2012 ERISA Advisory Council

Examining Income Replacement During Retirement in a Defined Contribution Plan System

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Good morning Mr. Chairman, Mr. Vice Chair and members of the Working Group. My name is Cynthia Mallett. I am Vice President for Industry Strategies & Public Policy in the Corporate Benefit Funding division at MetLife and am here today to testify on behalf of my company. We commend you for holding this hearing today and thank you for inviting MetLife to testify. We believe today's hearing, and the work of the Council generally, is critical to ensuring that defined contribution (DC) plan participants will be able to generate adequate retirement income that lasts throughout their lifetimes.

MetLife is the nation's largest life insurance company, a leading provider of employee benefits and a pensions and retirement plan innovator. In 1921, MetLife was the first insurer to issue a group annuity contract. Today, MetLife guarantees income payments to more than 1 million plan participants.

MetLife was the first company to introduce a deferred fixed income annuity for use during a participant's working years within a 401(k) plan, thereby allowing plan participants to create their own personal pension by buying guaranteed pieces of future income over time. We also introduced into the market the first longevity insurance product, which is a fixed, deferred income annuity that is designed to generate guaranteed lifetime income starting at a later age, for example, an individual's 85th birthday (the average life expectancy for Americans who have reached age 65).

Today I am pleased to have the opportunity to discuss MetLife's recently released Retirement Income Practices Study: Perspectives of Plan Sponsors and Recordkeepers for Qualified Plans. We believe the study sheds a helpful perspective on why plan sponsors and their record keepers have not taken a more active role with regard to helping participants identify their retirement income needs, and making retirement income solutions a mainstay of their DC plans.

A Shifting Paradigm

One of the main reasons MetLife commissioned this study at this time is to highlight the point at which the evolving retirement plan paradigm currently stands. Our view and the study results are consistent with this, is that sponsors and providers are at a crossroads, which appears to be approaching the point of changing the nature of plan sponsors' and record keepers' roles. We are all aware that there continues to be a shift from defined benefit to defined contribution pension plans and, in light of that shift, DC plans have a new need to evolve from a supplemental savings plan to the primary – or in some cases the only – employer provided retirement plan for many workers. The retirement plans community, from academics to practitioners, has seen this paradigm shift coming and has been talking about it for the better part of a decade in conceptual and theoretical terms, and now the actual is beginning to replace the theoretical.

With the shift from DB to DC well established, it appears that a new trend may be starting to emerge. That is the idea that plan sponsors are beginning to recognize that they may have a new obligation or responsibility for decisions they make and the way they measure DC plan outcomes, and that this may be central to enabling their plans to provide the means for their workers to retire. This realignment of plan sponsor and plan participant interests is likely driven in part by the widespread industry focus and increasing government attention being paid to retirement income. However, as we know all too well, increased attention doesn't necessarily translate quickly or consistently into action. Plan sponsors and their record keepers both have key roles to play for retirement income in the workplace to become a practical reality. Without plan sponsors or their record keepers shifting the focus from assets to income, their participants will not be in the best position to figure out their retirement income needs or access the tools and solutions to generate guaranteed income in retirement.

When we originally conceived of surveying these two groups – which, to the best of our knowledge, is the first time a retirement income study has been conducted among both plan sponsors <u>and</u> record keepers – we had expected that there might be a bit of a disconnect between them. We also thought we might be in a bit of a chicken and egg situation – with plan sponsors not offering retirement income solutions because they weren't made available by their record keepers and, conversely, record keepers not wanting to offer these products unless there was more plan sponsor and participant demand. This morning, I'll focus on what we found.

Objectives of the Research

In commissioning this research, we had two primary objectives. First, we wanted to examine the dynamics of the plan sponsor-record keeper relationship with regard to the provision of lifetime income options in qualified plans. Second, we wanted to assess whether, and to what extent, plan sponsors of DC and DB plans, and record keepers are communicating about – and closely coordinating their efforts to offer – retirement income education, strategies and solutions for their participants.

We specifically wanted to address:

- the approaches taken to offer education and tools to enable participants to model their future retirement income needs;
- the correlation between the retirement strategies to which plan sponsors and their record keepers gravitate and the types of retirement income solutions being offered to plan participants;
- the most compelling retirement income product features and the top criteria for product evaluation;
- awareness about – and commitment to – industry standards for in-plan solutions; and,

- perceived obstacles to more widespread offering and adoption of products that provide guaranteed lifetime income.

