Testimony to the 2012 ERISA Advisory Council
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Executive Summary

How can an almost guaranteed income stream be created to replace the Defined Benefit (DB) plan in a rapidly expanding Defined Contribution (DC) world? The overall goal of this response is to answer this question.

Part I: Important Background

- The framing of retirement income solutions matters. DB plans were never the gold standard of retirement security that they are sometimes considered to be. Private sector DB plans only covered just over one-half of all Americans at their peak, and they had large and often unappreciated risks. The dominant source of retirement income for the vast majority of Americans will be Social Security. DB plans, DC-type plans, and other income are very important but supplemental to Social Security.

- A DB plan is a property right on a lifetime income promise made by the employer. A DC plan is a property right on assets owned by the employee. Pursuing DB-like retirement income in a DC world means changing a basic set of property rights and finding ways for individuals to replace the institutional skills and management that come with the DB property right of promised lifetime income.

- There is no risk-free retirement income plan. The dominant retirement-income risks can be enumerated and clearly stated, and the decisions involved in managing the risks can be identified, but the risk cannot be made to go away. The five dominant risks are: not saving enough during working years; longevity risk; investment risk, including inflation risk; counterparty risk; and liquidity risk.

- Longevity pooling provides large gains, with up to 30% fewer assets needed to fund a given level of retirement income. Social Security and annuities incorporate longevity pooling; mutual funds do not.

- An individual managing DC assets and converting them into income for a lifetime is no match for an employer that can hire experts to manage a DB plan.

- Most employers will not want the responsibility and potential liability for attempting to provide lifetime income options to employees participating in their DC plans without a firm and fair safe harbor. Even with a safe harbor, some employers will choose not undertake the expense and assume the risks.

Part II: Desired characteristics of DB and DC plans

- Saving enough today to fund retirement income tomorrow;
- Access to professional calculations based on current market and demographic data for:
  - Required savings rates for different desired retirement income levels;
  - Discounting future payouts at low-risk government bond rates;
  - The assets-to-income calculation performed at low-risk, inflation-protected government market rates, showing what lifetime income can be generated for a portfolio beginning at the age of 65;
- Access to longevity pooling in retirement;
- Access to inflation-protected income in retirement;

- A clear delineation of the risks incurred and the trade-off choices that can be made; and
- Clarity of costs.

Part III: Recommendations

Accumulation

- Continue to promote increased savings with programs like Save More Tomorrow. The amount saved for retirement is by far the most influential variable. Good participant choice architecture and incentives to save more can have a dominant influence on saving and investing behaviors, and therefore on lifetime income.

- Require the use of public benchmarks for QDIA target-date portfolios. At the core of a QDIA target-date program is the management of risk over time. Without a benchmark there is no common lexicon for describing the assets and their associated risks, no metrics for quantifying the risks taken, and no reference point for measuring performance of target-date funds. This lack of a common language for discussing risk among plan sponsors, consultants, investment managers, and participants is common in many plans today. The benchmark provides default asset allocation levels and specific risk profiles. Fiduciaries can monitor the selected manager using the benchmark's performance and risk as a measuring device.

Decumulation

- Create a lifetime income safe harbor, such as the QRIA suggested by Kevin Hanley of United Technologies. Much like the QDIA safe harbor for target-date funds, without a straightforward "prudent man" rule for providing lifetime retirement income choices, many, perhaps most, employers will not choose to undertake the time, effort, expense, and risks to offer lifetime income options.

- Require public benchmarks; promote choice and competition. Currently many choices for obtaining lifetime retirement income exist. For the employee/retiree, the problem is not that options are lacking. The issue is how to choose among those that do exist: how to see and measure risks, how to compare trade-offs, how to make an informed choice today, how to react to events as they occur, and how to make better choices in the future. There is also the problem of accessing any given lifetime-retirement income choice from an existing DC accumulation plan. For the sponsor, the issues are the expenses and risks involved in creating, managing, and monitoring the choice menu. If there is no safe harbor, then any choice that leads to a real or perceived bad outcome creates real risk for the company.

  What is missing is a decumulation benchmark that creates a yardstick for measuring the wide range of lifetime-retirement investment options. The benchmark for decumulation should be the benchmark that minimizes the four dominant decumulation risks: longevity, investment (including inflation), counterparty, and liquidity. It should also be an executable and indexable portfolio. One benchmark that does this is the DCDB™ Benchmark.

