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Written Testimony of

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Before the

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

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INTRODUCTION

I am Marc Pester, managing director with Prudential Retirement's Institutional Income Group.

On behalf of Prudential, I want to thank the Council for the opportunity to explore means by which to promote guaranteed lifetime income solutions within defined contribution plans.

Prudential was founded in 1875 on the belief that financial security should be within reach for everyone. Prudential has a long history of helping Americans achieve financial wellness and prepare for their retirement years. Today we are a leading provider of guaranteed lifetime income solutions both in defined contribution plans and Individual Retirement Arrangements (IRAs).

We have all heard the statistics – 10,000 Americans reaching retirement age every day. And, it has been well documented that very few of those individuals are being afforded the opportunity to consider a guaranteed lifetime income option as part of their retirement plan. Employee financial wellness has many elements, but a foundational component is to design retirement plans to help employees optimize their retirement income and retire on time. That is why we believe that a defined contribution plan design that incorporates a guaranteed lifetime income solution is key to improving employees' retirement outcomes and is an essential element of financial wellness.

We also know that managing investment and longevity risks during one's retirement years can be a daunting undertaking, even for the most-educated among us, especially in today's relatively heightened market volatility and relatively low interest rate environment. We believe this is a particularly significant issue for women, who tend to have lower levels of retirement savings than men, while having longer life expectancies.[1] Guaranteed lifetime income products provide a means by which all workers can enjoy both certainty and security in their retirement years.

Prudential's learnings from our research on plans and participants demonstrates that when lifetime income options are added to defined contribution plans:

(1) participant satisfaction increases;

(2) participant confidence increases; and

(3) participant outcomes improve due to better long-term savings, investing and spending behaviors.

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[1] See Prudential's white paper entitled *Retirement Income Gender Gap – The Opportunity is Now* at https://www.prudential.com/media/managed/documents/rp/Women_and_Retirement.pdf. Also see Council of Economic Advisers' report entitled *Supporting Retirement for American Families* (February 2, 2012).

Specifically, our experience indicates that the key drivers to better participant outcomes center on improving the following three behaviors, all of which are shown to improve with the benefit of an income guarantee offered in a defined contribution plan:

- Better savings behaviors - Our book of business showed that providing an in-plan guaranteed income option results in participants contributing more—38% more—than average 401(k) plan participants contribute.[2]

- Better investing behaviors (staying the course) - Our book of business research demonstrated that during the down market from 1Q/08 -2Q/09, plan participants invested in in-plan guaranteed retirement income were 2.5 times more likely to stay invested in equities than participants without an in-plan guaranteed retirement income option (i.e., staying the course afforded the opportunity to benefit from the 200+% market run-up since 2Q/09).[3]

- Better spending behaviors - Plan participants with the benefit of an in-plan income guarantee can employ a more aggressive withdrawal strategy (e.g., 5%) relative to that of participants without the benefit of an income guarantee who may be concerned they will outlive their savings.

We also believe that a guaranteed lifetime income solution can help reduce the amount that employees need to save for retirement. We estimate, for example, that a 65-year-old person on the verge of retiring without a guaranteed lifetime income product would need to save 36% more in their account than if their account included such a product.[4]

For these reasons, we commend the Council for undertaking this review of lifetime income, with a focus on providing further guidance on an annuity provider selection safe harbor and modifying the rules governing Qualified Default Investment Alternatives (QDIAs).

My testimony today will focus on the following topics:

- The Emerging Retirement Risks

- Retirement Income Alternatives and Relative Trade Offs

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2 Aon Hewitt, 2010: IncomeFlex Behavioral Analysts," Prudential Retirement, 2011.
3 Study of nearly 20,000 Prudential Retirement full service Defined Contribution participants, age 50 and older, researched during the period of Q1/2008 through Q2/2009.
4 Prudential Financial, What Employees Lose in the Shift from Defined Benefit to Defined Contribution Plans ... and How to Get it Back, 2015, page 9. Calculations of 2,000 Monte Carlo simulations using a guaranteed minimum withdrawal benefit.

- Fiduciary Challenges and Solutions of Plan Sponsor Adoption
- Fiduciary Challenges of Participant Awareness and Solutions

THE EMERGING RETIREMENT RISKS

With the shift away from defined benefit plans, American workers are increasingly having to look to defined contribution plans as their primary source for retirement income.[5] As a result, workers are not only having to assume responsibility for the adequacy of their retirement savings, but also for addressing the emerging risks attendant to ensuring that their savings last throughout their retirement years; risks that are not adequately or consistently addressed today.