The research was conducted in two phases: (1) a qualitative phase included in-depth interviews, conducted during mid-October to mid-November 2011, with 12 of the largest DC plan record keepers that service primarily FORTUNE 500® companies, and (2) a quantitative phase included a total of 215 plan sponsors that offer a DB and / or DC plan, including 113 from FORTUNE 1000™ companies. The online interviews were fielded between December 14, 2011 and January 30, 2012.

Plan Sponsors Encourage a Self-Service Approach to Retirement Income Projections

One of the important areas the study explored was the education and tools being offered in the workplace to enable DC plan participants to model their future retirement income needs. We wanted to gauge whether or not plan sponsors and their record keepers are proactively sharing retirement income projections with their plan participants or, at a minimum, making it easy for them to model how much retirement income their retirement savings are likely to generate. This is particularly important because it is often very difficult for plan participants to conceptualize what their DC plan balance can mean in terms of a stream of income for any significant time horizon, let alone a lifetime.

The study found that projections are not automatically shown to plan participants when they view their account balances online, nor are they routinely provided to participants on statements summarizing their total and vested account balances. In fact, only 28% of plan sponsors say retirement income projections are automatically shown to participants when they view their account balance online and only one-third of plan sponsors (33%) report that they include retirement income projections on participant statements.

Instead, 81% of plan sponsors say their plan participants have the ability to model how much retirement income they could expect based on their current account balance. This essentially shows that plan sponsors are expecting their participants to take a self-service approach to projecting retirement income but, unfortunately, relatively few participants are interacting with the tools provided.

When we asked record keepers if retirement income projections are automatically shown to participants when they view their account balance online, half of them say they are available, and the same six record keepers report that they include retirement income projections on participant statements. Nine of the 12 record keepers already offer the feature where plan participants have the ability to model how much retirement income they could expect based on their current account balance. Unfortunately, however, this “do-it-yourself” model is not taking hold as the majority of record keepers surveyed estimated that only a quarter of plan participants or fewer have made the effort to project their retirement income.

The good news is that, sometime in 2012, four record keepers are planning to automatically show projections to participants when they view their account balance online, and two record keepers are planning to add retirement income projections to participant statements. This is consistent with how we believe plan sponsors would ideally approach retirement income projections. In fact, MetLife has long supported having benefit statements for 401(k) plans show an equivalent monthly lifetime stream of income, in addition to the total account balance. This approach has been introduced in Congress over the past few years in the Lifetime Income Disclosure Act, which has companion bills in both the House and the Senate. It is also our understanding that the Department of Labor is revising its benefit statement regulation to include direction to plan sponsors on how to incorporate an equivalent lifetime income calculation in the benefit statements they provide to their plan participants. We applaud both Congress and the DOL for addressing this very critical educational tool and look forward to working with the DOL once they issue their proposed regulation.

Additionally, there may be an opportunity for more regulatory clarity regarding how plan sponsors can effectively provide active plan participants with education and advice regarding their defined contribution plans. The DOL has done excellent work in that regard. For example, Interpretive Bulletin 96-1 ("IB 96-1") sets forth guidelines regarding how employers can provide participant education with respect to the allocation of retirement savings among classes of investments. IB 96-1 has been used extensively by employers that want to help their employees without taking on fiduciary liability for the provision of investment advice.

Over the years, the DOL has also issued critical guidance with respect to the provision of investment advice. The SunAmerica Advisory Opinion led to a great expansion of advice based on computer models using generally accepted investment theories. Moreover, much of this advice is provided through managed accounts, where the advice is implemented automatically and thus is more effective than advice that participants must implement on their own. The DOL has an opportunity to build on the important success that it has achieved in the savings phase by applying the same framework to distribution planning.