  Since there is no risk-free retirement income solution, the challenges and risks are large. To undertake the expenses and to do the work to solve these problems, employers need a firm and fair safe harbor. The most powerful protections are clear rules and regulations combined with transparency, benchmarks, and competition.

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Thank you for the invitation to appear before the US Department of Labor's Advisory Council on Employee Welfare and Pension Benefits Plans. I have been asked to address eight questions regarding retirement income.[1] To help me prepare this response to the Advisory Committee, committee members Michael Sasso and Richard Turner offered a helpful summary of the eight questions: How can an almost guaranteed income stream be created to replace the Defined Benefit (DB) plan in a rapidly expanding Defined Contribution (DC) world? The overall goal of my response is to answer this question.

This response has three parts: Part I provides some important background information that is too often overlooked and its significance too often underappreciated. Part II enumerates the desired characteristics of DB and DC plans. Part III describes recommendations for gaining lifetime retirement income in a primarily DC world. [2]

Part I: Important Background

Understanding some important background facts on retirement income solutions is essential when examining how an almost-guaranteed income stream can be created to replace the DB plan in a primarily DC world.

The discussions of retirement income solutions that can work for 133 million working Americans and 55 million retired Americans, and that can work for decades into the future, tend to anchor in excessively rosy views of the past. DB plans were never the gold standard of retirement security that they are sometimes considered to be. We also tend to pursue "almost riskless" solutions when history and economics teach us that there is no risk-free retirement income solution.

All retirement income solutions—including Social Security, DB plans, and DC plans—are dominated by a few common characteristics. Understanding these characteristics well can go a long way toward determining successful policy solutions that will move us closer to gaining better options for lifetime retirement income.

What follows is a summary of six key issues.

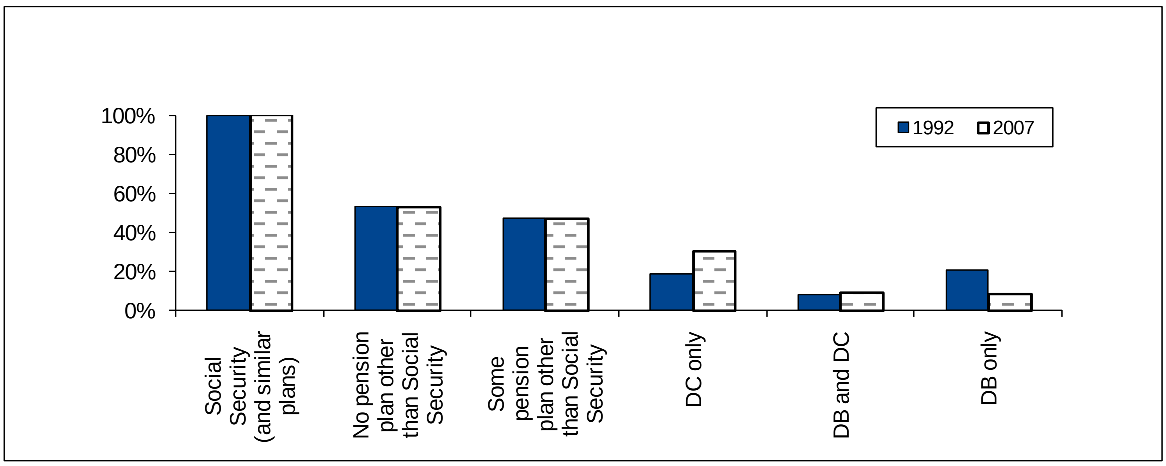
1. DB plans: Coverage issues, failure issues

[1] The eight questions are listed in appendix B on page 13.
[2] Much of the content of this response is based on the joint work of Daniel Cassidy, Michael W. Peskin, Laurence B. Siegel, and Stephen C. Sexauer. Specific references are footnoted.

The framing of retirement income solutions matters. Because many people consider DB plans to have been widespread and successful solutions to lifetime retirement income, they believe that DB should define the goals for DC-based retirement income solutions. Such a framing captures two widely held misconceptions about retirement income from DB plans.

First, for the vast majority of Americans, the dominant source of retirement income will be Social Security or a public-employee government plan that replaces Social Security, such as some teacher retirement systems. Thus, a DB or DC plan will be a secondary, not the primary, source of income.[3] Second, private sector DB plans only covered just over one-half of all Americans at their peak and had large and often unappreciated risks.

