Written Statement of Bradford P. Campbell
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Advisory Council on Employee Welfare and Pension Benefit Plan's
Working Group on Model Notices and Plan Sponsor
Education on Lifetime Plan Participation

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Council Members, thank you for the valuable work the Council is doing to assist the Secretary of Labor in better understanding the issues facing ERISA plan participants and plan fiduciaries. Having had the privilege of serving at the Department of Labor and working with the Council in the past, I appreciate how much time and effort you all devote to the Council, as well as the value to the Department your activities provide. Thank you for the opportunity to discuss these matters with the Council today.

Most Public Policy Efforts to Date Have Been Focused on the "Front End"-- Getting People to Participate in Plans

Defined contribution pension plans offer significant benefits for participants—they are widely offered by large and small employers (though unfortunately not universally available), the accumulated retirement savings generally are very portable, the tax benefits and matching contributions (if available) are valuable, and the fees and expenses are generally lower than individual retirement savings vehicles. However, most defined contribution plans also require action on the part of participants—we must make decisions throughout our working careers to ensure our retirement savings and retirement income will meet our retirement needs. In many cases, perhaps even most cases, we have little professional advice within our plans to help us make these decisions.

Accordingly, our public policy efforts have focused on attempting to encourage more active participation and prudent decision-making by participants. In addition to reaching out to participants, our efforts have focused on encouraging plan sponsors to structure plans and investments in ways that make decisions for participants to the extent possible.

For example, the Pension Protection Act of 2006 and the Department's Qualified Default Investment Alternative regulation made significant progress on the "front end" of retirement savings—millions of Americans are now participating in plans who might otherwise have failed to do so. Though our experience with automatic enrollment and QDIAs is only a few years along, results so far suggest that these changes have been very successful. Participants automatically enrolled generally stay in the plan, and remain even after scheduled increases in their contribution amounts. Further, target date funds and similar investment vehicles have become very popular because they make allocation and rebalancing decisions for participants.

All of this progress has been essential to improving outcomes. After all, the most important factors in retirement savings outcomes are how early and how much is contributed. While more can still be done, all of these are proactive measures taken to get people "in" plans. The next logical phase of public policy, however, is to focus on how to get them "out."

Public Policy Efforts Need to Begin Focusing on the "Back End" – How Do People Prepare for and Spend Their Savings in Retirement

There are significant opportunities and risks facing participants as they accumulate retirement savings and begin to face issues associated with using those savings in retirement. The primary risks include:

- <u>Underestimating Retirement Needs</u>—the lack of understanding of the amount of savings necessary or the amount of replacement income needed to preserve an adequate lifestyle;
- <u>Longevity risks</u>—the significant statistical probability that individuals will live longer in retirement than they expect;
- <u>Sequence-of-return risks</u>—the impact of investment market downturns at the "wrong" time and the lack of understanding about the appropriate rate at which retirement income can be withdrawn from a defined contribution account or IRA;
- <u>Inflation risks</u>—the potential for significant erosion of the purchasing power of retirement savings in the future; and
- <u>Cognitive risk</u>—the loss of decision-making capacity as we age.

While we have talked about these issues, we have made relatively little progress in our public policy efforts on the "back end" of retirement savings. These have proven to be a much more difficult set of issues to tackle.

First, the phases of retirement savings are not so neatly divided into "accumulation" and "distribution." Matters of plan design, selection of investment products, consideration of income-producing strategies and products, and participant education and outreach are intertwined through a participant's working career. Thus, the Council's study of the concept of "lifetime plan participation" is both timely and necessary to address the reality of the issues facing both participants and plan fiduciaries.

Second, the legal infrastructure facilitating distribution and other "back-end" issues is not as well developed as for "front-end" issues like automatic enrollment and QDIAs. While some steps have been taken, such as reforming required minimum distribution calculations for certain annuities or establishing a safe harbor for selecting an annuity provider, these are of limited utility or address only discrete areas of a larger set of concerns.

My testimony today will address some of these challenges based on issues I have seen in my professional career in private practice and as a government official.