As stated in the 2007 report of the ERISA Advisory Council's Working Group on Financial Literacy of Plan Participants and the Role of the Employer, "96-1 needs to address information, education and advice in the decumulation stage as well as the savings phase." MetLife testified before the 2008 Council which advocated a similar recommendation in its report. MetLife supports expanding IB 96-1 to clarify what information and education may be provided to participants about the distribution phase without that guidance being treated as fiduciary advice. Such guidance should be as detailed as IB 96-1. For example, the guidance could clarify that computer models that generate generic distribution approaches should be treated as education, not advice. Under this type of IB 96-1 expansion, a participant could provide his/her own information, such as other assets, other sources of income (such as Social Security or a pension or spousal pension), age, risk tolerance and annual living expenses. The computer model could then generate a generic distribution model regarding the portion of the participant's account that should be annuitized, the portion that should be rolled over, the portion that should be taken in the form of installment payments, etc.

In addition, a thoughtful expansion of IB 96-1 could clarify that education regarding investment into in-plan annuities during working years is within the reach of IB 96-1's existing framework and would not be treated as fiduciary advice. As we have indicated in the past, the DOL can help achieve this by providing that acceptable computer models would take into account any in-plan income accumulation annuity and/or guaranteed insurance product available under the plan. This would be entirely aligned with the emergence of a balanced focus between setting aside funds today in order to provide income tomorrow in DC plans.

Retirement Plan Focus Correlates to Retirement Income Strategy

MetLife's Retirement Income Practices Study found that the specific retirement income strategy offered to DC plan participants – either systematic withdrawal payments or guaranteed lifetime income payments – is strongly correlated to whether the focus of the DC plan is on retirement savings or retirement income.

It's probably not a surprise to hear that nearly all plan sponsors say that retirement savings is still the primary focus of their DC plans. On the flip side, only 9% of plan sponsors surveyed say that retirement income is the primary focus of their DC plans. Eleven of the 12 record keepers agree, stating that the majority of their plan sponsor-clients view retirement savings as the primary focus of their DC plans.

When plan sponsors were asked which was closer to their own view where they thought about retirement income, systematic withdrawal payments or guaranteed lifetime income payments – 67% of plan sponsors overall think of retirement income in terms of systematic withdrawal payments (SWiPs).

However, for the small group of plan sponsors who state that retirement income is a primary focus of their plan(s), the opposite is true – 74% think of retirement income as a guaranteed lifetime income payment vs. 26% who think of retirement income in terms of SWiPs. This strong correlation suggests that changing the retirement plan's ultimate focus from savings to income is a prerequisite for creating the frame of reference necessary for both sponsors to offer, and for participants to select, guaranteed retirement income.

When record keepers were asked which was closer to their own view when they thought about retirement income – systematic withdrawal payments or guaranteed lifetime income payments – it was difficult for many of them to choose one over the other. A number of record keepers cited that there was a strong place for both strategies, depending on client and participant needs. Among those record keepers that chose one strategy over the other, systematic withdrawal payments were selected slightly more frequently than guaranteed lifetime income payments.

Perspectives about Guaranteed Income

Plan sponsors are split on whether DC participants favor lump sums versus a guaranteed income. When asked whether or not their participants favor a lump sum distribution from their DC plans over a monthly stream of income, plan sponsors were divided with 43% who agree that when their DC plan participants retire, the majority of these participants would prefer to "receive at least part of their retirement savings as monthly income for as long they live rather than receiving all of it in a lump sum that they would invest themselves," while 57% of plan sponsors feel that their plan participants would prefer the lump sum.

Although almost half of plan sponsors think their participants favor monthly income, lump sum distributions are the most widely offered DC plan distribution option, offered by almost all plan sponsors (97%), followed by SWiPs (45%) and installment payments for a defined period of time (44%).

Despite the fact that many plan sponsors believe participants want guarantees and lifetime income, we know that take up rates for income annuities are still relatively low. In fact, the study found that just 16% of plan sponsors say they offer income annuities to DC plan participants even though more than two-thirds of plan sponsors (68%) believe their DC plan participants favor "guarantees that offer stable but somewhat lower returns" over a "higher degree of risk because the returns could be greater" (32%), and almost half of respondents (44%) said that the majority of their DC plan participants would prefer to "receive at least part of their retirement savings as monthly income for as long as they live rather than receiving all of it in a lump sum that they would invest themselves."