US Workers With and Without Pensions



Source: "Frequently Requested Data." Center for Retirement Research at Boston College. http://crr.bc.edu/images/stories/Frequently_Requested_Data/frd_figure_1.pdf

Moreover, to say that half of workers were "covered" does not mean that all of them were covered well. Because of high and unexpected rates of inflation, especially in the late 1960s and in the 1970s, the benefits provided by many DB plans, even though secure in nominal terms, were subject to devastation in real terms. Corporate bankruptcies caused many plans to simply disappear, with the beneficiaries getting nothing because the plans were not fully funded. Starting in 1974, ERISA's funding requirement mitigated this risk, but did not eliminate it, since full funding is a goal that is not always met. In addition, in difficult economic times the funding rules have even been relaxed, adding more risk of plan failure.[4]

[3] In 2007 the current median balance in a 401K plan for 55- to 65-year-olds was $77,000. This could be converted into $3,657 of inflation-protected income at today's rates. If used to replace 80% of today's median family income, it would last less than three years.

[4] For example, MAP-21, the federal transportation reauthorization bill passed on July 6, 2012, included a section that decreased the required pension contributions by 15% to 20% for typical DB plans.

The establishment of the Pension Benefit Guaranty Corporation (PBGC) did protect individual benefits up to $54,000 per year in today's dollars, a significant degree of protection. However, in a number of high-profile bankruptcies, including those of United Airlines and Wisconsin Steel, this protection proved inadequate, since benefits lost in the bankruptcy exceeded what the PBGC provided to beneficiaries. For public funds, the failures of municipalities such as Central Falls, Rhode Island, have been catastrophic: the retirees are not covered by Social Security, and many could see pension payments cut by 50%.[5]

As we pursue solutions and safe harbors for retirement income in a primarily DC world, it is important to keep in mind the limitations, risks, and failures that have occurred and could occur again with DB plans.

2. **A DB plan is a property right on a lifetime income promise made by the employer. A DC plan is a property right on assets owned by the employee.**

All DB plans are a promise from an employer to an employee. The employee accepts the promise in place of some part of current wages. The employee has a legal claim on the income promised. The employer undertakes to fulfill this promise—including actuarial planning, funding the plan and investment management, the assets-to-income conversion, and longevity pooling.

All DC-type plans are property right claims on assets by the employee. The employee owns the assets, once vested. However, there is no lifetime retirement-income claim by the employee on the employer. There is no actuarial planning and funding schedule, limited-to-no investment management (QDIA target-date funds provide some of this), no explicit mechanism for assets-to-income conversion, and no longevity pooling.

Pursuing DB-like retirement income in a DC world means changing a basic set of property rights and finding ways for individuals to replace the institutional skills and management that come with the DB property right of promised lifetime income.

3. **There is no risk-free retirement income plan.**

The dominant retirement-income risks can be enumerated, they can be clearly stated, and their decision choices can be presented, preferably with public benchmarks and transparency of costs. But the risk cannot be made to go away. The five dominant risks are:[6]

1. Not saving enough during working years;
2. Longevity risk, outliving one's savings;

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[5] Abby Goodnough, "City in Rhode Island Asks Retirees to Sacrifice," *The New York Times*, July 19, 2011.
[6] Sexauer, Stephen, Michael W. Peskin, and Daniel Cassidy. "Making Retirement Income Last a Lifetime." *Financial Analysts Journal* 68, no. 1. (2012):74-84.

3. Investment risk, including inflation risk;
4. Counterparty risk; and
5. Liquidity risk (the preference to not hold all or the majority of the portfolio in an annuity contract).

When the regulatory standard sets out to accomplish limited-to-no risk combined with a very limited-to-no safe harbor, we are asking the plan sponsor to assume risks that are so large and that last for so long (ages 65 to 100+ for a worker who today may be only 20 years old) that many will choose the alternative option: not to offer lifetime-income choices to DC participants.

If the goal is to give employers incentives to offer lifetime-income options, to do the research, to provide the education, and to manage and administer a menu of lifetime-income choices, then they must have a "prudent man's" safe harbor that matches the enormous scope of this task. Some specific steps regarding a retirement-income safe harbor are offered in Part III.

