within a QDIA, but the DOL could remove any uncertainty by clarifying the forms of guarantees that the QDIA could provide, and also that safe harbor extends through the payout phase of such a QDIA as well.

Second, the rules related to qualify joint and survivor annuities and spousal consent need clarification. When retired participants make irrevocable decisions to annuitize benefits over their lifetime, the qualified joint survivor annuities insure that the surviving spouse have a meaningful opportunity to protect themselves against loss of income. With the type of secure income-date portfolio I described, participants retain control and therefore don't make irrevocable selections. We feel the department should remove any ambiguity in the qualified joint survivor annuity requirements when providing secure income-date portfolios and other guarantees that do not entail irrevocable decisions.

Critically, the administrative requirement for the sponsor should be clear and simple. For example, it would help if the regulations clarified a simple one time waiver with no additional waivers be required. We've seen extraordinary advances in DC plans over the past decade, especially since the PPA and your department's further clarifications. The next step is to help Americans achieve sustainable sources of income through retirement. We believe the actions we've outlined offered significant and meaningful ways to help participants and AllianceBernstein would be happy to assist the agencies in any way to further advance the retirement security of U.S. workers. Thank you for your time today.

Greg Burrows:

Good afternoon. My name is Greg Burrows. I am the senior vice president of Retirement Investor Services for the

Principal Financial Group. The Principal is a diversified financial services company. Our largest operating segment, Retirement and Investor Services, currently provides services for nearly 35,000 plan sponsors and more than 3.6 million participants. We continue to support them as they enter retirement, providing monthly income annuity payments to nearly 250,000 retirees. I am here today on behalf of the Financial Services Roundtable, which represents 100 of the nation's largest integrated financial services firms. Roundtable members provide banking, insurance and investment products and services to American consumers and businesses. Member companies provide fuel for America's economic engine accounting directly for 74.7 trillion of managed assets in 2.3 million jobs. Thank you for the opportunity to share our views on the critically important subject of helping retirement plan participants secure lifetime income at retirement.

As you have heard from other presenters, there is a sense of urgency to act now as the first wave of 76 million baby boomers begins to retire in 2011. Of all the challenges facing this generation and the next, few are as daunting as the risk of outliving their savings. According to our research just unveiled today most Americans are worried but unprepared. The Principal Financial Wellbeing Index which is a quarterly survey of American workers conducted over the past decade, reports that 75 percent of Americans are very concerned about their long term financial future, the highest level of concern since 2005. One of their top concerns about retirement: being able to afford the basic necessities. Despite that only 14 percent of preretirement participants have actually created a plan for how they will transition their savings into a steady stream of income for life. Clearly there is a need to expand financial literacy long before an individual enters the work force with programs in the schools. However, we believe the work place is also a logical and highly effective place to promote financial literacy, particularly Retirement Income Literacy for workers. Plan sponsors are in the best position and have a strong desire to provide this assistance.

Today we will ask for your help with four recommendations. First, remove barriers that prevent plan sponsors from providing the crucial retirement income assistance participants need. Second, encourage the use of retirement income illustrations to drive home how long savings should

last in retirement. Third, provide guidance and the right information at the right time for participants to make lifetime income decisions. Fourth, support incentives, not mandates, to encourage plan sponsors to address retirement income issues on a voluntary basis.

The majority of our plan sponsors tell us they believe it is their responsibility to offer retirement income education and access to lifetime income products. But concerns about fiduciary liability prevent many from acting. Plan sponsors worry that education about guaranteed lifetime income options would be construed as advice. It would increase their potential fiduciary liability. We are pleased that the Treasury is focusing on a national strategy for financial literacy, and we salute DOL for the excellent education materials you have produced to promote financial literacy. We encourage you to do more, especially around the retirement income education. We ask for your regulatory guidance. It would provide fiduciary protection and safe harbors to plan sponsors who provide education about lifetime income options. Specifically we recommend a risk [spelled phonetically] of Section 404(c), Type Safe Harbors, which currently cover participant's selection of investment options in the plan, be developed to apply to participant selection of guaranteed lifetime income options and education about those options. A plan fiduciary would remain responsible for the prudent selection and monitoring of the lifetime income option products. We ask, however, that it be made clear that the plan fiduciary is insulated from the liability over the results of the participant's choice. This strong legal protection would go a long way toward encouraging plan sponsors to provide the resources necessary for participants to make crucial retirement income decisions. But what kind of information do participants need, and most importantly, when do they need it?

Retirement income education should come early, long before retirement is on the horizon. Retirees report wishing they could have learned more about the realities of managing money in retirement 10 or 15 years before retirement. One way to provide what people need is to illustrate expected monthly income and retirement on benefit statements for all ages of participants. Learning that a \$50,000 balance at age 65 would amount to only about \$275 a month for life can be a real wake up call. While legislation has been

introduced we ask the DOL to take administrative action to encourage the use of retirement income illustrations more broadly. Regulatory guidance that includes fiduciary protection for plan sponsors could promote these illustrations as a best practice and help change how participants think about savings for retirement. Participants we have studied also tell us they want education and guidance before learning about specific products. They say focusing on products first breeds skepticism. Participants want to understand the risks and costs of retirement, their own personal circumstances, learn what options are available to them, and then receive guidance to develop a personalized plan that takes into account their very unique needs. Once they are at the point of retirement, then they are ready to learn about product options. We believe decisions about selecting lifetime income products are best made at retirement, the point at which participants have the best understanding of their unique Retirement Income needs. Because those needs are as varied as retirees themselves, we do not believe that any single investment or product is a one size fits all solution for all participants.

It is likely many participants will need a retirement portfolio containing a blend of products ranging from mutual funds to income annuities, so they need education on a full array of options and guidance on their use. As the DOL considers its role in helping Americans with lifetime income, we ask that you recognize the importance of participants making lifetime income product decisions at the point of retirement and the need for access to education on the full range of options to meet the unique needs of retirees. While there is not one silver bullet product that can effectively address every need or retirement goal, there is one product that is specifically designed to optimize guaranteed lifetime income. The traditional income annuity used as a distribution option at the point of retirement. Because of their higher pay out rates, income annuities can play an important role in a retirement portfolio, particularly for retirees with limited sources of guaranteed income. Plan sponsors are in a good position to explain the benefits of these income annuities and to dispel the myths that make participants reluctant to consider them. They are also in a very good position to provide access to distribution income annuities, but once again are concerned about fiduciary liability.

The DOL took an important step towards addressing this with regulation that adopts a safe harbor for the selection of annuity providers. However, the regulation requires the fiduciary to include the annuity provider is financially able to make all future payments.

This is an extremely difficult standard for fiduciaries to meet. We know the DOL has given serious consideration to this, and we will work with our industry groups to provide specific recommendations for changes. Because distribution income annuities address the primary challenges faced by retirees today and in their future, there needs to be strong legal protection for plan sponsors who offer access and education to lifetime income options.