We see these risks as three-fold:

- Managing market risk before and at retirement (sequencing of return risk can compromise a secure retirement if there is a material market decline immediately before or after retirement. In effect, it's the opposite of dollar cost averaging in that even if the market recovers, participants/retirees in distribution mode have fewer assets to benefit from an upswing);
- Managing conversion risk (understanding account values as a lifetime income stream);
- Managing longevity risk to ensure that their savings will last throughout their retirement years, while maintaining consistent lifetime spending.

Surveys show that less than 25% of defined contribution plans provide access to in-plan lifetime income options that would address these emerging risks.[6] For the large number of participants without such access, these challenges have created uncertainty and anxiety about their ability to retire. In this regard, Prudential's research indicates that the top three financial priorities of retirees are: 1) having enough money to maintain their lifestyle throughout retirement (68%); not running out of money in retirement (59%); and affording medical care (53%).[7] The June 2, 2018, Barron's cover story highlighted the challenges of financial security facing today's workers with the

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[5] 4 in 5 participants believe their defined contribution plan will be a major or minor source of income in retirement, compared to just 50% of retirees, according to the 28th Annual Retirement Confidence Survey (April 24, 2018) conducted by the Employee Benefit Research Institute and Greenwald & Associates.
[6] See 2016 Willis Towers Watson Lifetime Income Solutions Survey.
[7] See *2016 Retirement Preparedness Survey Findings* at https://www.prudential.com/media/managed/documents/rp/2016-Retirement-Preparedness-Survey.pdf.

following introduction: "High stock and bond prices, more market volatility, rising inflation, and an uncertain economic outlook, make retiring a tougher calculation than ever before."[8] These factors may explain why 4 in 5 workers with a defined contribution plan are interested in an in-plan investment option that will guarantee monthly income for life at retirement [9]

There has been considerable innovation in the marketplace in an effort to design and offer lifetime income products and solutions responsive to the emerging risks facing today's defined contribution plan participants. In addition, there has been a growing awareness on the part of many employers of the importance of helping their employees ensure an adequate and secure retirement. Prudential is calling this growing awareness the "wellness effect" – that is, a larger number of plan sponsors are recognizing that financially secure employees are less distracted, more engaged, and more likely to retire on time.

However, as I will discuss later in my testimony, the Department of Labor, as well as the Department of the Treasury and Congress, can - and must - play a role in promoting and facilitating industry and employer efforts to address the needs of today's working Americans as they plan for retirement. We believe the insights and recommendations of this Council can be critical to determining the direction and timing of the Department of Labor's regulatory efforts in this area.

Having noted the risks facing today's defined contribution plan participants, I will now turn to a review of some of the retirement income alternatives available in the marketplace and how they address those risks.

Retirement Income alternatives and Relative Trade-offs

There are a number of retirement income alternatives available to plan sponsors, which can be grouped into three categories: 1) best efforts (or non-guaranteed); 2) fixed annuities; and 3) hybrid innovation, referred to as guaranteed lifetime (minimum) withdrawal benefits (GLWB/GMWB). These three types of options can be made available to participants both in and out of plans.

These three types of options present a plan sponsor with varying trade-offs revolving around the certainty of income generated and level of flexibility in addressing the aforementioned emerging risks facing their plan participants. These three types of income solutions can be offered as standalone solutions or as an integrated component

[8] At https://www.barrons.com/articles/rethinking-retirement-rules-1527898022?mod=BOL_columnist_latest_col_art.

[9] See The 28th Annual Retirement Confidence Survey (April 24, 2018) conducted by the Employee Benefit Research Institute and Greenwald & Associates.

of traditional asset allocation investment options, such as target date funds, managed accounts and model portfolios.

Best Efforts (non-guaranteed income) solutions

Best efforts (or non-guaranteed income) solutions tend to afford participants the greatest level of flexibility (e.g., access to account value), but they do not eliminate the tail risk events stemming from sequencing of negative returns or longevity. These non-guaranteed solutions (managed payout mutual funds, systematic withdrawal programs as part of managed accounts or target date funds) attempt to diffuse those risk events through prudent investment management.

Managed payout funds, as their name indicates, are essentially mutual fund investments that create ongoing retirement income as the fund's investment objective. Depending on the payout fund, this can be done with either the preservation of principal, where the income generation is targeted from returns, or through the targeted liquidation of the principal over time to help with the income generation. These products may be attractive due to the simplicity of the design or the familiarity of the structure to participants who are typically familiar with mutual funds.