Since income annuities combine stable returns and guaranteed lifetime income, we concluded in the study that this clearly points to an opportunity for plan sponsors and their record keepers to explore the range of options that can be made available to plan participants, which is particularly important as both academic and industry studies show that income annuities can generate the highest level of lifetime income per dollar of retirement assets put to work.

When plan sponsors do consider offering lifetime income products to plan participants, the most important criterion for evaluating specific products before deciding which to offer is "financial strength / credit rating of the insurer" cited by 29% of plan sponsors who offer them. Portability of guaranteed income when a participant has a distributable event is also important. Among sponsors who report that they offer in-plan retirement income products, the features cited as the most compelling for offering such products are "protection against longevity risk" (35%) and "annual payments" (21%).

Retirement Income Enabling Capabilities

The study also looked at why more lifetime income products aren't being offered in the workplace. Well, for starters, there appear to be some major disconnects between plan sponsors and record keepers – the chicken and egg approach I alluded to earlier.

For example, although record keepers point to plan sponsors' low level of interest as one of the primary reasons there is not more widespread offering of retirement income products to plan participants, there also appears to be an incomplete understanding on the part of some plan sponsors as to the retirement-income commitment, capabilities and offerings that are available from their record keepers.

Nearly one-third of plan sponsors (29%) do not know whether their record keeper's platform currently allows for in-plan accumulation annuities and other retirement income products to be offered to their DC plan participants. And, among the 28% of plan sponsors who said that their record keepers do not currently offer these products on their platforms, one-quarter (22%) are unsure about the likelihood of their record keeper building the infrastructure for in-plan accumulation annuities and other retirement income products in the next 18 months.

Today, the availability of in-plan retirement income options among record keepers is still relatively low, with only four of the 12 record keepers currently offering them. What's promising is the fact that, of the eight record keepers who do not currently offer an in-plan option, four said they are very likely to devote the resources to build the infrastructure required for in-plan retirement income options to be available on their platforms in the next 18 months.

According to those record keepers who state that they do not currently offer in-plan retirement income options and are not planning to devote the resources in the foreseeable future to an infrastructure build, they point to low demand from plan sponsors and their participants.

Retirement Income Predicted to Become Biggest Retirement Practices Trends

One of the most interesting findings of the study was that both plan sponsors and record keepers believe that a focus on retirement income will be one of the biggest retirement practices trends to emerge in the next three to five years.

One plan sponsor noted that they believe "lifetime income will gain traction within DC plans and will be the biggest retirement trend over the next five years," while others echoed this sentiment by commenting that "there will be a greater concentration on retirement income" and there will be "more of a shift from a retirement savings focus to a retirement income focus." Another plan sponsor predicted that companies will "start to offer more guaranteed income options such as annuities again" and another believes there will be "greater concentration on annuity-type distributions."

Some record keepers predict that “there will be increasing focus on retirement income” and the “shift to retirement income will continue to come to the forefront as sponsors will increasingly view the retirement benefit from the income lens.” Another record keeper believes “the shift in focus from accumulation to income streams is definitely starting.” The advisor community will play an important role going forward with a record keeper predicting that they “will make changing the dialogue from accumulation to retirement income their number one priority.”

Call to Action for Plan Sponsors and Record Keepers

In our view, no study would be complete without offering considerations for your intended audience – in this case, plan sponsors and record keepers – about how they can apply the findings to their plans and practices.

For starters, we think reframing the basic purpose of DC qualified plans from building savings to planning for income is an important first step. We also think these two groups play a critical role in educating participants about the importance of guaranteed income – and as I mentioned earlier – we think they are starting to understand the gravity of that role. Options should be made more widely available to participants to convert at least a portion of their DC savings to income. Although today’s hearing is focused on DC plans, plan sponsors and their record keepers should also not lose sight of the original intent of DB plans – to provide guaranteed income for life.

The time appears to be right for retirement income discussions to become a priority for plan sponsors and their record keepers. This will help each group better understand each other’s commitment to these options and also become acquainted with innovative options that are available in the marketplace.

