AARP Real Possibilities

STATEMENT OF DAVID CERTNER ON BEHALF OF AARP

SUBMITTED TO THE ERISA ADVISORY COUNCIL U.S. DEPARTMENT OF LABOR

ON

LIFETIME INCOME SOLUTIONS AS A QUALIFIED DEFAULT INVESTMENT ALTERNATIVE

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For further information contact:
Michele Varnhagen
Financial Security & Consumer Affairs, Government Affairs
202-434-3829

Thank you for inviting me to speak on behalf of AARP. AARP, with its nearly 38 million members in all 50 States, the District of Columbia, and the U.S. territories, is a nonpartisan, nonprofit, nationwide organization that helps empower people to choose how they live as they age, strengthens communities, and fights for the issues that matter most to families, such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse.

U.S. Retirement Savings Policy

As the Council knows, the United States private employer retirement system has shifted from a mainly defined benefit to a defined contribution type of system. Because this shift did not happen as part of a deliberative thoughtful process, it has evolved and continues to evolve over time. When Congress initially permitted primarily higher paid employees to defer some tax deferred wages into the new code section 401(k), it had no idea these individual account plans would become the primary retirement vehicle for American workers. As a result, Congress, the Administration and interested policy experts have periodically proposed reforms to improve the ability of 401(k) plans to provide adequate retirement savings to supplement Social Security's guaranteed coverage and benefits.

After decades of incremental changes, many retirement experts also recommend making the system simpler and more cost effective, rather than more complex. This is largely due to many employers phasing out of active involvement in retirement design, lack of financial expertise among typical retirement savers, decades of investment experience, and the development of computer technology that can more easily standardize the lowest cost, highest return and most effective retirement savings options for individuals.

As the Council considers these issues, we urge the Council to focus on three key elements of retirement saving systems:

1) Coverage – including an automatic way to save (unless individuals affirmatively opt out);
2) Prudent Investing – including automatic investment in low cost, diversified, broad based market investments (unless affirmatively opt out); and
3) Retirement age retention and spend-down – including maximized retention of assets until retirement with appropriate options to spend down assets in retirement.

AARP would briefly note that while less than 55 million workers have access to meaningful retirement options, more than 55 million workers do not have workplace retirement coverage. We will not be able to effectively contend that the United States has an adequate supplemental retirement system until all adult Americans are covered by an automatic retirement savings option. AARP has long supported proposals such as Automatic IRA, Automatic 401(k), and State Work and Save programs and will continue to do so. These programs are needed in addition to Social Security, which remains the most important program providing Americans a solid base of retirement income security.

Worker and Retiree Income Delivery Preferences

According to the 2018 EBRI and Greenwald Associates Retirement Confidence Survey (https://www.ebri.org/pdf/surveys/rcs/2018/2018RCS_Report_V5MGAchecked.pdf), we know the following:

- 47% of workers and 33% of retirees surveyed were not confident they will have enough money to last their entire life;
- 34% of retirees received professional advice to move their workplace savings, 24% did not like leaving money with a former employer, and 9% moved money because they wanted guaranteed income;
- 44% of retirees rolled their account into an IRA, 29% kept their money with their former employer; 20% rolled their money into another type of account, and 7% purchased a guaranteed monthly income product;
- 51% of workers are not confident they know how much to withdraw from retirement savings in retirement and 49% are not confident they know how much income they will need each month;
- 41% of retirees hope to maintain their asset level in retirement and 25% hope to increase their assets. 39% have the level of assets they expected and 26% state they have higher assets than expected;
- 23% of retirees said that managing their finances was difficult;
- 48% of workers and 19% of retirees would be interested in using some savings for longevity insurance; and
- 80% of workers would be somewhat or very interested in an in-plan guaranteed monthly income for life investment option and 79% would be interested in a similar out of plan option for some or all of their retirement savings.