Managed Accounts with systematic withdrawal programs combine fee-based investment advice that takes into account the individual participant's specific needs and risk tolerance along with periodic withdrawals to create an ongoing income stream. These programs may seek to target income until a specific age or for the duration of the participant's life. For the former, some providers may utilize longevity insurance as an asset class to help generate income beyond the targeted age. The personalized investment strategy along with a "set it and forget it" approach is user friendly to the participant but does add an additional fee for the service.

Both of the aforementioned best efforts products (along with target date funds in conjunction with systematic withdrawal programs) utilize structures primarily designed for asset accumulation, although now addressing retirement income. A significant challenge is ensuring that the plan participant understands that these solutions are not guaranteed and that resulting investment performance and retirement income risk are retained by the participant, which can lead to uncertain outcomes.

Fixed Annuities

Fixed annuities tend to afford participants with the greatest certainty of income generated and the lowest level of flexibility and control over their account value. Fixed annuities primarily include immediate payout annuities and deferred income annuities (i.e., longevity insurance).

The product that generates retirement income most similar to that in defined benefit plans is the payout annuity. As the name implies, participants can purchase guaranteed payments of income for a specified amount before the income "turns on." The variability in design of payout annuities includes the term or duration, single or dual lives, if the income is purchased over time or with a single premium amount, and in the instance of variable immediate annuities, the underlying investment options. With a fixed payout annuity, the participant has the certainty of receiving payments that are guaranteed. The challenges that participants may have with this product construct include giving up control of the principal, having limited flexibility in accessing the principal amount should financial needs arise, and in the case of life only annuities, not having a residual balance for the benefit of their beneficiaries/estate should they die prematurely. We believe this lack of flexibility in product design has resulted in a very low participant take-up rate in those plans with such offerings. In turn, low participant take-up rates have led some plan sponsors to broadly, but incorrectly, assume participants have little interest in guaranteed income solutions generally. Such assumptions appear to run contrary to survey results reflecting a high level of participant interest in access to in-plan guaranteed income solutions.[10]

Longevity insurance, also known as deferred income annuities, is a variation of the payout annuity described above. With longevity insurance, the participant can purchase guaranteed income today that won't begin until a later age (e.g., 85). Insurers can utilize the concept of pooled mortality as in the case with payout annuities to provide the guarantee. The product design produces challenges similar to those of payout annuities, although recent deferred income annuity products provide a death benefit during the deferral phase and payout options guaranteeing return of at least the principal. While we believe fixed annuities can be an attractive option for some participants, we recognize they may not appeal to everyone seeking guaranteed lifetime income.

Guaranteed Lifetime (Minimum) Withdrawal Benefits

More recently, products such as guaranteed lifetime (minimum) withdrawal benefits (GLWB / GMWB) have been introduced to create guaranteed income similar to payout annuities but they address some of the perceived drawbacks of payout annuity products. These new product structures allow for substantially more flexibility while still providing an explicit guarantee.

GLWBs are offered in several variations. A standard in-plan GLWB may be offered on one or more underlying mutual fund investments. During the years preceding retirement, the GLWB tracks two separate values for the participant: 1) the current

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[10] *Ibid.*

value of the underlying investment; and 2) the participant's periodic 'high-watermark'[11] value plus the value of contributions into the investment from the high-watermark point. Upon retirement or when the participant begins to take income, the GLWB guarantees that the participant will receive a specified percentage of the higher of the actual investment value or the high-watermark amount for their life. A general illustration accompanies our testimony as Appendix A.

Once guaranteed lifetime income is activated, the ongoing values tracked will be the specified withdrawal amount multiplied by the current account value versus the 'locked' guaranteed income. If market appreciation allows for a participant to increase their guaranteed income amount, they may adjust their income higher. Alternatively, if market values deteriorate, participants retain the higher guaranteed income value.

In addition to the guaranteed income stream, participants always have access to their current investment value. However, should a participant opt to take a withdrawal (or make a transfer out of the plan) in excess of the guaranteed amounts, the future guaranteed income stream will be reduced proportionately; subject to the required minimum distribution (RMD) rules and applicable plan provisions.

If the participant dies and has a positive investment value, this amount is made available to beneficiaries. Given that the underlying investment has equity exposure, the participant has the potential opportunity to address inflation risk while maintaining downside protection. Typically, GLWBs can also deliver income for the lives of the participant and a spouse, although, like a defined benefit plan, with a decreased income stream. GLWBs are offered for an additional fee on the investment to the participant.