Finally, we support incentives not mandates and we believe planned sponsor should be encouraged to address lifetime income education and options on a voluntary basis. Strong legal protection such as we have described would make education about and access to lifetime income options appealing without a mandate, especially if it were combined with tax incentives. We support tax breaks for plan sponsors who make income annuities available at the work site and for participants to put some of their retirement savings into a guaranteed monthly income. We ask the DOL to join in supporting annuity tax incentive legislation like the Lifetime Pension and Annuity for You Act of 2007, sponsored by Representative Earl Pomeroy. This type of legislation can help retirees avert the growing risk they may outlive their savings by encouraging them to create their own guaranteed pay check for life.

I appreciate the opportunity to appear before you today. We look forward to working with you as you consider the critical work site education to help employees secure lifetime income and retirement. I would be happy to answer any questions you have.

Male Speaker:

Let's see, I think it was Mr. Oliver. Yeah, you seemed to express certain reservations about disclosing the annuity equivalent of any lump sum payout. Perhaps you could elaborate on that.

Trevor Oliver:

Yeah, of course. You know, one of the concerns that we have as we look at this is there has been a lot of focus on

reframing, but in some very real sense we don't actually care about how people think about the problem, we care about how the way they think about the problem impacts their behavior. So when you talk about reframing, you really have to think about what type of behavior or what strategy you are encouraging people to adopt. You know, when you are looking at somebody who is 25 or 30 years old and they see a lot of volatility in their future or current income, you know, if the, say, the correct product is you know a deferred real annuity that will kick in when they are 65, that product simply doesn't exist for them at that age. And so there is no direct change in behavior that we are advocating for that person. And so just reframing the problem sort of breeds anxiety without the ability to mitigate the risks that they face.

Male Speaker:
Thanks.

Male Speaker:
Mr. Fortier, you talked about a product that embeds annuities within target-date fund.

Mark Fortier:
Correct, I did.

Male Speaker:
A target-date fund. Can you talk about how you guys dealt with the portability issue to the extent that a participant wants to move from fund to fund or plan to plan? How do you deal with that?

Mark Fortier:
Sure, I think the comments throughout the last day and a half have all been right on the mark. There is the three-headed monster -- I think it was referred to -- of participant portability, plan portability, and then provider portability. I think they're actually in that order. I think the participant portability arguably is probably the easiest; it is most tactical. You know the feature sets, benefits can move actually to an IRA at time of termination or separation of employment. The provider portability -- I'm sorry, the record keeper portability can -- you know, certainly through standardization can be dealt with, but the ultimate answer there is availability. If they aren't available in other places, having a standard doesn't solve the problem. So I think getting, you know, I

mean, we have to take these things in order, getting safe harbor, getting early adoption, getting proliferation is ultimately going to address that issue.

I think the challenge ultimately is in the provider portability. I think that's the one where our belief around the need to have a multiple insurer strategy, not just because sponsors have told us that is a necessity, but, arguably at the end of the day, what you really need is a solution that can move on despite the fact that one insurer may not issue capacity; one may no longer be price competitive. If you don't design and build that up front, you can't think about it after the fact. I mean, it is nice to talk about assumption reinsurance at some future date but you have to have an answer for it today. I think that is what a lot of the theme has been throughout this is that it is nice to have safe harbor, but you have to give thought to these events now. With that said, I think the provider portability ultimately us going to always be given the nature of some of these forms of guarantees, not something where you are going to see a blanket answer to. There is going to be different solutions and different structures to solve that.

Male Speaker:
Thanks.

Male Speaker:
Well, do you -- are you suggesting some kind of public policy intervention to encourage that in some fashion, that provider portability solution?

Mark Fortier:
Yeah, no, unfortunately I would say that is ultimately the function of the state insurance regulator.

Male Speaker:
Right.

Mark Fortier:
I am not suggesting a federal charter or intervention into the process. I guess I am using history as an example, so if I go back to the 80s and the GIC crisis, and the events that unfolded was a function of getting time. Time was the solution. It's actually the financial -- the answer to the financial crisis of today. So if you don't plan for a way to buy time, so in other words, putting in another insurer

to deal with the next level of capacity; that is where you build the run on the bank; that is where you build the crisis. So I think the inevitable answer of how do I port these benefits from one insurer to the other is not going to be solved through regulation. I don't even think it is going to be solved through state insurance departments.

Male Speaker:

So I am curious. Now, I have heard and a number of panels have mentioned kind of the annuity feature in the context of a QDIA construct, and I am struggling with how that works at a couple of levels. One, we're again assuming a basic fiduciary standard in terms of selection that's satisfied. And I assume we are talking in most instances about a default. That is whatever the lifetime income solution is, insured annuity or financial restructuring solution, withdrawal benefit, that there would be some fiduciary relief for, I guess, those activities that take place post investment. The hard part for me is the fact that kind of unlike the current QDIA framework is a lack or inability perhaps or limited ability of the participant to unilaterally change that act. So maybe you could shed some light on your concept of how this safe harbor would work, what it would do, and kind of what flexibility, if any, participants ultimately have.

Kristi Mitchem:

Sure, and maybe what I'll do is I'll speak to something that we are very familiar with, which is a target date that would actually purchase deferred fixed annuities, and then maybe you can speak a little bit about a wrap [spelled phonetically] or a GMWB. So the way that we think about the annuity is just like any other asset class within a target date construct. And in essence it becomes, in certain instances, the fixed income exposure inside the target date fund. Now, it can be structured as a fund holding such that the purchase is made by the fund and not the individual, and that's something that we alluded to in our testimony but perhaps didn't fully explain. So essentially what you can do is you can create a generic annuity, a type of annuity that is held by a fund but is freely transferable from individual to individual up to the time that that individual actually begins receiving the lifetime benefit at retirement. So in essence what you have is it looks and feels like any other option on your plan. It is fully liquid, fully transferrable, again, up to the date at retirement. So I don't think liquidity is a

concern from that perspective, and I almost would state that I think liquidity should be a requisite of the type of income options that we place on 401k plans. I think it is clearly constructible both within our model and within yours.

Male Speaker:

Yeah, I think to segue -- I think the basic design is very similar, the utilization of a target date fund, where you are really just embedding the guarantee inside of it and for lack of a better word it is another asset class. Yesterday I want to protect against inflation, I buy tips; tomorrow I want to protect longevity market, I buy this. I think the key distinction for us in choosing the form of guarantee was the liquidity aspect. I mean, we see liquidity moving not just to retirement but through retirement, and the irrevocable nature of that decision is both sponsor and participant alike. So, I mean, I think the value -- the trade off of control and liquidity is what we are all debating. I think the value of that trade off with the sponsor in this case is you always have that right, right. The value of liquidity is I can move it, the participant, I can move it. If interest rates go up I can do something with it. I think that's really where we settled on the form of guarantee. It wasn't just about the participant's value of control; it's about the sponsor's value for control. I mean that is arguably what they demand. I think there was one other sort of aspect for us.

