
Testimony on Behalf of Hewitt Associates LLC

By Dan Campbell

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Before

Department of the Treasury

and

Department of Labor

Joint Hearing on Certain Issues Relating to Lifetime Income Options for
Participants and Beneficiaries in Retirement Plans

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Hewitt Statement

Introduction

As one of the world's premier human resources services companies, Hewitt Associates has extensive experience in both designing and administering 401(k) plans for mid- to large-sized employers, including helping employers to communicate with their participants about this increasingly important benefit. We are the largest independent provider of administration services for retirement plans, serving more than 11 million plan participants. We do not manage funds and we have no affiliations with any investment management firms.

My name is Dan Campbell, and I am the practice leader for our Defined Contribution Administration business. We are honored to provide comments to the Department of Labor (DOL) and the Internal Revenue Service (IRS) today on the topic of a lifetime stream of income after retirement for participants and beneficiaries of retirement plans.

Achieving income adequacy in retirement is becoming a growing challenge for many Americans and an increasing concern for employers that provide retirement programs to their employees. Recent Hewitt research¹ shows that fewer than one in five Americans will be able to meet 100 percent of their estimated needs in retirement. Many factors are contributing to this shortfall. Americans are living longer today than in prior decades, and many now rely solely on a 401(k) plan for their employer-provided retirement income, meaning they are at a far greater risk of prematurely depleting their existing retirement savings. In addition, the overwhelming majority of Americans either elects or is forced to take their savings out of their retirement plan when they retire. Participants who take a lump sum are subject to inflation risk, longevity risk and market risk. Few are equipped to independently manage that risk, so they reach to others for assistance. The dizzying array of options in the retail market to help deal with these challenges can be overwhelming, and retail fees are generally higher than what mid- to large-sized retirement plans can offer through their collective buying power. Consequently, fees erode savings, and participants are at greater risk of buying products that are inappropriate for their needs.

With Americans' retirement income needs in mind, we applaud the Agencies for soliciting input on this important topic, and we encourage employers, retirement plan service providers, regulators and Congress to take a closer look at changes needed to make retirement plans effective vehicles for managing lifetime income streams after retirement.

In my testimony, I will discuss:

- Specific participant concerns affecting the choice of lifetime income relative to other options
- Alternative designs of in-plan and distribution lifetime income options

¹ Hewitt Associates' 2010 Retirement Income Adequacy at Large Companies: The Real Deal Study.

Specific Participant Concerns Affecting the Choice of Lifetime Income Relative to Other Options

There are many participant benefits of electing in-plan and distribution lifetime income options. Hewitt's testimony will focus specifically on two of these benefits: fee transparency and institutional pricing.

Fee Transparency

Despite the stock market's recovery, Americans are still struggling to recoup the historic losses sustained in their 401(k) plans over the past two years. One obstacle is excessive 401(k) plan fees, which can rob participants of thousands of hard-earned dollars over the course of their career. Fee transparency can provide participants with the confidence needed to make informed, educated choices about distribution options.

Hewitt believes that a lack of full fee transparency contributes to the low adoption and usage of lifetime income options within retirement plans. The interim final rules recently released by the DOL will improve this issue. They will provide plan fiduciaries with greater information about compensation received by service providers as well as certain costs associated with specific plan investment options, including any lifetime income options. We also expect future rules on participant fee disclosure to help individuals receive better fee information from investment managers and other service providers relating to all fees applicable to lifetime income options. This will increase the likelihood of usage of such options. Specifically, we anticipate that full fee transparency will result in the following benefits to lifetime income options:

- Increased competition, and resulting lower cost of such options;
- Increased fiduciary confidence in selecting such options for retirement plans;
- Better comparisons by plan participants of lifetime income versus non-lifetime income options;
- Better comparisons by plan participants of lifetime income options within a retirement plan versus outside of a retirement plan; and
- Increased usage of lifetime income options by participants due to the more meaningful comparison of options.