Lifetime Plan Participation Recommendations Must Take Into Account the Needs of Participants <u>and</u> Plan Sponsors and Fiduciaries

While there is clearly still much progress to be made in improving retirement savings rates, the approach taken with respect to automatic enrollment has been successful because it took into account not only the needs of participants using plans, but also the liability and other concerns of the plan sponsors and plan fiduciaries providing those plans in our voluntary system.

Automatic enrollment works for participants because it addresses their real-world experience of difficulty in making complex financial decisions. It works for plan sponsors and plan fiduciaries because it provides a legal liability safe harbor and other benefits. The law would not have been as successful had it not balanced and joined these interests together.

Similarly, the Council's recommendations regarding lifetime plan participation should recognize the complimentary but not identical roles and concerns of participants and plan sponsors/fiduciaries.

<u>Issues Facing Plan Sponsors and Fiduciaries:</u>

While the concerns of participants are essential, lifetime plan participation starts with the plan sponsors and plan fiduciaries. The plan's design follows its purpose, and is shaped by liability and cost concerns as well.

- Plan Design and Investment selection Issues

One of the key issues necessary to facilitate lifetime plan participation is to address plan design and investment option concerns. Most 401(k) plans are intended to be, and are operated as, asset accumulation vehicles. A typical 401(k) plan has limited features addressing structured distribution options, and tends not to offer investments that contain lifetime income features. Adding a lifetime income feature, for example, is an elective decision, and plan fiduciaries have to perceive that the risks and complexities involved in adopting these voluntary features are manageable and the end products worthwhile to participants.

New products and services continue to be developed to address these issues, and the marketplace is evolving rapidly. However, in deciding whether to offer a lifetime income product, fiduciaries need to employ a prudent process to assess whether doing so will be in the best interests of the plan participants, and to evaluate the merits of the different products available. For example, fiduciaries have to understand the basic differences between the kinds of lifetime income options available. Is the lifetime income product using insured annuities or a non-annuity investment strategy to provide retirement income?

With respect to insured annuities, a key concern for plan fiduciaries is the liability for prudently selecting an annuity provider. While the Department has taken steps to address these concerns, they have not been as effective as one might hope.

Recommendation: Amend the Safe Harbor Regulation for Selecting an Annuity Provider to a Defined Contribution Plan

While the Pension Protection Act of 2006 clarified that the "safest available" standard did not apply to defined contribution plans (and DOL regulations were similarly amended), the current safe harbor regulation for selecting an annuity provider subsequently adopted by DOL does not work as well as intended. I should add that I served as the Assistant Secretary of Labor at the time we adopted the safe harbor. While I promulgated the safe harbor regulation in 2008 the belief that it would be beneficial, time has proven me wrong.

Rather than providing objective criteria, the current safe harbor is inherently subjective. As a result, it does little to assure plan fiduciaries that they are clearly within it when they make decisions. For example, the safe harbor is available if the fiduciary "appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments…[and] appropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract…[and] if necessary, consults with an appropriate expert or experts." (29 CFR §2550.404a-4)

This principles-based standard of "appropriate consideration" does not work for the purposes of a safe harbor. In 2010, during the joint hearings held by DOL and the Treasury Department in connection with a Request for Information ("RFI") on lifetime income issues, witnesses testified that because the safe harbor does not expressly allow fiduciaries to rely on objective measures of solvency, and because it is not clear when consultation with an expert is necessary under the rule, fiduciaries have difficulty using the safe harbor. There was also discussion that the safe harbor's application may be limited to traditional annuity products, and that it was uncertain whether the safe harbor was available for newer products coming onto the market that contained insurance features.

I was pleased that the Department's 2014 Spring Regulatory agenda included a regulatory proposal to amend the safe harbor based on the response to the RFI and the joint hearings with the Treasury Department. While this regulation has not been included in the most recent regulatory agendas, the Council should recommend that DOL consider this regulatory project again in future years.

<u>Issues Facing Plan Participants:</u>

One of the biggest issues facing plan participants is the lack of education or investment advice available to them in their plans concerning lifetime income issues. While education is more common than advice, it is difficult to reach participants with the information they need to understand the issues they face.