I think the focus on the QDIA also relates to the insurer. I mean, the fact is that you know a lot of the experiences in the retail products are adverse selection. They are any selection. We have heard a lot about gender biases, timing biases. I mean, the value of the default space is it is a broad swath of the American public, all ages, all genders, all savers, all generations. You know, it really provides in my opinion a safe haven for the insurers. It is an opportunity for them to right business, not unlike the DB plan, where -- you know, if you ever tried to ride a DB plan for just 65 year olds, it really wouldn't have worked. I mean, it's -- you've got to think of it as crossing generations, crossing types of people and ages is what again the QDIA brings to all parties. So it is not just about the nudge and favorable benefits.

Greg Burrows:

I would offer an opinion -- first of all financial services roundtable doesn't have a formal opinion, but the principal financial group does. We are actually reluctant to validate any plan for annuity as a QDIA solution for a couple of reasons. As we identified in our testimony, we believe that the right time to make decisions about retirement income options is at retirement. Once individuals fully understand their financial needs, the uniqueness of their needs, their financial position and things like that. We also believe that income annuities play an extremely important role in income management in retirement, but once again the decision in our opinion should be made at the retirement stage, not during the accumulation savings stage.

When I think about the QDIA I think about individuals who are being defaulted into a product that they may not understand the product construct, and they may be paying premiums for product guarantees that they may never use, and then we have already touched significantly on the portability issue. So from our point of view, we actually favor financial literacy, education, maximizing savings during the accumulation phase, protecting the assets as you reach the retirement stage, and then once you are at the point of retirement and understand the individual and unique needs at retirement, then understand the product portfolio available to you including income annuities and really build the right kind of distribution strategy and manage income.

Male Speaker:

And maybe you could speak a little more to the 404(c) analysis. They seem to get fairly close in my mind. In the 404(c) construct, would you envision one annuity provider, multiple providers, multiple products, one provider in perhaps your vision, kind of what we would do in the 404C construct?

Greg Burrows:

Again, for us it was the use of the QDIA, so getting safe harbor and 404(c) protection around that vehicle. The insurers within that were still independent selection decisions by the sponsor, not unlike working with multiple investment managers inside a custom target-date portfolio. At the end of the day, they have to make those independent decisions. In this case, they would have to make those independent decisions. So again, I think our safe harbor

need was around the selection of the insurer. So, you know, coming up with due process, coming up with a way for them to sort of, unfortunately, avoid what they considered to be a very daunting and scary task. I think it is never going to necessarily be an easy task but at least it is a task they should be able to understand and follow.

Kristi Mitchem:

So I would just add that I think it really is more guidance around what you specifically need to consider in terms of selection and monitoring of the insurers. Maybe you say that you know would like to see multiple insurers or perhaps favor a multiple insurer type platform. But I think just outlining the specifics of the things that you would like for plan sponsors to consider. And then I would also state you know that I do think one of the values of, real values of having annuity purchases sit within a QDIA is that you do have an ERISA fiduciary manager making these decisions on how much to annuitize, how much to annuitize, and the pace of annuitization. The pace is really critically important because one of the real values to starting an annuitization program early on in your life is that you actually annuitize in various different interest rate cycles as opposed to really concentrating that interest rate risk at the point of actual conversion to the distribution stage. So, again, I think we would be very happy to come back with some very specific recommendations in terms of selection and monitoring. But I think overall the idea would just be to clarify the types of things that plan sponsors should be considering in making those decisions.

Male Speaker:

I want to come back, I guess, to this question of liquidity and a deferred annuity because I am having trouble connecting a few of the different dots here that I have heard. So by default or otherwise, if across my career, I am buying in installments different interest rate environments, I am buying this future annuity, is that what we are saying can actually be liquid, and by liquid do we mean that I would have the opportunity as an individual to turn it into cash and invest it into something else?

Kristi Mitchem:

It is marked at commuted value on a daily basis and you can sell it at commuted value.

Male Speaker:
And I can sell it?

Kristi Mitchem:
Which means that if you were even charged insurance premiums those then have a value as an asset in the target date fund that you can realize upon liquidation.

Male Speaker:
So that insurance that I have been paying in some sense is being paid in advance. It is not like a term insurance. So it has built up some value and I can cash that out, too?

Kristi Mitchem:
[assent].

Male Speaker 1:
Okay, so if that is true then, do I lose something because of that liquidity? Do I lose some of what might otherwise have been a remediation of adverse selection? Because the decision to get out of the annuity might be subject to adverse selection the way that decision to buy annuity at retirement age would be.

Trevor Oliver:
Certainly there will be some loss of efficiency. I mean, if you are looking at a 25-year-old who is purchasing annuity to begin payments at 65, the ability of that person to self-identify as having exceptionally long life expectancy is non-existent.

Male Speaker 1:
But later down the road when they decide whether to sell that --

Trevor Oliver:
Exactly, and so, you know, without evidence to support this, we would certainly expect that if it's defaulted and people have been holding it for a long time, you're going to see a different population uptake the annuities. Traditionally what you see is sort of the annuitant group, the people who actively go out and select to be in annuities. Those people have longer life expectancies than the general population. But if you default people in early and keep them in their, in these products for their entire careers, what you will actually get is the entire population minus the people who would opt out of an

annuity, which is a slightly different group and will have hopefully more favorable actuarial characteristics and get better pricing.

Kristi Mitchem:

I think it is important not to understate the effects of inertia in these situations. So recognize that when we have participant populations or really any population that goes out and buys an annuity they are by default an active decision maker, right. When we think about using annuitization within a default, you are talking about a population which in many instances is largely passive. So to think that that passivity would actually change meaningfully throughout the course, I think, of their investment horizon both accumulation and distribution may be somewhat of a fallacy.

Male Speaker:

To Greg's point about principals emphasis on the decision making at the time of retirement can we reconcile these views or at least hash out this difference a little more? I mean, isn't there for one thing potentially less inertia at the time of retirement where people are confronted with a once-in-a-lifetime kind of decision associated with once-in-a-lifetime stakes which is part I think of what Greg Burrows is alluding to. If you are talking about mitigating adverse selection through the broad default space, but at the same time providing liquidity defined as the ability to get out at retirement, you are promoting a lot of choice, and, of course, how much of a hair cut one has to take when they take some version of the commuted value is key here. But isn't there a sort of continuum or a set of tradeoffs here? I mean, the earlier you start the more you mitigate adverse selection, the more you contribute to dollar cost averaging with respect to interest rate risk, but to the extent you then water that down, if you will, with a lot of liquidity, a high value, a small haircut ability to get out at retirement. I suppose principal might ask, "Well, why did you go through that whole exercise for the preceding 20 years if essentially you are giving people the choice at retirement? And if you present the choice in a very salient way how much have you gained?" To Greg I would ask, what about the dollar cost averaging? What about the mitigating of adverse selection? How do you view those benefits of early default or at least early option to commence an annuity even if it is not by default?