4. The dominance of longevity pooling in providing lifetime income.[7]

Longevity pooling provides large gains, with up to 30% fewer assets needed to fund a given level of retirement income. Longevity pooling requires the organization and management of pools of people to share survivorship property rights. Social Security does this. Annuities do this. Tontines, while illegal, do this. Mutual funds with a prorated claim on net asset value do not do this.

5. DB plans can exploit economies of scale in expertise; at present, most DC plans do not.

When funding the assets in a DB plan, an employer has made one promise to many individuals, so it can buy expertise and specialization at a low per-employee cost when it hires staff to manage retirement income planning and implementation. The DB staff manages, with its institutional consulting and investment management partners, the actuarial calculations; the required funding levels; the investment management, including the assets-to-income steps in the retirement period; and the operations of the fund that include issuing checks for the lifetimes of the retirees.

The average person in a DC plan does not have these specialized skills. Nor do they always have access to these skills at a cost that they can afford. The impact of the loss of this expertise increases with age. Research has shown that as we age, our cognitive skills materially diminish.[8]

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[7] It takes $1.54 without longevity risk pooling to provide the benefit that can be provided for $1.00 with longevity risk pooling. Waring, Barton M., and Laurence B. Siegel. "Don't Kill the Golden Goose! Saving Pension Plans." *Financial Analysts Journal* 63, no. 1. (2007):31-45.

[8] There is a growing recognition that longevity risk may be more than outliving one's savings; it can also be the age-related loss of our cognitive ability to make the financial decisions required to actively make retirement income decisions. http://befi.allianzgi.com/en/Publications/Documents/allianz-dol-rfi-response.pdf, page 9.

So an individual managing DC assets and converting them into income for a lifetime is no match for an employer that can hire experts to manage a DB plan.

Additionally, as pointed out in 3., above, many employers have made the determination that they do not want the responsibility and potential liability for attempting to provide lifetime income options to employees participating in their DC plans without firm and fair safe harbors in place.

6. **There are 133 million working Americans and 55 million retirees. A single "best" DC solution for almost 200 million working and retired Americans will not exist.**

   Much has been written about the wide range of QDIA fund returns in the crash year of 2008, from -40% to -8%, for 2015 target-date funds. A loss of 40% in one of the peak sequencing-risk years, so close to retirement, is an extraordinarily bad outcome if a target-date fund combined with Social Security is the major source of lifetime retirement income.

   There may, however, be circumstances where a substantial loss, such as a 2008 loss from a high equity allocation, while not good, can be tolerated, such as when the employee has Social Security, a well-funded and generous DB plan, a truly supplemental DC plan, and higher risks were taken in the pursuit of higher returns.[9]

   Matching the appropriate accumulation plan and lifetime-retirement income plan to the employees is one of the most important roles that a plan sponsor undertakes. Part III will demonstrate that the required use of public benchmarks will make this process clearer, more measurable, and more reliable.

Part II: Desired Characteristics of DB and DC Plans

Each of the three core sources of retirement income—government-based income such as Social Security, DB plans, and DC/IRA assets—has two common core components: a wealth transfer mechanism from the present (work) to the future (retirement), and an assets-to-income capability that provides lifetime inflation-protected retirement income.

The important common characteristics of a well-run plan, whether DB or DC, are:

1. Saving enough today to fund retirement income tomorrow;
2. Access to professional calculations based on current market and demographic data for:
   a. Required savings rates for different desired retirement income levels;

[9] This example is based on a recent decision by a Fortune 100 company to choose a higher-risk target-date fund family because the plan sponsor judged the base income from Social Security plus the employer's DB plan to be high enough to allow for the exposure to higher long-term returns associated with the higher risk profile of the target-date funds.

b. Discounting future payouts at low-risk government bond rates. If, instead, an assumed long-term average return for risky assets is used as a discount rate, a trade-off is being made that should be explicitly acknowledged, explained, and disclosed;
c. The assets-to-income calculation performed at low-risk inflation-protected government market rates, showing what lifetime income can be generated for a portfolio beginning at the age of 65;

3. Access to longevity pooling in retirement;
4. Access to inflation-protected income in retirement;
5. A clear delineation of risks incurred and the trade-off choices that can be made (the professional staffs of retirement plans and their consultants are best equipped to evaluate these risks); and
6. Clarity of costs.

Part III: Gaining Lifetime Retirement Income in a Primarily DC World: Recommendations

Since retirement income requires accumulated savings, this section is organized into two parts, accumulation and then decumulation.

