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Testimony Before the ERISA Advisory Council

On Behalf of NISA Investment Advisors, LLC by Mark Fortier

Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA) – Focus on Decumulation and Rollovers

June 19, 2018

NISA Investment Advisors, LLC is an independent investment manager with over $288 billion under management.[1] NISA is a leader in liability-driven investing and de-risking strategies for pension plans. NISA focuses on risk-controlled asset management for institutional investors and works closely with large, sophisticated plan sponsors to design customized solutions.

My name is Mark Fortier, and I am a Director in the Defined Contribution group at NISA Investment Advisors, LLC. I am honored to address the ERISA Advisory Council on ways to foster default investments focused on both, accumulation and decumulation.

My testimony will focus on four key areas that are meant to provide:

1. **A perspective on the opportunities and challenges with target date funds as they apply to decumulation advice.**
2. **An example of a target date investment default designed to reduce income volatility by building a spending floor from fixed income exposure.**
3. **A perspective on the current QDIA regulatory language and related safe harbors.**
4. **Recommendations to the Council on ways to clarify the existing QDIA rule and foster greater adoption of investment defaults focused on lifetime income.**

Opportunities and Challenges with Target Date Funds

While target date funds (TDFs) date back to the 1990's, it was not until the passage of the Pension Protection Act in 2006 that their meteoritic rise began with the advent of qualified default investment alternatives (QDIAs). While some plan sponsors have chosen balanced funds or managed accounts as their plan's investment default, target date funds dominate the QDIA landscape today. According to a survey in 2017 by Towers Watson, "93% of sponsors use TDFs as the QDIA, an increase from 86% in 2014 and 64% in 2009."[2] Ironically, however, the same QDIA safe harbor (with its fiduciary protections) which fostered growth has also challenged innovation.

[1] Represents $166 billion of physical assets and $122 billion in derivatives notional value as of 3/31/2018. The data supplied by NISA are based on trade date and calculated according to NISA's pricing policies. NISA maintains the data only for its portfolio management, guideline verification and performance calculation purposes and the data may differ from the recordkeeper. See www.nisa.com for additional information.
[2] The Willis Towers Watson 2017 Defined Contribution Plan Survey

As a simple, age-based, and risk-managed solution, TDF's popularity among participants is evidenced by Vanguard's 2018 *How America Saves* report, which states that 75% of participants are using a TDF and 51% of participants are entirely invested in one TDF. TDFs' strength as a one-size-fits-all solution for accumulating retirement savings to an average retirement age has also limited TDFs' effectiveness in addressing more complex and personal decisions related to retirement such as:

- What age can I retire?
- How much money can I safely withdraw each and every year in retirement for what I need to spend - such as food and housing?
- How can I grow and access my wealth for what I want to spend - such as travel and leisure?
- How can I be confident that I won't outlive my savings or be unable to afford unexpected spending - such as healthcare?

While the behavioral trappings of inertia, procrastination, and anchoring biases have informed our views and practices in structuring default investing during the accumulation years, we, as a whole, have only begun to consider the cognitive and behavioral demands placed on retirees when faced with the multiple challenges of decumulation. These challenges have real life impacts on the quality of life of retirees - such as under-saving for retirement from the illusion of wealth or under-spending in retirement from fear of poverty.

Lifetime Income Product Innovation and Ways to Encourage Usage

Now I turn to an example of an innovation in target date investing designed to help the vast majority of participants with decumulation by connecting income with spending and encouraging framing in terms of lifetime income. Although innovative in nature, this approach is more evolution than revolution.

Like all target date investments, the glidepath for this approach is based upon a participant's age and target retirement date, and the underlying investments are implemented utilizing a mix of equity and fixed income exposures. Unlike today's target date funds, this innovative target date approach does not assume that all participants retire at the same age.

As labor trends and attitudinal surveys have shown, there is a wide (and ever widening) range of retirement ages driven by those that "want to" work and those that "have to" work. A trend that likely results in participants working longer to reduce the volatility of income for their non-discretionary expenses. An "income focused" investment strategy of fixed income exposures designed to provide stable and sustainable retirement income can help reduce income volatility by better matching the duration of the fixed income exposures to expected time in retirement. Moreover, when utilized as a QDIA, this approach helps those that need it by defaulting based upon an average retirement age and retirement outcome, while providing the necessary flexibility, cost effectiveness, and daily liquidity that participants will need in all phases of their life.