Greg Burrows:

That's a good question. One of the things I think I might point to a little bit on that is and you have heard it from this panel, and you have heard it over the last two days, is we have not solved the portability issue, and American workers change jobs very frequently. And without being able to solve the portability issue, we have a real issue as to paying for something that may never get actually exercised in that situation.

Male Speaker:

So is there a middle ground where there is some kind of optimal age like 50 or early 50s, so that you have reduced a lot of the portability risk? You have enough of a lead in time to mitigate interest rate risk through dollar cost averaging over a decade, let's say, or five years, 15 years, what have you. Perhaps you have to some degree ameliorated adverse selection.

Kristi Mitchem:

I think that is very good.

Mark Fortier:

That is very fair. As Kristi mentioned earlier, when we think about providing liquidity through annuity products, you know, we are talking about a generic annuity which is not necessarily the type of product that people would actually want of that exact structure when they reach retirement. As we have seen from people presenting the number of income products in the market place is growing rapidly. But they will have some common characteristics going forward including some exposures to changes in mortality, changes in interest rates. So even if people don't directly take the deferred income that they have accrued within their savings plan and take that exact product, they can turn it into something else. They can turn it into a GMWB; they could turn it into some other type of income product which has those same exposures. It hedges their exposure to those interest rate and to those mortality changes and therefore provides them more stability and they are getting something for the insurance that they pay for even if they don't receive the product specifically.

Male Speaker:

Mark, I think what you described is exactly what we were trying to solve for which is somewhere around midlife sequence risk. You know, you make that trade off then, but the value of control, the value of certainty are what people are seeking, and you've got to balance those two. You can't have complete certainty and complete control. You have to find something in the middle. So you know, again, I think we sometimes make a religious debate about what's better or a fixed annuity or GMWB? When you have to come back to what we are trying to solve for, what are the needs of the participant, what's the value of liquidity? I mean, I heard the word value last time but you don't value optionality by running a model. You value optionality by understanding the issues people are facing, healthcare. I mean, how do you put a price tag on people's access to money in the event of healthcare? You don't. So you make that decision first, and then you solve it in the best way possible. I think we just went down the path first of let's solve for what people need. What they need is control. Now, let's make sure the sponsor, the pricing is right you know, the economics are there, the asset allocation, so I think it is order of event. Maybe I would put it that way.

Male Speaker:

You know, Mark, one more comment I would say is once again we will emphasize we believe there is an extremely important role for income annuities and in retirement; we really do. I think maybe the difference of views is the timing of when those annuities are purchased in the premium and transportation and portability of those for that decision and that situation. We happen to believe maximizing savings during the accumulation phase, protecting that savings as you approach retirement, and then making a decision around the right product portfolio to manage income for fixed cost, and then having liquidity for emergency situations is extremely important.

Mark Fortier:

Just one thing I would like to add is that there is the idea of annuitization and liquidity even during the decumulation phase is not, they are not mutually exclusive. The reason is that I don't think anyone I have seen talk today has suggested that people should put 100 percent of their savings into annuities. So to the extent that you have an annuity or some sort of income product in your portfolio, which provides your baseline expenses, you know

that there is some sort of floor; there is a minimum that you are going to want throughout retirement. You fund that through an annuity then you provide liquidity through the remainder of your assets that you can use in case of emergency or medical expenses, and that's where the flexibility comes from.

Panel Seven

Male Speaker:

Do we have a view as to who should start?

Shlomo Benartzi:

Excellent, thank you. I deliberately picked that seat because from this angle, you cannot see the clock. So there is a lot of time. Thank you for the opportunity. It is a pleasure being here and sharing my thoughts today. Just to clarify, I have two hats. One is I am at UCLA where I run the behavioral decision making group; and the other hat, the chief behavioral economist for Alliance Global Investors. We just launched a behavioral finance center, which is very exciting.

Let me start with a scary thought about longevity risk. Six people on one table, three on the other, less one hiding, so a total of 10. If you take 10 people, and suppose we all made it to 65 and we went to high school together, we've got a reunion dinner, and you ask a question, "When would the first one die," if you look at actuarial tables, the first one is likely to die within four years after that dinner. The fifth one would die roughly after 20 years, and the last one is likely to die at age 99, 34 years later. Now, think about the financial implications for someone who made it to retirement and has to now set the plan where under one scenario, he would live four years and under another scenario he would live 34 years. That is not a simple problem to solve, and I would actually argue that behaviorally, I believe that most people play a huge weight on investment risk because it is very salient. Every day in the news you hear about stock market going up, down, and I think people don't plan enough for longevity risk. I am very excited to see the Department of Labor and the Treasury are focused on this because I think it is a huge problem. Some preliminary analysis we have done at the center at Alliance would indicate that for some people, especially as they get older, if you do an apples to apples comparison, longevity risk is actually greater than investment risk.

What I want to talk today about in the unlimited time I have is about behavioral finance, about incorporating the human element into thinking about retirement income solutions. I am not actually going to talk about any product. It is really more about understanding the needs

of retirees and older people because I think it is very difficult to think of products or policies without understanding the unique characteristics of those people. I am going to talk about the human element and about behavioral finance. I think there is a good reason to try and use behavioral finance in this domain. We have seen behavioral finance making a contribution in the accumulation phase with research on automatic enrollment, on escalator features being implemented in the Pension Protection Act, and I think it is time to think about how we apply the knowledge to the decumulation phase, longevity risk issues.

A couple of months ago I submitted through Alliance a response to the request for information, and it was focused on behavioral insights having to do with the decumulation phase. I don't have time to cover all of the things, but I want to highlight four behavioral principals that I think are very important to think about when we think about solutions or policies.

Let me start with the work of Professor Goldstein from Columbia from London Business School about vividness. He feels that one of the problems that we have with people making decisions today for the future, whether it is someone saving for retirement, or whether it is a retiree deciding to day about a stream of income for the next 30, 40 years that people have a very easy time to think about themselves in the current situation and a really difficult time to think about the future selves. There is a disconnect. That is one of the reasons people don't say because that is for the future, and it is one of the reasons I think people have a hard time evaluating retirement income solutions at the point of retirement.

What Professor Goldstein has done -- he actually takes pictures of people and he shows them how they would look 20 and 30 years down the road. Those pictures make people double their saving rate because they can relate to their future selves. Now, I think the general point, though, is that the type of calculators and tools that we have designed as an industry is really designed for the experts. It is almost like we designed it for ourselves, and we forget about designing behavioral tools that are emotionally engaging, that would enable people to make better decisions in the accumulation and the decumulation phase and relate the future to the present. So I would

actually argue that to the extent possible. It would be great to see the industry more comfortable from a legal and regulatory perspective, to use more innovative tools that are not just about tables. I think it is important for people to be able to relate themselves to the implications to their future selves.