To obtain all these advantages, however, we recommend three modifications be included in the upcoming rules on fee disclosures to plan participants:

Modification #1: Lifetime income products may be very complicated. As a result, we believe the DOL should clarify that the rules on fee disclosures to plan fiduciaries and plan participants should apply to all fees that could potentially arise in all phases of plan participation—whether it's in the accumulation phase, decumulation phase or at distribution. For example, if a lifetime income option provides participants with choices throughout their lifetime, and additional or different fees could apply based on those choices, plan sponsors and participants should be made aware of all the possible fees that could apply with respect to the choices available throughout the usage of the product. These disclosures will help plan sponsors and participants make more meaningful comparisons between lifetime income and non-lifetime income investment options within the plan. They will also help plan participants determine how to draw down assets in a lifetime income option or whether they should invest in a lifetime income option within or outside the retirement plan.

Modification #2: Hewitt believes it is important to separate fees that are specifically applicable to a lifetime income product from investment management fees. This unbundling of fees will give fiduciaries and participants a clearer picture of the true costs of the program. It will also enable them to compare various lifetime income option providers and therefore facilitate competition, keeping costs down for plans and plan participants.

Modification #3: Fee transparency should also apply to service providers that earn compensation from cross-selling lifetime income options to plan participants that are outside a plan's investment options or optional forms of payment. This will permit plan participants to compare the costs of the options offered within their retirement plan with the retail products outside of the plan that are being marketed to them through cross-selling. It will also enable plan sponsors to compare the costs of the two options, which may influence their decision on whether to offer lifetime income options within their retirement plan (e.g., if the plan sponsor can negotiate lower fees than those that apply to the retail products).

These additional fee disclosures for lifetime income options are necessary to ensure the future success of lifetime income options. Without these disclosures, plan sponsors and participants will not have a true picture of the fees related to such products, and the lack of interest in these products from plan fiduciaries and participants will likely continue.

Institutional Pricing

Another important advantage associated with offering lifetime income options within retirement plans is that participants would receive direct benefits through lower-priced options. Many large employers already leverage the size of their retirement plans and choose low-cost, non-mutual fund alternatives, including collective trusts and separate accounts, or institutional shares of mutual funds. These options are not available in the retail market and participants cannot access these prices independently, however they can ultimately enable participants to accumulate more retirement assets.

Similarly, Hewitt sees much lower prices emerging for institutional income products compared to retail products. Participants are able to benefit from these lower prices just as they do from the lower priced investment options if income options are offered within a plan or through a plan provider. Retail annuity products are often two or even three times more expensive than rollover annuities available through certain retirement plans when institutional pricing is available. Other products available in some retirement plans include a guaranteed return with upside based on investment performance, a guaranteed stream of payments over the retiree's lifetime and/or continued investment flexibility. Generally, prices for these insured income products in large plans range between 50 basis points and 150 basis points in fees, depending on the product and the underlying investments.

If an individual rolled over his or her 401(k) into an individual retirement account (IRA) at retirement, this pricing would not be available. Many similar retail options range in cost between 300 basis points and 350 basis points per year, significantly eroding the probability of receiving higher payments resulting from positive investment performance. The combination of leveraging institutional investments and eliminating many of the sales and commissions can make a real difference to participants' savings levels.

We encourage the DOL to encourage adoption of income solutions within plans or through plans to enable reduced sales and distribution charges and increased financial security for plan participants.

Alternative Designs of In-Plan and Distribution Lifetime Income Options

Most defined contribution plans today fail to provide participants with the necessary tools to effectively manage postretirement risks, forcing them to look toward external, retail-focused options. Our research shows that when traditional features such as immediate rollover annuities are made available, few participants take advantage of them.