Fiduciary Liability Concerns Still a Major Deterrent

All of that said, even if plan sponsors and their record keepers were to put into practice all of these ideas, there is still a major deterrent standing in the way of income annuities being offered in DC plans. I am sure members of the Council know that, as a result of a provision included in the Pension Protection Act, the DOL issued regulations in 2008 on the fiduciary standard to be applied by defined contribution plan sponsors when selecting an annuity provider. The standard (incorporated in DOL’s regulation 29 CFR § 2550.404a-4) was intended to provide a fiduciary safe harbor for the selection of annuity providers for the purpose of benefit distributions from defined contribution plans.

The new standard had addressed some of the concerns raised by plan sponsors with the “safest available annuity” standard promulgated by the DOL for defined benefit plans, including the statement that the fiduciary does not have to choose the “safest” annuity available. However, we know that plan sponsors have consistently continued to express concerns regarding any plan decisions that may expose them to future lawsuits that they believe they would have under the new regulation. Our study showed the same result, with plan sponsors expressing reservations about their ability to implement the standard without exposure to undue risk.

Plan sponsors and record keepers agree fiduciary concerns and perceived low demand prevent more widespread offering of annuities in the workplace. In fact, eight in 10 plan sponsors (79%) say that fiduciary liability concerns are discouraging them from more widespread offering of income annuities within their DC plan(s) – with at least one commenting that their company "tends to shy away from offering options that expose [them] to greater fiduciary liability." More than half of plan sponsors (56%) also believe those concerns are dissuading their record keepers from more widely offering these products on their platforms.

Record keepers unanimously agree: plan sponsors are much more concerned about fiduciary liability issues than they are. The record keepers believe there are several reasons for this – the primary one being that plan sponsors are very conscious of their fiduciary responsibilities. From the in-depth interviews, we also know that record keepers believe plan sponsors are "waiting for the Department of Labor to issue fiduciary safe harbor guidance" and they are "somewhat unlikely to add these [products] unless there is a regulatory change that provides the plan sponsor with some fiduciary protection." Other reasons cited by record keepers as preventing more widespread offering of income annuities: low level of interest by plan sponsors; perceived confusion over product features; and, a belief by several record keepers that advisory services, including the record keepers' own propriety services, were more appropriate solutions for participants.

Despite these perceived barriers, some plan sponsors said that income annuities are not offered because they are not available on their record keeper's platforms, and one record keeper admitted that they recently had a plan sponsor client who threatened to leave its platform if they did not make a retirement income option available to their participants.

Recent Regulatory Developments Are Promising

There have been quite a few developments on the regulatory front with regard to lifetime income over the past few years, including a fairly major development this year. We note that the Obama Administration, through its Middle Class Task Force, has supported the promotion and availability of lifetime income products. In 2010, the Department of Labor's Employee Benefits Security Administration, in conjunction with the Department of the Treasury, issued a Request for Information asking for ideas on how to help reduce the chances that workers will run out of funds during their retirement years, for which they received a significant number of responses.

Earlier this year – on February 2, 2012 – the Treasury Department and Internal Revenue Service released a package of proposed regulations and revenue rulings on guaranteed lifetime income options. The Treasury Department called the package the "first step in clearing the way for better and more accessible retirement income options."

When the guidance was issued, MetLife applauded the U.S. Department of the Treasury for issuing an initial package of proposed regulations and revenue rulings intended to clear the way for millions of Americans to have better and more accessible retirement income options and we said that the Treasury Department was to be commended for paving the way for the plan sponsor community to help millions of workers generate retirement income to last a lifetime…" which we believed was a "…major step toward helping [Americans] strengthen their retirement security."

If they haven't already done so, now is the time for plan sponsors and record keepers to familiarize themselves with this guidance and assess what administrative changes or plan amendments might be needed, should they decide to implement changes that the new rules or regulations, when final, may make possible. They should also give some consideration about how to best communicate with plan participants about any new offerings they may make available as a result of this new guidance.

And, of course, as I noted earlier in my testimony, it appears quite clear that fiduciary concerns must be addressed in Washington in a different way than they have been to date before income annuities will take hold as a primary feature of DC plans. We have spoken with many plan sponsors and record keepers individually, and note that they continue to voice their concerns about the lack of a workable fiduciary safe harbor. Clarification on the fiduciary selection regulation would go a long way toward more widespread offering of income annuities in DC plans…to the benefit of millions of American workers.

I want to thank the Council for inviting me to testify today, and in its interest in our study. I would be happy to answer any questions you may have.