I want to touch also on hyper-loss aversion. We know that people are very sensitive to losses. If you lose \$100 it feels a lot more painful than the pleasure of winning \$100. We had a gut feeling that retirees are more sensitive to losses than the average population, but not the extent to which they are more sensitive to losses. Professor Johnson from Columbia University did a fascinating study where most retirees are not willing to play a bet where they can win \$100 or lose \$10. That bet, 50-50 chance, flip a coin, lose 10, win 100 is unattractive to the vast majority of retirees. Those sets of preferences, I feel, need to be incorporated in whatever policy we are thinking about or whatever product as an industry we are coming up with.

I also want to talk about cognitive impairment where it is a bit frustrating, scary, and demoralizing. By age 85, half the people suffer from dementia or significant cognitive impairment to the extent that they cannot be responsible for financial decision making. Research by Professor Labson [spelled phonetically] clearly shows that. When you think about it a lot of people tell me 85 it is so far away. Why are you talking about it? But we know that half the people who retire at 65 will get to that point. There are serious questions about when do you want people to make decisions. If they make it too late, there is the chance that they are doing it when they are not capable of making the decisions.

The last behavioral issue I want to touch on is the issue of active decision making, when people actually have to choose and when there is no defaults., and I want to relate it to the work of Professor Puvitero [spelled phonetically] from Western [unintelligible] University, and the demand for lifetime income solutions. I have a strong suspicion that a lot of people, whether it is in the industry, whether it is in Washington feel there is not much demand for lifetime -- guaranteed lifetime income, whether it is in the form of an annuity or other forms; people don't buy these things, they are not really interested in it.

I think, actually, Alexander [spelled phonetically] has done actually quite a bit of work for Alliance in this, has been searching the literature for every possible piece of evidence to see what do people do when they have to choose. I think looking at the overall market and seeing that people don't buy guaranteed lifetime income is not very meaningful because typically they don't know what it is, where to get it. So it is not easily accessible so it doesn't necessarily reflect on their preferences. It might reflect more on the environment.

He has been looking for papers that looked at people who are on defined benefit plans and have a choice between the lump sum and the guaranteed lifetime income, and there is no default so they have to choose. There is a perception out there that everyone takes the lump sum, but if you look at the numbers, I got a long list of papers and I will be happy to share it, we don't have a lot of time, but one study self-reported data from retirees, 55 percent select lifetime income; another study, the Oregon Public Employees Retirement System, 85 percent select lifetime income. Each one of these studies, though, would have some caveats. I mean, it's not easy to find the perfect setting for these type of studies.

The case of self-reported data -- you know, that's always got issues, what people understand from the question. In the case of Oregon, there are some incentives to take lifetime income. One other plan that Vanguard analyzed, 27 percent picked lifetime income, but if you look at older people, 46 percent picked the lifetime income. IBM -- at IBM between 61 and 88 percent select the lifetime income. The lowest number that Alexander was able; Professor Puvitero was able to calculate was 61 percent. There is a range because you have to guess who had special packages where the lifetime income had a bonus, like early retirement benefits, if you take the lifetime income. But no matter how we sliced the data, can't get it lower than 61 percent. Looking at international data from Switzerland, 73 percent selected lifetime income. We just can't find any numbers that are lower than that.

So that raises obviously the obvious question that we were totally puzzled by. How come so many people think that the number is much lower, that everyone takes the lump sum distribution? So we took one large plan in the U.S., and we found that 87 percent took the lump sum. That sounds

like everyone takes the lump sum. Then we looked a bit deeper, and we split the employees into those who had \$5,000 and more and those who had tiny accounts. One-hundred percent of the employees below \$5,000 took the lump sum. They had to. These were the plan provisions, and you wouldn't want an \$8-a-month check anyway. Ninety-five percent of the employees with the larger accounts took the lifetime income option. Put them together without digging in, you might have absolutely the wrong conclusions.

So I see that I am running out of time, so what we have done we have taken all of the behavioral insights that we thought out there. We interviewed about 20 of the top behavioral economists, selected 10 insights and created a behavioral check list where you can put through this engine a product, if you are in the industry, a policy if you are in the government, and see how would a policy or product would score from a behavioral perspective. Does it address the behavioral needs of retirees? I think that is available on our website, on the government website. We have submitted it. Let me stop here and thank you.

Benjamin J. Yahr:

Good afternoon. I am Ben Yahr. I am a fellow of the Society of Actuaries and of the CFA Designation. I am here today as a concerned citizen, and the views that I am expressing are my own. I appreciate the opportunity to testify at this hearing. I have over 17 years of industry experience which has given me the opportunity to help a number of insurance companies develop innovative products and manage the risks associated with them. For the last four years I have led the Wealth Management Practice within the 1934 Group, which provides consulting services to define contribution plans and investment advice to affluent individuals. I plan to discuss the following topics during my testimony: recommendations to address participant reluctance to choose lifetime income options, disclosure of account balances as monthly income streams, and characteristics of a more desirable in plan lifetime income option.

As an advisor I have heard each of the participant concerns regarding lifetime income options that the agencies have outlined. I believe the agencies could address the majority of the concerns by insuring any in plan solution has the following four aspects. A simple and easy to understand default option. While some participants will

take an active role in decision making, most participants do not. In addition I believe the majority of participants in retirement plans do not have a relationship with a trusted professional advisor. As such, they will likely seek advice from a co-worker, a parent or a friend or elect whatever choice the plan sponsor has made on his or her behalf. This is one of the primary reasons why default elections chosen by the plan sponsor shapes participant thinking and attitudes with respect to their benefit choices. Furthermore, since people have a natural aversion to things they don't understand, the default option needs to be simple and easy to understand.

Two, participant choice. I believe the participant choice is critically important. As you know, each individual's personal situation is unique, and any one size fits all solution will be counterproductive for some people. By giving participants a choice of whether to use an in-plan solution, they can weigh the advantages of the solution against their concerns.

Three, participant education. In general, participants want to be more informed and feel more comfortable with the decisions they are making. However, there is so much information that is available that many people who want to learn simply become overwhelmed, and they give up. I would encourage the agencies to think of education in terms of providing an unsophisticated participant with focus content to help them answer a small number of key -- help them understand the impact of a small number of key decisions on their ability to maintain their standard of living in retirement. Some examples would be: How much should I save? What happens if I delay retirement and continue to work? And what are the advantages and disadvantages of choosing an in plan lifetime income option?

Number four, risk transfer. Since most participants are not equipped to manage the risks associated with generating lifetime income from a pool of assets, I believe the default options should be a solution which transfers a significant amount of risk to a financial institution who is in that business.

The second topic I plan to discuss is the disclosure of account balances as monthly income streams, which is closely tied to participant education. I strongly believe that presenting monthly income streams on participant

statements will begin to shift participant action and behavior related to retirement income. With this knowledge in hand a participant would be in a much better position to understand and observe the impact of the decisions they make. Agencies have asked a number of appropriate but complicated questions with respect to this calculation. Given the time constraints I am going to limit my comments to five key aspects that I believe are critically important. Number one, any monthly income stream that is shown on a participants statement should be expressed in today's dollars.