For lifetime retirement-income solutions, the enormous size of the tasks, combined with risks that will not go away and therefore must be held by someone, are such that there will be no Gordian-Knot solution, no simple rule, no risk-free path to lifetime retirement income.

It will be much more productive to focus on transparency of risks and costs, informed choices, innovation and incremental improvements, and safe-harbor incentives and protections in order for employers to undertake the work necessary to expand their DC accumulation options to include DC decumulation choices.

<u>Accumulation</u>

1. **Continue to promote programs like Save More Tomorrow.**[10]

   Saving more is the most powerful variable. It also the variable the saver has the most control over. Good participant choice architecture and incentives to save more can have a dominant influence on saving and investing behaviors, leading to accumulation of lifetime income.

2. **Require public benchmarks for QDIA target-date portfolios.**

[10] Thaler, Richard H., and Shlomo Benartzi. Save More Tomorrow[tm]: "Using Behavioral Economics to Increase Employee Savings." *Journal of Political Economy,* 2004, vol. 112 no. 1. http://befi.allianzgi.com/en/Topics/Pages/save-more-tomorrow.aspx. http://www.morethanbudgets.org/images/Docs/SaveMoreTomorrow.pdf

At the core of a target-date fund is a schedule of risk that systematically changes over time across up to ten portfolios—the glide path. While managing risk is the *raison d'être* of a QDIA target-date program, without a benchmark there is no common lexicon for describing the assets and their associated risks, no metrics for quantifying the risks taken, and no reference point for measuring performance of target-date funds. This lack of a common language for discussing risk among plan sponsors, consultants, investment managers, and participants is common in many plans today.

There are two paired steps that plan sponsors can be required to take and to document. First, fiduciaries must choose a public benchmark for the overall investment strategy that has a risk profile appropriate for the participants in the plan. That is, they first need to agree that the investment goals represented by a particular benchmark are suitable for the investor pool they are pledged to help. The benchmark provides default asset allocation levels and specific risk profiles. Today a wide range of competing high quality benchmarks exist—ranging from very low risk to higher risks.

Second, fiduciaries must choose a manager that, in their judgment, matches the benchmark risk profile. The manager can employ an active or passive investment strategy. Fiduciaries can evaluate candidate managers by observing how each manager's strategy takes active risk. This includes more than security-selection risk; it also involves asset-allocation risk, specifically the risk of the manager adopting an asset allocation that deviates from that of the benchmark. Fiduciaries can then monitor the selected manager on an ongoing basis, using the benchmark's performance and risk as a measuring device.

By adopting these practices, a fiduciary can execute the responsibility that he or she has agreed to take on, and do so while using the decades-old and deep institutional infrastructure of benchmarks, risk management, and performance analysis.[11]

<u>Decumulation</u>

3. **Create a lifetime-income safe harbor, such as the QRIA suggested by Kevin Hanley of United Technologies.[12]**

Much like the QDIA safe harbor for target-date funds, without a straightforward "prudent man" rule for providing lifetime-retirement income choices, many, perhaps most, employers will not choose to undertake the time, effort, expense, and risks to offer lifetime income options.

Lifetime income solutions that include longevity pooling and income guarantees will require

[11] Cassidy, Daniel, Michael Peskin, Laurence Siegel, and Stephen Sexauer. "Be Kind to Your Retirement Plan—Give It a Benchmark." Submitted to the *Journal of Wealth Management* (August 2012).
[12] Hanley, Kevin. Testimony to the ERISA Advisory Council. June 13, 2012.

building a bridge between the existing DC world, which is based on a property right claim on liquid *assets* in 1940-Act mutual funds, and a future world in which funds composed of assets are combined with contracts wherein a legal counterparty provides *income*. As Part I, section 2 explained, to do this is very complex and does not exist in scale today. Innovation, if prudent, will remediate the situation somewhat, but the underlying risks (Part I, section 3) cannot be made to go away.

4. **Require benchmarks; promote choice and competition.**

Currently many choices to gain lifetime retirement income exist. Choices include: a laddered bond portfolio lasting 40 years (hard to outlive); a laddered TIPS portfolio for 20 years plus a deferred nominal annuity (impossible to outlive); an immediate annuity; an immediate inflation-protected annuity; a variable annuity with lifetime income guarantees; a diversified portfolio of assets that generates current income; and a diversified portfolio of assets that generates current income and returns principal on a preset schedule.