In addition, AARP has two older surveys and research that asked views on annuities and the effects of a default presumption for immediate and longevity annuities that can be found at the following links: (https://www.aarp.org/work/retirement-planning/info-06-2012/older-americans-ambivalence-toward-annuities-AARP-ppi-econ-sec.html; https://www.aarp.org/work/retirement-planning/info-10-2012/do-default-and-longevity-annuities-improve-annuity-take-up-rates-AARP-ppi-econ-sec.html).

Retirement Savings Accumulation Issues

One of the important protections that Congress adopted to expand and protect workers' retirement savings has been the creation of the qualified default investment option with the preference for target date and balanced fund investing. Regrettably, most of us are neither knowledgeable nor successful investors. Even Nobel Laureates in Economics have been surveyed and admitted their investing failures and limitations. The creation of investment funds that invest in diversified swaths of the investment markets has enabled millions of investors to achieve more adequate investment returns at low cost and reduce the risk of vastly underperforming with all of their savings. And with today's computer technology, it is becoming even easier to compare investment funds and improve investments and lower costs.

One of the key remaining challenges is to reduce pre-retirement leakage of savings. On leakage, we face two realities. One is that workers change jobs periodically and need to know what to do with their former employer retirement account. Some former employers are willing to hold the assets, some are not. Some new employers are willing to accept prior savings, others will not. Some workers are comfortable with leaving assets with a former employer and having multiple accounts, many are not.

Also, workers face moments in their life when they need money -- such as for college, home purchase or medical expenses -- and their retirement savings may be an all-too-convenient option. And finally, some brokers and advisers use these life changes to encourage workers to inappropriately cash out or rollover their savings and/or invest in less than prudent investments. AARP regrets that the Department and courts did not maintain the updated fiduciary rule. A crowning achievement of retirement law has been its fiduciary duties. The requirement that employers and anyone having discretion over retirement assets act prudently and solely in the interests of workers, retirees, and their families has both protected and enhanced trillions of dollars of retirement savings. Fortunately, the fiduciary standard continues to protect employer retirement plan investors. However, without the enhanced rule, millions are at risk of less than scrupulous advisers who will persuade investors to invest their hard-earned retirement savings in more risky and more expensive investments.

A good deal of work is being done to address each of these issues. More former and new employers are willing to hold and accept retirement assets. New firms are emerging dedicated to making the roll-over process easier, including encouraging record-keepers to work together to coordinate and simplify roll-overs. Some employers are permitting roll-overs to their defined benefit plans which provide annuity benefits. The PBGC, this year, began to connect terminated defined contribution plans and former participants and accept roll-over assets from plans. Bipartisan bicameral legislation has been introduced to create a national retirement clearinghouse to track and hold small accounts. Other countries are starting to test out similar clearinghouses. AARP has endorsed the clearinghouse approach, which could also lessen perceived burdens for employers and plans that do not wish to hold small accounts.

Legislation and other efforts also are being considered to encourage individuals to set up emergency savings accounts to prevent workers from having to withdraw from their retirement savings accounts in times of need.

Retirement Spend-down Issues and Options

Ultimately, there is the critical issue of how workers draw down their retirement savings. There are 3 main variants – 1) permit the retiree to request payments of any amount at any time; 2) permit periodic payments tied to a fixed number of years, typically 20 or 30 years; and 3) permit periodic payments tied to estimated life expectancy. The first two options do not guarantee that retirees do not out-live their savings, but could be combined with another option such as a qualified lifetime annuity contract (QLAC). The Federal Employee Thrift Savings Plan will soon start to provide periodic payments, and many large retirement plans are beginning to as well.