One simple way to illustrate values in today's dollars would be to use a conservative real interest rate to calculate a sustainable level of income. Number two, the baseline retirement age is an important signal. It should be linked to the social security normal retirement age. Number three, both the accrued benefit and the projected benefit should be illustrated. Showing both allows a participant to see how much income they have already replaced based on their current savings and whether they are on track to replace the desired amount of income if they continue contributing at their current rate. Number four, all other assumptions that the participants -- all assumptions other than the participant's current contribution rate should be mandated and updated periodically. These assumptions would include the assumed real rate of interest, mortality rates, base line retirement age, etcetera. By using a standard set of assumptions there will be consistency as participants move between jobs and plan sponsors switch between providers. Number five, in addition to the base line projections several alternative scenarios should be provided. One scenario would be what happens if retirement is delayed to either age 70 or say three years beyond the --

Benjamin J. Yahr:

-- or say three years beyond the normal retirement age. Another important scenario would be what happens if the participant increases contributions by one percent. These two scenarios would allow a participant to easily determine the impact of contributing more money and or delaying retirement.

I would like to spend the rest of the time that I have today to discuss an alternative design of a lifetime income that could be used as either an in-plan or out-of-plan

solution. At a high level, the alternative design that I'm suggesting would allow a participant to build an inflation adjusted defined benefit inside their existing defined contribution plan and or IRA. I refer to this benefit as an individual pension account with purchasing power protection. To participants, this benefit would look like any other investment option inside their existing defined contribution plan or IRA. Contributions and fund transfers into this new investment choice would purchase units for this benefit. For each attained age and gender combination, the unit value would equal the value of a differed immediate annuity, payable with the target retirement age, using a predefined real interest rate. The participant's total number of units at any point in time will equal the annual inflation adjusted benefit the participant has accrued in today's dollars.

Each year the number of units would be increased by inflation, very similar to tips. This feature would make it very easy for participants to observe their accrued annual retirement benefit in today's dollars. When participants reach the specified retirement age, monthly payments will begin. As a result, the individual pension account with purchasing power protection will provide participants with an option to produce a predictable guaranteed level of inflation adjusted income and retirement. A government sponsored entity would provide governance to this benefit. This government entity would select a financial institution to be a lead provider of the benefits from an open bid process. The government's sponsorship of the program would ensure portability and enable a broad sharing of longevity risk across the financial institutions who wish to participate. The financial institutions would primarily invest in tips to hedge the inflation risk.

The individual pension account with purchasing power protection would have a number of appealing features. Number one, it's simple and easy to understand. A participant can see the amount of annual inflation adjusted income they have accrued simply by looking at the number of units in that investment choice. Number two, it offers participant choice. It gives participants the choice to lock in a guaranteed level of inflation adjusted income when they wish. Number three, portability, because the benefit will look just like a mutual fund, the current record keeping systems could handle the benefit as is,

which removes one of the largest obstacles of portability. Number four, it's a private sector solution. While the benefit will be sponsored by a government entity, it would be managed by financial institutions in the private sector. These institutions would be responsible for pricing, managing the assumed risks, and administering the benefit. In other words, the potential government costs could be limited to an oversight function. Number five, transfer of risk, it transfers the investment risk, inflation risk, and longevity risk to the financial institutions which are experts in managing those risks. As with any new idea, there would be a number of potential transition issues. Some of the ones that I would note are the creation of a safe harbor for this benefit to be selected as a QDIA. The creation of a special series of tips, with varying times to maturity and a fixed real rate of interest to ensure the availability of a hedging instrument, allowing DC plans to use gender based annuity factors and possibly federally regulating the specific insurance benefit.

In conclusion I want to thank you again for giving me the opportunity to testify today at this hearing, and I look forward to answering any questions that you have.

Robert J. Toth, Jr.:

Schlomo, I am at a disadvantage. I can see the clock, so. My name is Bob Toth. I have been studying DC annuitization for some 10 years now or so. Besides having to answer the charge of that I really do need to get a life, I hope that some of my observations will prove to be helpful to you. Ben and Schlomo actually -- their comments demonstrate what many of the witnesses have been -- a point they've been making throughout the last two days is that whatever standard you come up with, it's got to be flexible. We've got to let smart people like these folks come up with ideas to provide and more ideas to come up -- provide with retirement security. We know that retirement security is more than just income. It's a lot of other things that go along with it, so the standards need to be flexible however they be developed.

Now, I'm afraid I'm going to turn back to the mundane, though. I'm going to turn to -- my two issues I'm going to address are the fiduciary issues related to solvency and to the portability issue, both of which you heard much of in the last two days. The solvency issue really has two classes. The witnesses -- I actually spoke of two kinds of

approaches. The first one is what I would call the future approach. Right now we have an ad hoc approach within the states. It works; it works in some degrees, but is it really the solution that we need to move forward as a matter of federal pension policy? What do we really need? Do we need an FDIC? Do we need these allocation accounts that Millum [spelled phonetically] spoke of? Do we need these kinds of things? And that's going to take time.

As an attorney, I am more important with the second class, and that's the current state. Yes, while you all speak of and talk of how we're going to develop what should be the true standard as a matter of federal policy, we actually have to deal with reality now. What do fiduciaries have to deal with now? And of course we all start with the DOL safe harbor standard that actually demands fiduciaries appropriately consider and conclude that the insurer is financially able to meet all future payments under the insurance contract. To answer that question, you really have to step back a little bit. You have to ask the question what is appropriate. When you think about it, there really is no data which can give any of us or any of my fiduciaries any assurance that any insurer will be here 10 years from now or 15 years from now. It just isn't there. I'm sure you've looked for it. I can see the struggles in your writings. I've looked for it. Many have looked for it. It's not there. And if I recall, the ERISA prudent standard doesn't demand that an ERISA fiduciary does something that can't be done. It's the like person or like circumstances of applied knowledge. And indeed when you again step back and think about it a little bit more, you know that no purchaser of an insurance policy can or should individually bear the risk of insurer solvency, but we actually have a problem on our hands because we know that the pooling of mortality risk and longevity risk are really critical elements to the welfare of a state's citizenry. It just is. We have to be able to take care of each other in that way, but no individual has the ability to do it.

So what has happened? Well, two things have happened. First, of course, you've heard several testimony of -- I've had several witnesses testify about the regulatory scheme that has spawned within the states over the last 100 years to be able to help cover that insurance solvency risk. It's there because no individual can do it. But that regulatory scheme has also created very complex financial

institutions, which no one can really understand. Most CPAs, most fiduciaries can't open the books of an insurance company or open the green book or blue book issued by the state and really understand what that means or get any sense of it. So the rating agencies have actually served well to refine a lot of that material for us. So, what do we have? We have state regulation, which attached to it, the insurer solvency statutes, which are flawed. There's no question they're flawed. We have the rating agencies, which there is no question, they are flawed as well. But fortunately if you think it through often their strengths offset, to some extent, some of the flaws in each other.