For the employee/retiree, the problem is not that options are lacking. The issue is how to choose: how to see and measure risks, how to compare trade-offs, how to make an informed choice today, how to react to events as they occur, and how to make better choices in the future. There is also the problem of accessing the desired choice or choices from an existing DC accumulation plan.

For the sponsor the issues are the expenses and risks involved in creating, managing, and monitoring the choice menu. If there is no safe harbor, then any choice that leads to a real or perceived bad outcome creates real risk for the company.

What is missing is a decumulation benchmark that serves as a yardstick for measuring the wide range of lifetime-retirement investment options. The benchmark for decumulation should be the benchmark that minimizes the four dominant decumulation risks: longevity, investment (including inflation), counterparty, and liquidity. It should also be an executable and indexable portfolio. One benchmark that does this is the DCDB™ Benchmark. See Appendix A and www.dcdbbenchmark.com.

The combination of a QRIA-like safe harbor, a DCDB™-like Benchmark, and a professionally managed choice menu will make material progress in the pursuit of lifetime retirement income.

There are approximately $15 trillion in mutual fund assets and $5 trillion in insurance company assets. Both the mutual fund and insurance industries have the motives, resources, and skills to find and deliver lifetime-income solutions.

5. **Always be respectful of the following realities when setting rules and regulations:**

a. There is no risk-free retirement income solution.
b. The challenges and risks are large, so to do the work to solve problems, employers need a firm and fair safe harbor. The most powerful protections are clear rules combined with transparency, benchmarks, and competition.
c. There are 133 million working and 55 million retired Americans, each of them different: except for Social Security, there will be no single solution for lifetime retirement income.

Appendix A

Introduced in the January/February 2012 *Financial Analysts Journal* article, "Making Retirement Income Last a Lifetime," [13] and expanded upon in the August 2012 *Society of Actuaries Risk and Rewards Journal*,[14] the DCDB[tm] Benchmark consists of only two assets:

1. A self-liquidating, laddered portfolio of TIPS with maturities up to 20 years, providing retirement income from ages 65 to 85; and
2. A deferred, inflation-adjusted (real) life annuity, with payments starting at age 85, and scaled so that the first deferred annuity payment is expected to be the same, in real terms, as the last cash flow from the TIPS portfolio.

Because of the long wait to receive the deferred annuity payments, and because mortality after age 85 is high, the cost of the deferred annuity is surprisingly small, leaving most of the portfolio in liquid TIPS. For a 65-year-old male in the United States in 2010, the portfolio weights would be 88% in the laddered TIPS portfolio and 12% in the deferred annuity at age 65.

This benchmark has minimal risk. It provides inflation protection through age 85, does not contain any equity risk or fixed income duration-mismatch risk, and only the deferred-annuity cash flows starting at age 85 have any credit risk. To further reduce inflation risk would require annuitizing the whole investment balance in a real (inflating) life annuity, but this would expose the whole portfolio, instead of just 12% of it, to credit risk, and would be unacceptable to most investors because of the liquidity loss.

The name of the benchmark, DCDB, for defined-contribution decumulation benchmark, connotes "DC to DB," defined-contribution to defined-benefit, reflecting the conviction that a well-engineered DC plan should be experienced by the participant much like a DB plan, providing predictable retirement income and having very little risk.

These ages are only examples. A benchmark can be constructed along these principles for any retirement age and any annuity deferral period. Thus this benchmark is properly viewed as a *family* of benchmarks, one for each retirement age, gender, and so forth.

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[13] Sexauer, Stephen, Michael W. Peskin, and Daniel Cassidy. "Making Retirement Income Last a Lifetime." *Financial Analysts Journal* 68, no. 1. (2012):74-84.

[14] Cassidy, Daniel, Michael W. Peskin, Laurence B. Siegel, and Stephen C. Sexauer. "Be Kind to Your Retirement Decumulation Plan—Give It a Benchmark." *Society of Actuaries Risk and Rewards Journal* (August, 2012).