The third option usually involves an insurance annuity, either as a plan option or as an opt-out (QDIA). There are two main problems with expanding the inclusion of annuities in defined contribution savings plans. First, many employers are phasing out of their role as active retirement plan negotiators. Increasingly, except for the top tier of very large employers, employers depend on investment firms to design and manage the retirement plan. Even sophisticated investment firms may not be sophisticated or motivated annuity purchasers. It is not obvious that individual account type plans can easily convert to an insurance form of benefit that relies on pooling to smooth payments and costs. And that leads to the next problem – the annuity market is complicated and not very transparent. There are two main types of annuities – fixed and variable. Fixed annuities are simpler and pay a fixed amount, generally for the life of the retiree and possibly their spouse. Variable annuities provide a payment that fluctuates with identified investment markets (and may have confusing acronyms like GLWBs (guaranteed lifetime withdrawal benefits)). Variable annuities tend to have higher fees, below market returns, hidden termination charges, etc. The insurance industry sells dozens of different types of variable annuities that are often hard to understand and evaluate. Variable annuities tend to be more desirable for higher income, more sophisticated tax sensitive investors. Regrettably, insurers often compensate brokers and advisers more highly for selling variable annuities, which can skew the market away from more basic fixed annuities.

For many years, the insurance industry has been lobbying both to make clear that any type of annuity can be part of a QDIA and that any type of annuity can be an investment option in a 401(k) type plan. DOL has provided some guidance, and any future guidance should build on EBSA's important and longstanding consumer protections. "When evaluating whether it is prudent to use this type of investment alternative as a default investment alternative, the fiduciary must engage in an objective, thorough and analytical process that considers all relevant facts and circumstances." (DOL

Information Letter to TIAA issued December 22, 2016). EBSA added examples of key factors including plan demographics, needs of participants, nature and duration of liquidity restrictions, level of guarantees, costs, and benefits provided.

AARP supports two basic premises under ERISA – 1) it ALWAYS is a fiduciary decision which investment options to include in a retirement plan, and 2) ERISA generally does not preclude the types of investments that fiduciaries may select. Therefore, AARP does not believe that ERISA automatically precludes the consideration or inclusion of any type of annuity in a retirement plan. However, we strongly believe that under the law and in any guidance that the Department may put forward, it must be absolutely clear that any fiduciary that selects any type of investment for a retirement plan, including any annuity option, must determine that the annuity is prudent for those investors, including with respect to costs. Should the Council or Department conclude that an annuity may be appropriate to consider as part of a QDIA, AARP would urge the Council and Department to make it very clear that the selection of any annuity must be separately reviewed and determined by a fiduciary to be prudent for those participants and beneficiaries. While few fiduciaries today may determine that most variable annuities are in the best interests of most retirees and their families, we accept that a fiduciary could conclude -- after careful review and negotiation – that a product may be prudent. Again, AARP would strongly urge the Council to make clear that this is a fiduciary determination. Also, in a rolled product with both investment and annuity elements, the fiduciary must ensure that both elements are prudent – not just the en toto product, but each major component – the investment and the annuity components.

Similarly, a fiduciary must carefully consider the needs of the participants and beneficiaries in the plan. As other speakers have noted to the Council, many workers change jobs frequently or have low account balances, or mostly are young in age. In all cases, the fiduciary must assess the needs of the overall pool of participants and feel confident that any investment or annuity option is prudent for them. Frankly, this can be complicated when most employers have a mix of workers with very different incomes, savings, and job tenure. In addition, the fiduciary will have to negotiate protections for workers who change jobs and leave the plan, and may want to terminate the annuity. Another complication is that in small companies, the employer often does not actively operate the plan and an insurer may manage the plan. It is unlikely that an insurer, who may not agree to act as a fiduciary, will prudently determine if an annuity product is in the best interests of the participants and beneficiaries. Smaller plans also mean a smaller pool and higher costs.

One promising option being considered is converting participant accounts into a partial annuity so retirees have some lifetime income and some account and investment control. However, this type of option is competing against other emerging spend-down ideas, and none has yet taken hold. Also, as retirement investments become easier to compare with improving technology, insurance products will need to reduce their costs and improve returns to successfully compete with other private sector investment options.

We urge the Council to thoughtfully consider not only how retirees may want to receive their income in retirement, but the mix of spend-down options that can best meet their needs. AARP urges the Council to fully review the wide range of options – both existing options and those in development. The market is trying to respond to the maturing of the 401(k) system and the growing need for spend-down options. No doubt more products and approaches will emerge within the coming years.

AARP appreciates the opportunity to present our views to the Council. Please feel free to contact us for any further thoughts or assistance.