So I'd actually like to propose a natural standard that you could use to -- for a fiduciary to consider what is actually an appropriate consideration. I would suggest that the real answer -- a fiduciary is acting appropriately if they first of all teach themselves or have themselves taught as to what their rights upon solvency are. They need to know what will happen to them and what they will be able to do if the insurer goes insolvent. They should commit to themselves or to the plan and perhaps in the investment policy statement, talk about doing the mundane, that they will enforce those right, and they will act on behalf of plan participants to enforce those rights. This should then, to help fill in the holes, be able to rely upon the ratings at a certain level and above. You don't want to get into the granularity in ratings for goodness sakes, but the current financial system, state of the company as reflected by ratings, are appropriate.

But it shouldn't stop there either. In taking care of the rest of the safe harbor, where they need to do their due diligence on price, on benefit, on liquidity, on terms, and things like that, if there is a red flag there, they should not then -- they should be then, as a matter of fiduciary responsibility, go back and question certain things about the solvency of the insurer, and I think a particular point, Executive Life. Executive Life was well rated at the time of its insolvency. It was also covered by the state guarantee associations, but they were also offering really, really cheap annuities. They were also paying really, really high crediting rates on their guaranteed investment contracts. If it's too good to be true, the fiduciaries probably have an obligation to ask the questions saying, "What are you doing in order to give us those kinds of rights?" So, under this scenario, under

this kind of safe harbor, I think even under Executive Life, fiduciaries should have in response to their safe harbor responsibilities flush out a bad actor, and if you didn't act at flush out the bad actor, they could be held liable. So this is my proposal. There is hardly any other answer, unless you're going to hold fiduciaries to a standard to which no one can be held.

The second issue I want to address is portability. Portability exists. It happens. It's been happening for a long, long time. It's been happening since the Internal Revenue Code has been around; 403(b) is the classic example of the individual pension, individual terminal funding annuities. 412(I), though the IRS would cringe at that one, properly done is an individual pension. It works. The vendors of these products which fund these things actually administer public policy that stands behind them. It's there. The problem we have in the 401(k) world is people aren't familiar with them; it doesn't have high use. However, vendors are trying. They know what those rules are, and they are trying to fit their products into these rules.

There is one hope on this individual pension concept on portability. This is very important hold and it's that if you are using elected deferrals to purchase a guarantee that you can't take, without a distributable event, if there's a falling out between the insurer and the plan, if they have to get rid of them, this thing, this guarantee is stuck within the plan. What do you do? Well, it's not illegal. There's nothing wrong with it, but it's just unseemly to have planned fiduciary who has had a falling out with the insurer to keep them in the plan and spend all the money on their extra record keeping in order to get rid of it. So I actually have -- I suggest four different things that would perhaps help on the portability issue, given this little bit of background.

First of all, on the qualified plan distributed annuities, those individual pensions that have been around for a while. We need to establish a set of rules and probably five or six different discrete areas to clarify how they should apply in the 401k world. Things like you've heard the joint survivor annuity rules. What should the plan documents say? When does a risk apply and when does it not apply? There are probably four or five others that -- distinct elements like clarification would actually set the

world straight. I'm afraid though we need a legislative change for the second piece and that has to do with allowing the in-service distribution of an annuity guarantee or any kind of guarantee that has been purchased with elected deferrals, and there's been no distributable event. That needs legislative change, but it seems like we could develop a set of rules that could make that kind of proposal work. The third one really is an odd one, is the prohibited transaction rules, the QPDAs. The prohibited transaction rules that's applied to IRAs under 4975 don't apply to QPDAs. We need some kind of protection there, so that would probably require legislative change as well. And finally an important portion of portability is really consolidation and that's what we hear -- I think that's what's being referred to as insurer portability. You know, it's out there. Prior to 2007, we had 9024 transfers between 403(b) annuity contracts that you could really do it as long as you met a certain set of rules; 1035 exchanges exist in the retail market. People are currently taking their annuity guarantees that they purchase with one carrier, and they're doing tax free exchanges under closed section 1035 to another. It happens. The rules are there. Let's take advantage of the structure that we already have in place.

There are actually two other final -- that I'm not going to speak of, but I think are worth mentioning is, number one, none of this works without transparency. We need to figure out what is a transparent annuity. We've got to do it. It doesn't work without it. Second of all is, yes, this is the IRS; yes, this is the DOL. We can't forget about the security laws. They are particularly when you get to distribution of a new individual annuities and the qualified plan distributed annuities and the innovative products that these gentlemen speak of, you have to consider the application of the security laws and changes which make those work, and thank you very much. I appreciate the opportunity and look forward to your questions.

Male Speaker:
Go Ahead.

Male Speaker:
Professor Benartzi, there's a lot of talk in the previous panels about benefit statements and translating account balances in the form of a monthly income. Do you think

that strategy would add value from a behavioral standpoint? Would it change behavior or is there more that needs to be done?

Professor Shlomo Benartzi:

I think there's a lot of merit. One of the issues I think with account balances as opposed to monthly income, people don't have a good sense for those big numbers. It reminds me, I once was sitting on a call of one of these toll free numbers that a lot of mutual fund families have. And an individual called, and she said, "I want to stop saving." And the protocol for the agent was you should ask, "Why?" So the agent asked why she wants to stop saving. She said, "I already have \$100,000 in my account." And the agent didn't know how to answer. There was nothing on the screen for the agent to "[unintelligible], that makes sense. Okay, see you later."

[laughter]

But when you think about it behaviorally, we know that we have an intuitive understanding of \$3 and \$5 and \$10. We buy a bottle of water, and we have a cup of tea. We deal with these numbers often. We know what they mean at an emotional level. When it gets to a statement saying, "You have \$200,000," or it says, "If you keep saving, you will have \$232,000, \$322,000." We don't know how to interpret it at an emotional level. Translating it to monthly income I think is going one step further. Is that where we should end? Hopefully not, hopefully one day we would be able to take those numbers, the monthly income and convert it to video clips of a lifestyle. So you would see if you save - - I mean, we're doing very strange things with 401k plans as participants. We have to decide if we're going to save five percent, 10 percent, 12 percent. What do these numbers mean? It's in a vacuum. If you disclose the monthly income it would buy you, I think it's a great step in the right direction, but suppose hypothetically you had video clips. That is your lifestyle in retirement, if you save five percent, 60 second clip.

[laughter]

There is your lifestyle if you bumped it to 10 percent. That's where I think people would be able to relate to it, but to answer your question, I think monthly income is definitely a step in the right direction. It would also

change the debate from thinking about investments to thinking about what does it buy me, which I think is good as well.