Fiduciary Challenges and Solutions for Plan Sponsors

Despite the aforementioned innovations in the marketplace, specifically designed to address the emerging risks facing today's plan participants, and despite the recognition on the part of an ever-increasing number of plan sponsors of the importance of addressing these risks, far too few plan sponsors are including these solutions as part of their defined contribution plan design. We believe such inaction on the part of plan sponsors is largely attributed to concerns and uncertainty regarding fiduciary responsibility and liability, which is very understandable given the current litigious environment in which 401(k) plans now exist. In this regard, we have identified three areas of fiduciary concern that, if addressed, could significantly enhance participant access to and utilization of guaranteed lifetime income solutions without compromising consumer safeguards. They are:

[11] For purposes of determining an income base, a value that reflects the highest measured values as of prior measurement dates as stipulated under the terms of the contract.

- The annuity provider selection safe harbor's requirement that fiduciaries assess an insurer's long-term financial capabilities.

- Product portability issues.

- Participant education issues.

Assessing an insurer's long-term financial viability

As early as 2010, when the Departments of Labor and Treasury – through the publication of a Request for Information and a multi-day public hearing – initiated a public dialogue on the importance of, and impediments to, including lifetime income options in retirement plans, it became clear that the 2008 annuity provider selection safe harbor[12] was not serving its intended purpose of promoting the inclusion of lifetime income products in individual account plans. Since 2010, this Council, albeit with different members, recommended in 2012 and in 2014 that the Department update its annuity provider selection safe harbor to address this problem.[13] In 2016, the United States Government Accountability Office (GAO) joined the chorus identifying the annuity provider selection safe harbor as an impediment to plan sponsors offering annuities as part of their retirement plans.[14]

Unfortunately, our experience confirms the concerns expressed by the Council and the GAO that many employers are not including guaranteed lifetime income products as part of their plan due to the risks attendant to compliance with ERISA's fiduciary standards applicable to the selection of annuity providers, as well as uncertainty as to whether the safe harbor applies to in-plan solutions, such as GLWBs and GMWBs. As recognized by the GAO, as well as in bipartisan legislation introduced in both the Senate and the House,[15] the primary problem with the current safe harbor rule is the requirement that plan fiduciaries, in connection with the selection of an annuity provider, "conclude that … the annuity provider is financially able to make all future payments under an annuity contract."[16]

While we recognize the importance of such determinations, we believe such assessments are appropriately the responsibility of state insurance departments – that

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[12] 29 CFR § 2550.404a-4 (Oct. 7, 2008).
[13] See Advisory Council on Employee Welfare and Pension Plans reports entitled *Examining Income Replacement During Retirement Years in a Defined Contribution Plan System* (December 2012) and *Issues and Considerations Surrounding Facilitating Lifetime Plan Participation* (November 2014).
[14] See Report GAO-16-433, entitled *401(k) Plans – DOL Could Take Steps to Improve Retirement Income Options for Plan Participants* (August 2016).
[15] *Id.* at p. 55; S. 2526 Retirement Enhancement and Savings Act of 2018 (115th Cong.), at Sec. 204; H.R. 5282 Retirement Enhancement and Savings Act of 2018 (115th Cong.), at Sec. 204; and H.R. 4604 Increasing Access to a Secure Retirement Act of 2017 (115th Cong.), at Sec. 2.
[16] 29 CFR § 2550.404a-4(b)(4).

manage and enforce financial solvency and other rules designed to protect their citizens – not plan fiduciaries. We do not believe that advisers – hired at the expense of the plan sponsor or the plan's participants and beneficiaries – will ever be as well positioned as state insurance regulators to determine the long-term capability of a provider to satisfy its contractual obligations under an annuity contract. State insurance departments, in the discharge of their oversight and enforcement responsibilities, have access to an array of financial and other issuer-related information which typically would not be available to plan sponsors or their advisers. For this reason, effectively requiring plan fiduciaries, or their hired advisers, to second guess determinations of state insurance regulators on the financial capability of an issuer is both an unreasonable and an unnecessary requirement, especially for a safe harbor rule intended to facilitate participant access to guaranteed lifetime income solutions.