Appendix B

2012 ERISA Advisory Council

Examining Income Replacement During Retirement in a Defined Contribution Plan System

Issue Chair: Michael Sasso

Issue Vice Chair: Richard Turner

Drafting Team: Gary Thayer, Cindy Hounsell

Description

As our retirement system continues to trend toward expanding defined contribution plans (DC plans) and shrinking defined benefit plans (DB plans), a growing number of employees will be forced to rely increasingly on their accumulated account balances in DC plans to provide financial security during their retirement years. As the number of employees in this situation continues to grow, these individuals will face important decisions regarding how to make their account balances last for a desired length of time, and in many cases, last throughout their retirement years, a period in life that is becoming increasingly longer due to improved longevity.

In the not-so-distant past, the challenge of providing retired employees with a source of income to last during their retirement was primarily met through employer-sponsored DB plans. However, with a continued shift from DB plans to DC plans as a primary source of retirement income, there is a growing need to examine alternate options designed to address participants' retirement income needs, and more importantly, to assist participants in understanding how to translate their account balances into a steady stream of income that is continuous throughout their retirement years.

In response to this need, some DC plans offer annuity distribution options, either through commercial annuities that are incorporated inside the DC plan, or via transfers to a DB plan also sponsored by the same employer.

Another option is to provide access to the account balance by the participant. When offered the opportunity to gain access to account balances, as is the case when employees near retirement, or when beneficiaries become entitled to the funds accumulated in the account, many individuals elect to take a series of withdrawals from the plan. Often, this option is exercised without any understanding or expectation of whether the amount will last throughout their retirement years. In some cases, other participants opt to receive a lump sum distribution, where the account balance is paid either directly to the individual, rolled over to another plan, or rolled over to an Individual

Retirement Account or an Individual Retirement Annuity (IRA). Often, little planning, if any, is done to ensure that the account balance is transferred to a source of income to be paid over the period of the participant's (or beneficiary's) retirement years.

In instances where the participants opt to leave their account balance in the plan without depletion, they can be faced with multiple options regarding how to improve their chances that the account balance will last for the elected period. These options can range from taking withdrawals (scheduled, unscheduled, or both) to annuitizing the account balance (partial or total; immediate or deferred; etc…), and additional alternatives that fall in the middle of the range. Generally, the availability of these options raises some important questions for fiduciaries and plan sponsors, including,
but not limited to:

- Whether the plan should focus on providing a single option or multiple options in an effort to adequately address the different needs of participants, including diversification;
- What are the major factors to be considered by the plan sponsor in making these options available; and,
- Whether there are additional fiduciary considerations raised by making various options available, and the prudent management of these issues while adequately assisting plan participants.

<u>Objective and Scope</u>

The Council is examining the topic of income replacement in a predominantly DC plan retirement system. The examination will focus on:

A. What are the challenges participants face in making their account balances in DC plans last for the length of their retirement years, including improved longevity?

B. What are some of the alternative options available to participants that would be helpful in their efforts to make their accumulated savings last over their retirement lives or the lives of their spouses?

C. What are the considerations and challenges plan sponsors encounter when making some alternative options available to plan participants?

D. What are the considerations and challenges faced by plan sponsors in providing education outreach for participants regarding the available income replacement options?

Questions for Witnesses

1. What options could be made available to plan participants to best utilize their account balance(s), and to facilitate the goal of securing a stream of income over the elected period designated by the participant? Discussion of the options, generally, may include:
    a. Scheduled withdrawals from general investment options, or from more specific investment options, such as Target Date Funds, and including investment strategies employed by some of the funds in an effort to match expected/assumed distribution schedule to underlying investment allocations.
    b. Scheduled withdrawals combined with withdrawal or income guarantee features, such as guaranteed minimum withdrawal or income benefits (GMWB, GMIB) with respect to deferred annuity or accounts.
    c. The range of options regarding annuities designed to provide a stream of income for life, or over a fixed number of years. The options being considered could include those with features that allow for full or partial immediate annuitization, longevity annuities, or other products.

2. What factors should the participant consider with respect to income replacement options described above?
3. What are the risks plan sponsors face with respect to certain options, and how can these risks be minimized?
4. What are the factors to be considered by the plan sponsor regarding the options to be offered under the plan, such as participant demand, product portability risks, and fee structure?
5. In considering education alternatives with respect to income replacement, what role should an employer play with respect to retirement savings held outside of the employer-sponsored plan?
6. What fee disclosure requirements would apply for providers/plan sponsors to participants with respect to income replacement options?
7. What unique considerations, if any, would be required by the fiduciary for any of the options being offered?
8. Do the fiduciary concerns interplay with other potential barriers, and if so, what are those barriers?