Male Speaker:

Schlomo, you talked about the data regarding annuities selection versus lump sums selection. Of course, the previous portions of this hearing today and yesterday have included a fair number of data points that pointed in the other direction. I think that the reference you make to distinguishing employees by account balance size clearly has got to explain some of it, presumably age. Also since people with large account balances who are changing jobs and are rolling -- thinking about rolling somewhere else at a time well before they're ready to start annuitizing, to consider annuitizing, even if -- whether or not they would ultimately decide to annuitize, they're certainly going to be inclined to take the lump sum. They're not generally going to begin an annuity much earlier than they think they really want to, and for other reasons, I'm assuming that this will be really interesting discussions, which has already begun in the community and will reconcile the data and come up with a unified understanding of what's going on. But the really interesting question is to what end? What does this say to us? Are you proffering these data partly to make the point that this exercise is worthwhile because demand is not hopelessly low for some kind of lifetime income, or are you pushing toward another kind of conclusion?

Professor Shlomo Benartzi:

Believe it or not, I'm not pushing either way. There have been people who've been looking at that data and blaming me that I'm going to Washington to suggest that everyone should be annuitizing, because look, people like it. You could take it the other way as well. You could say, "People already selected. Why do you need to mandate annuitization?" Those who want it, select it when it's made available. So in all honesty, I actually don't have a policy proposal or a product to push. My main message is that I think policy should be based on scientific facts, and I'm just trying to highlight the fact and where people take it, I think, is whatever they feel appropriate. And the fact is there is quite a bit of demand for this type of quality. If we figure out the right quota, I think people would probably buy it.

Back to your questions about the numbers, and we spent a lot of time trying to understand these numbers, and I wouldn't say that, you know, we got it necessarily perfectly right. Every data set we've looked at here, and Professor Puvitero who has done a lot of work for us on this, got its own issues. It's very difficult to find a perfect, clean data set here, but we did find that age makes a very big difference, too. If you look at people below age 50 and you lump them together with all the people, you might conclude that everyone takes the lump sum. If you're mixing DC and DB plans, you might get another. So how you slice the data makes a huge difference.

Mark Fortier:

You referred to DB plans as well, may I ask all three of you, and really also interested in people's reactions who are not on the panel at the moment, do you think that as a matter of best practices, not as a matter of regulatory requirements or rules, but simply best practices in the DB world, are DB plans traditionally framing the lump sum versus annuity choice, where they offer a lump sum as we just heard data suggesting that 50 some percent are? Are they framing a way that is appropriately open to a partial choice, part annuity, part lump sum, or do they tend to frame the choice in a way that suggests can take a lump sum, you can take an annuity, there are various kinds of annuity, so we're using up some of the available complexity of explanation here by describing the hundred percent J and S, the 50 percent J and S, the single life, the 10 C and C, et cetera, by the time we've delivered all of that information, the lump sum is the alternative and that's the way it's presented to people? Is that notion of do you want 50-50, half lump sum, half annuity of some kind, or 75-25 in either direction, or 0-100 percent in either direction? Is that kind of framing uncommon? Is there a -- and would it matter, do you think, if there were more of that kind of framing, rather than something that implies, even though there's something in the planned document or the SPD that says, of course, you have a continuum of choices, you can mix the two? Is there a framing issue here? Is there a common practice or best practice issue here in the DB world?

Professor Shlomo Benartzi:

Let me jump in, Mark. The -- I mean framing is obviously very important. We know from the literature that if you

frame things as an investment product or income plan that attractiveness of certain lifetime income solutions changes dramatically. We also know that there's a big difference in the fraction of people picking the lump sum versus lifetime income in cash balance plans versus DB plans, and I think a lot of it has to do with the framing as well. But one of the most puzzling things that I'm studying with Professor John Payne [spelled phonetically] and Suzanne Shoe [spelled phonetically] and Richard Taylor is this issue of partial annuitization. You would think that there would be the most attractive thing on the planet, and in a couple of plans in the U.S. and outside, where that option was actually displayed and highlighted, it was not, you know, in footnote 17, nobody likes it. So with the IBM data, six percent picked the mixed strategy. You would think that some mix of, you know, lifetime income and lump sum, whether you have more of one or more of the other, would make a lot of sense. Nobody likes it. In the Swiss data, 10 plans, nobody liked it either, and that is very puzzling. We've ran some studies, and it was just at the beginning of this, but we've ran some studies where we asked people to pick between stock, bonds, and half and half, everyone loves half and half; annuity, lump sum, half and half, nobody wants the half and half.

Now, the two things going on there, and we really have to study it more carefully, but one of the thing is I think when you frame the mixed strategy as you could have the lump sum, you could have lifetime income, or a mix, people mentally say the mix is half and half. And we know that even those who pick a mix, they pick more of the lump sum, less of the lifetime income. So I think there's a confusion when that option is made available, that if you need a mix, it's got to be exactly half and half. We know people don't like that, so there's a lot more research that I think is needed here, but the quick answer is, if we made this mixed strategy available without more research, I'm not sure that anyone would actually pick it up, surprisingly enough.

Male Speaker:

My, as an old practical view, is remembering what a DB plan is an important tool for a management company. And their choice to go cash balance or the choice to offer lump sum is very much reflective of the corporate culture and what senior management is trying to do with their employees. So remember that even the offer of cash balance is because we

want to get more bang for our buck because our employees don't see lifetime income. The, you know, \$1,000 a month for the rest of life has a valuable benefit. We want them to see \$300,000 in their account, so much of it is not going to be standardized. It truly is going to be what the management's style and choice of senior management of whatever company is making that choice.

Male Speaker:

Mark, to your question, I probably don't have enough experience with respect to how it's framed to participants to answer it, but what I have seen for some of our clients is they'll get a 20-page memo explaining here's all their different options and what the value is under each one, and they would bring it to me and say, "Well, what do I do?" So, I think given that and we know how -- what people do when they're confused. They would select the one that they understand, which is the lump sum.

Closing Remarks

Male Speaker:

Thank you very much. It's been very interesting. Before we adjourn, I'd like to give Mr. Davis and Mr. Iwry an opportunity to say any final words that may want to share.

J. Mark Iwry:

Well, I think it's late in the day, and we'd like to thank all of the panelists, you gentlemen and everyone else who's been here today and yesterday as well as everyone who submitted written comments, which have been very useful, very thoughtful. As we've mentioned at the outset, we're here in a listening mode. Now, the listening has been very worthwhile in our view, and we appreciate all of this careful thought and attention and input that you've provided. We'll all be now going back and digesting and reflecting on what we've heard and what we've read. Thank you for your participation. Michael.

Michael Davis:

Thanks to you all for attending this joint hearing on lifetime income options, both to the people that are here in the auditorium and the people who are watching via webcast. We thank you. This has really been a terrific couple of days, and we want to thank also the witnesses that invested so much of their time and intellect into their testimony. It was very helpful to us. As Mark said, we're going to go back and work on all of the ideas that we got together to think about, and we will work together as agencies to think through whether action needs to be taken and if so what specific steps we would take. Also as Bob mentioned at the beginning of yesterday, the public record is going to be open for thirty days to extend to anyone who wants to submit additional testimony. We look forward to receiving it. So with that I think we're adjourned. Thank you all for your time, and we'll see you soon.

[End of transcript]

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