Plan sponsors that wish to also educate or promote insured/guaranteed products, can also incorporate "annuity tracking" within the new target age approach to better match the duration of fixed income to the expected price of an annuity commencing at life expectancy in the form of a Qualified Longevity Annuity Contract (QLAC). When communicated within a QDIA, framed as "needed" spending, and engaged to consider insuring longevity risk, participants may be more likely to overcome the behavioral challenges that economists call the "annuity puzzle." In addition to providing a clearer path to longevity protection, some sponsors may combine an "annuity tracking" portfolio with conflict-free access to group-priced annuities through their plan's annuity distribution option for a more integrated and connected experience relating to retirement income. This approach also helps address some of the concerns relating to portability by allowing plan fiduciaries to retain control to add, alter or remove an annuity option.

Current QDIA regulatory language and related safe harbors

Recognizing the "substantial risk that savings will fall short relative to many workers' retirement income expectations, especially in light of increasing health costs and stresses on defined benefit pension plans and the Social Security program,"[3] the Department's overarching focus when developing the QDIA regulation was on the long-term accumulation of retirement savings as a way to ensure adequate retirement income. In the decade since the publication of the final rule, fueled by shifting demographics and participants increasingly transitioning to and living in retirement, stakeholders, both public and private, have come to recognize the importance of a focus on both accumulating savings to retirement and creating income for needed spending in retirement.

Yet, despite support for facilitating lifetime participation within the employer-based system and strengthening the QDIA's role in helping participants achieve greater retirement security, the majority of plan sponsors/fiduciaries today have adopted QDIAs that largely seek "to minimize the risks of large losses", rather than one that also produces stable income to meet needed spending over a lifetime in retirement. In large part this is due to the fact that the existing QDIA definition does not expressly state "income" as an outcome. Specifically, "An investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy" is mainly seen by fiduciaries as a prescription rather than the spirit in which it was intended.

Although the Department, along with the Treasury Department and other stakeholders, identified the need for lifetime income as an important public policy issue and has supported initiatives that could lead to broader use of lifetime income options, these efforts have largely addressed the role of insured or guaranteed products to minimize the longevity risk of outliving the assets.

Additionally through Treasury's 2014 Notice 2014-66 on deferred annuities in target date funds, the Treasury further clarified and explicitly supported the role of target date funds as the solution through which sponsors can satisfy qualified plans' nondiscrimination requirements. Although it should go without saying that "income" must be part of the solution (indeed "income" is in the very title of ERISA), the failure to mention "income" within the QDIA definition has lead to interpretations and implementation of QDIAs that leave out income from the QDIA.

Recommendations

In the spirit of measured change, our first recommendation is to clarify the existing QDIA rule's use of fixed income investments designed to provide stable and sustainable retirement income over life expectancy. This small but important clarification could act to remove uncertainty and reinforce ERISA's central theme of "Retirement Income Security". Although nascent today in defined contribution plans, fixed income investing designed to match the duration of needed spending (also known as liability-driven investing (LDI)) has a longstanding and significant role in the prudence and efficacy of managing defined benefit plan investments. The needed clarification could serve as a catalyst to introduce similar concepts into defined contribution plans on a participant level.

To that end, we recommend guidance that would assure plan fiduciaries that it does not violate their fiduciary duties in the selection of a QDIA designed to:

[3] Default Investment Alternatives Under Participant Directed Individual Account Plans; Final Rule, 29 CFR Part 2550 (October 24, 2007)

1. provide varying degrees of long-term appreciation, capital preservation, **and income stabilization**
2. through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan) **and the expected time horizon after retirement (such as life expectancy)**.

In addition to providing a clearer path for including an "income focused" outcome within a QDIA, a change (although arguably not as critical) to the basis under which the equity and fixed income exposures are determined from "or life expectancy" to "and expected time horizon after retirement (such as life expectancy)" can help provide further clarity and comfort to plan fiduciaries.

Although the most effective clarification would be in the form of a change to the rule, other means of clarification can be utilized for more timely guidance.

In conclusion, the benefits of default investing and the dominant position of target date funds afford a unique opportunity to build upon what has helped participants accumulate savings by clarifying the existing rule for plan fiduciaries. While decumulation is a complex problem and retirees' needs are diverse, rather than making perfection the enemy of the good, clarifying that "income" is an unambiguous part of a default alternative can help participants in the QDIA preserve needed spending over a lifetime in retirement. I appreciate the opportunity to share my experiences and perspectives with the Council and would be pleased to answer any questions at this time and provide any further support in the future. Thank you.