Thus, we were disappointed that the Department, during the prior Administration, rejected the GAO's recommendation that the Agency clarify the safe harbor "by providing sufficiently detailed criteria to better enable plan sponsors to comply with the safe harbor requirements related to assessing a provider's long-term solvency."[17] According to the GAO report, the Department responded to its recommendation by stating that "a clarification might erode consumer protections by degrading the oversight of fiduciaries making such selections."[18] The report further indicated that the Department suggested, as an alternative, that "plan fiduciaries outsource these decisions to a financial institution as an investment manager under Section 3(38) of ERISA."[19]

We concur with the GAO's expressed skepticism with regard to both the Department's concerns and suggested alternative. First, it is unclear how removing ambiguity in favor of providing compliance certainty with respect to any rule could erode consumer protections or undermine a fiduciary's obligations under ERISA to act prudently and in the interest of plan's participants and beneficiaries. Second, even in the absence of a requirement to assess the financial capability of a provider, compliance with the safe harbor requires that fiduciaries:

- engage in an objective, thorough, and analytical selection process,
- consider the costs (including fees and commissions) - in relation to the benefits and product features of the contract and the administrative services to be provided under the contract.

These requirements, with respect to which there are no recommended changes, have long served as a guide to the prudent selection of service providers and products generally under ERISA and, in and of themselves, impose sufficiently significant

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[17] *Supra* note 14, at p. 55.
[18] *Supra* note 14, at p. 56.
[19] *Ibid.*

obligations on plan fiduciaries to prevent erosion any statutory consumer protections. We understand that, unlike other products and services, annuity contracts have a long-term promise component. However, also unlike other products and services, the issuers of such long-term promises operate in the highly regulated environment of state insurance regulation, which itself is designed, through the imposition and enforcement of solvency and other standards, to protect consumers, including participants and beneficiaries of retirement plans, against insolvency. For this reason, we do not believe that a safe harbor rule that gives deference to an insurer's compliance with state solvency and other requirements would either erode consumer protections or undermine the obligations of an ERISA fiduciary.

With regard to the Department's suggestion that fiduciaries "outsource these decisions," we share the GAO's lack of confidence that "relying on such a strategy available to so few plans will effectively resolve the challenges posed by the current version of the annuity provider selection safe harbor."[20] First, such an alternative does nothing to change current law and disregards the ever-growing consensus in the private sector, in Congress and by the GAO that the current rule is not working to promote the inclusion of guaranteed lifetime income products in plans. And, second, while some large employers may be willing to incur the cost necessary to engage an adviser or an ERISA section 3(38) investment manager to conduct such assessments, we are concerned that most employers, based on our experience to date, will be unwilling to incur such costs – or have such costs imposed on their plan's participants. Finally, and consistent with the GAO's findings, we have seen few ERISA section 3(38) investment managers willing to play the selection and monitoring role contemplated by the Department's suggestion.

We believe that the ultimate success of any effort to expand access to guaranteed lifetime income products in retirement plans is predicated on the adoption of a workable annuity provider selection safe harbor and clarification of the application of the safe harbor to in-plan products, such as GLWBs and GMWBs. In this regard, Prudential fully supports adoption, through legislation or by regulation, of the annuity provider selection safe harbor set forth in the bipartisan Retirement Enhancement and Savings Act of 2018, as introduced in both the Senate and the House, as well as in the bipartisan Increasing Access to a Secure Retirement Act of 2017 introduced in the House.[21] To facilitate the Council's consideration of such approach, we have included, as Appendix B, an annuity provider selection safe harbor regulation modeled after the aforementioned legislation.

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[20] *Ibid*

[21] *Supra* note 15.

Portability

Concerns over portability – the anticipated difficulty in changing service providers when offering in-plan solutions – have also presented challenges for some plan sponsors considering the offering of in-plan retirement income products. Industry efforts to solve this issue have made progress in facilitating the portability of these products from one recordkeeper to another or, at the participant level, from an in-plan option to an out-of-plan option.

Participant-level portability has largely been solved as many product providers offer IRA-rollover solutions to participants. At the plan level, market growth has given rise to two other portability solutions - standardized data sharing (SPARK Institute standards) and middleware providers.

Efforts have already been made to standardize key information needed to facilitate portability across recordkeepers. The standards are intended to make it more feasible and cost-effective for recordkeepers and product providers to service in-plan retirement income solutions by resolving data connectivity issues that have been impediments for recordkeepers, plan sponsors, and participants.