According to Hewitt's research,² the overwhelming majority of participants choose to move their money out of their retirement plan when they retire rather than converting their balance to lifetime income directly from the plan. All 401(k) plans that Hewitt studied in its research currently offer lump-sum payments as a final distribution option, and 84 percent of terminating participants elect to take this option. More than half (54 percent) of retirement plans offer partial distributions, with 17 percent of participants electing this option when it is offered. Just 14 percent of 401(k) plans today offer a traditional annuity form of payment, and just 1 percent of participants in those plans elect the option when it is available. Hewitt's data shows similar lump sum preferences among defined benefit plan participants, with 57 percent of pension plan sponsors offering a lump-sum option, and between 60 percent and 95 percent of participants electing the option when it's available. Clearly, today's plan structures are not encouraging participants to protect themselves against postretirement risks.

Various alternative lifetime income solutions for defined contribution plans have been introduced in recent years to appeal more broadly to participants. These solutions offer guaranteed payments from within the plan designed to eliminate some of the barriers offered by traditional annuities. Few plan sponsors, however, have implemented these emerging options. Hewitt research shows that only 7 percent of 401(k) plans currently offer an insurance or annuity solution within the construct of the plan itself.

Hewitt believes that one of the main issues behind this lack of adoption by plan sponsors is their fiduciary concerns—particularly in selecting annuity providers. Plan sponsors need clarity and/or safe harbors on:

- How to choose in-plan lifetime income solutions;
- How to communicate them—what plan sponsors can say without either overselling or under representing the offering; and
- How to monitor them—appropriate direction so that what they are offering won't invite lawsuits from plan participants.

Providing guidance clarifying fiduciary requirements and encouraging plan sponsors to adopt lifetime income options will help spur adoption of lifetime income options. We encourage the DOL to support flexibility in design of these options. Various designs will appeal to different plan sponsors and participant groups. We do not believe there is one silver bullet solution that provides the right answer for every plan and every participant. To maximize adoption of lifetime income options, a spectrum of solutions should be made possible, including:

- Guaranteed lifetime income
- Potential increases in guaranteed payments based on investment performance
- Steady payments calculated via asset allocation methods
- Deferred annuities (also called longevity annuities)
- Guarantees structured within target date funds or other lifetime income options, with appropriate fee disclosure and transparency
- Rollovers into pension plans for annuitization

² Hewitt Associates' 2009 Trends and Experience in 401(k) Plans Study.

- In-plan and outside of plan options
- Fixed payments and inflation indexing

Most defined contribution plans today fail to provide participants with the necessary tools to effectively manage postretirement risks, forcing them to look toward external, retail-focused options. When traditional features such as immediate rollover annuities are made available, few participants take advantage of them, suggesting that new solutions or strategies are needed in order for retirees to meet the challenges and risks faced in today's environment. We urge the DOL to encourage flexibility and to support innovative solutions—including insurance solutions, asset management solutions and participant education and guidance—so that plan sponsors can offer the tools and features that are best suited for their own unique participant populations.

Conclusion

Hewitt Associates commends the Agencies for their ongoing efforts to help Americans achieve income adequacy in retirement. Plan sponsors have a unique opportunity to influence the decisions of millions of Americans when it comes to lifetime income options. Additionally, they can leverage their size, scale and fiduciary prudence to deliver cost-effective solutions designed with the participants' best interests in mind. We encourage the Agencies to take the steps noted above regarding full disclosure of fee transparency, encouraging lifetime income solutions within retirement plans, addressing plan fiduciaries' concerns by providing better clarity and safe harbors, and supporting flexibility in the design of lifetime income options.

We appreciate the opportunity to share our ideas with the Council, and volunteer our data and experience to continue conversations about improving retirement security for all Americans.

About Hewitt Associates

Hewitt Associates (NYSE: HEW) provides leading organizations around the world with expert human resources consulting and outsourcing solutions to help them anticipate and solve their most complex benefits, talent, and related financial challenges. Hewitt consults with companies to design and implement a wide range of human resources, retirement, investment management, health management, compensation, and talent management strategies. As a leading outsourcing provider, Hewitt administers health care, retirement, payroll, and other HR programs to millions of employees, their families, and retirees. With a history of exceptional client service since 1940, Hewitt has offices in over 30 countries and employs approximately 23,000 associates who are helping make the world a better place to work. For more information, please visit www.hewitt.com.