- Retirement Income Projections

The Department has engaged in a proposed rulemaking to require a retirement income projection on the quarterly benefit statement. Currently scheduled to be released as a proposal this July, the concept behind this regulation is valid, but how it is executed will be quite significant.

Conceptually, giving participants information about the potential retirement income their current plan savings will generate is a very helpful idea. At a glance, a participant can determine whether the path they are on will lead them where they need to go. I may not know, for example, what $150,000 in accumulated savings means, but it sounds like a lot of money. If my statement shows that $150,000 may yield about $400 a month in retirement income, I now know what $150,000 means, and can judge whether that is enough.

Recommendation: Encourage Retirement Income Projections to be Based on Estimated Accumulated Assets at Standard Social Security Retirement Age

Participants would benefit the most from projections that show where they will be if they stay on their current path. Naturally, this involves making assumptions about what the current path looks like in future years, but the value of a future projection on the continuation of current behavior is much greater than a projection based on current account balances.

A young worker with a small balance will be disincented to continue to participate in his or her plan if the projection of retirement income is based on the current balance. Instead, the future balance should be estimated based on current habits of contribution paired with reasonable assumptions about future contribution increases and market performance until retirement. For simplicity, a useful retirement age is the standard Social Security retirement age, permitting the participant to combine Social Security estimates with the plan estimates to better estimate total retirement income. The point of the projection should be to show a participant that a small increase in contributions now will leverage a major (and likely needed) change in retirement income in the future.

In my personal life, I still have retirement assets in the Federal Thrift Savings Plan, the government "401(k)." I receive an annual statement with an annuity income projection based on my current balance as if I turned 62 this year. While this is a reasonably accurate calculation with relatively few assumptions, I am not 62 and I am not retiring this year. I probably won't retire for another 20 years or so. As a result, the projection means little more to me than the accumulated balance, as I can't immediately grasp what either number will mean for me in future retirement income.

- Education and Advice Regarding Lifetime Plan Participation

While it may not be universally available or valued by every participant, the availability of education through face-to-face meetings or model tools can be life-changing for individual participants. Most participants likely have not developed a personal retirement plan, or likely have any real idea of how much they will need for retirement.

Recommendation: Expand the DOL Guidance on Participant Education to Include Lifetime Plan Participation and Retirement Income Issues

The current DOL guidance on participant education, Interpretive Bulliten 96-1 is very helpful, but it should be expanded to expressly include tools and discussions about retirement income and retirement needs estimation.

While the natural inclination of lawyers and regulators is to complicate discussions to protect people from themselves, these complications are the opposite of what participants need. Simple "directional" information based on reasonable projections with a disclaimer that these are educated guesses, not guarantees, would help participants make informed decisions without putting them or their educators at undue risk. Simplicity is not a concept that comes easy where concerns about abuse compete with concerns about undue legal liability—on both sides of that divide, disclosures, disclaimers, restrictions and limits seem to multiply. However, simplicity is the most important factor in providing useful education. A chart that shows two lines—one of my projected balance at a 4% contribution and one of my projected balance at a 5% contribution—is much more helpful to me, if ultimately less accurate, than a Monte Carlo simulation scatterplot showing all the potential outcomes accompanied by three pages of assumption disclaimers and fee disclosures.

While DOL recently proposed replacing IB 96-1 with a revised standard of education, I think the Council should consider the benefits and drawbacks of the suggested revision. While it would expand the guidance to cover retirement income discussions, it also limits certain discussions regarding investment options available in plans. As retirement income issues may be inextricably bound up in the investment options in may plans, and as these kinds of hybrid products seem to become more popular, it may be in the best interests of participants to have an educator explain how these investments work.

Conclusion:

Plan fiduciaries and plan participants must see the value in redesigning plans and investment options to facilitate lifetime plan participation. This requires a simpler approach to participant education and advice, increasing its utility, and a legal infrastructure that supports the adoption of products and educational materials by reducing liability concerns. In our voluntary system, we have to balance these competing interests better than we have so far—the alternative is to continue to make advice and education less useful to participants while reducing the willingness of plans to adopt new products and ideas to better serve participant needs. I commend the Council for its work in this area to better serve the needs of participants.