An additional enhancement in product portability between recordkeepers can be found in the developing middleware market. Middleware providers act as a conduit between in-plan retirement income product providers and recordkeepers, facilitating the exchange of participant specific data. Recordkeepers see a reduction in data complexity when a single connection to the middleware provider "communicates" with multiple in-plan retirement income product providers. Conversely, in-plan retirement income products connected to the middleware provider are immediately compatible with all recordkeepers also connected to the middleware. Simplifying the data transfers between product providers and recordkeepers greatly enhances the portability of in-plan retirement income products and reduces a key barrier to plan sponsor adoption.

The ultimate solution to the portability challenge, however, may rest with Congress. In this regard, we again express our support for enactment of the Retirement Enhancement and Savings Act of 2018 which includes a provision, amending the Internal Revenue Code, to permit portability of lifetime income options if an employer eliminates the lifetime income investment option from its plan menu. Under the amendment, any employee invested in such an option would be permitted to roll over that investment into an eligible retirement plan, regardless of whether the employee is otherwise eligible to take a distribution.[22] With regard to the foregoing, we commend

[22] See S. 2526 Retirement Enhancement and Savings Act of 2018 (115th Cong.), at Sec. 111; H.R. 5282 Retirement Enhancement and Savings Act of 2018 (115th Cong.), at Sec. 111.

Congressman Richard Neal for his early and continued leadership to provide for an annuity portability solution.[23]

Ability to educate workers

Another challenge facing plan sponsors relates to how best to assist employees with retirement preparedness without increasing their own or their plan's litigation exposure. In this regard, Prudential's research shows that employees are increasingly turning to their employers as trusted providers of solutions that can help them achieve and maintain financial security.[24] Given the importance of encouraging the provision of educational assistance to employees, our testimony will address two educational opportunities that we believe would benefit from a Department of Labor statement clarifying they are educational activities and do not implicate the fiduciary provisions of ERISA.

The first of these opportunities involves motivating plan participants to think about their retirement savings in terms of retirement income for their lifetime. In this regard, Prudential has long supported efforts designed to promote the periodic furnishing of disclosures illustrating a participant's account balance in the form of a monthly income stream over the life of the participant. We believe such illustrations will help condition participants to think of retirement savings in terms of future retirement income needs and thereby encourage greater savings.

While a number of providers offer online calculators that will generate similar illustrations, only a small percentage of participants actually take advantage of those tools. However, our experience also indicates that participants who have used the Prudential Retirement Income Calculator increased their savings rate by an average of 5% when they discovered an income shortfall (based on their specific time horizon, deferral rate, and tolerance for risk).[25] Such data reinforces our belief that the periodic furnishing of lifetime income illustrations could improve the level of retirement savings and, in turn, the level of confidence of plan participants as they approach retirement.

For these reasons, we fully support the provisions of the Retirement Enhancement and Savings Act of 2018, that, among other things, provides for the furnishing of lifetime income disclosures on a regular basis to plan participants.[26] We also support continued efforts by the Department of Labor to explore means by which it can encourage the periodic furnishing of such illustrations.

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[23] See H.R. 4523, the Automatic Retirement Plan Act of 2017, Sec. 7.
[24] See Prudential's white paper entitled *The Power of the Wellness Effect*, and Prudential's Financial Wellness Consumer Research, 2016.
[25] "Prudential Perspective," 4Q/2011, Prudential Retirement.
[26] See S. 2526 and H.R. 5282, at Sec. 203.

We note that in 2013 the Department, through the publication of an Advanced Notice of Proposed Rulemaking (ANPRM),[27] invited public comment on a number of issues relating to lifetime income illustrations. While commenters responding to the Department's solicitation generally expressed broad support for the concept of a lifetime income disclosure, we were unable to discern a consensus regarding the specifics of such disclosures; including whether the disclosures should be mandatory, whether the disclosures should be based on current account balances or include projections of contributions and/or earnings, and whether the methodologies employed should be uniform, among other issues.

As the Department continues its consideration of these issues, and in recognition of the time and resources typically required for a formal rulemaking, we encourage the Council to recommend that the Department issue interpretative guidance clarifying that the furnishing of lifetime income illustrations, as part of a pension benefit statement or otherwise, is an educational activity, which does not itself give rise to fiduciary responsibility or fiduciary liability. In this regard, and looking to principles reflected in the 2013 ANPRM, we believe the Department could, as an interpretive matter, condition "education" status on compliance with certain basic requirements, such as the following:

- the illustration takes into account generally accepted investment theories and generally accepted actuarial principles;
- the illustration is accompanied by any assumptions on which the illustration is based or provides instructions as to how such assumptions can be accessed (electronically or otherwise); and
- the illustration is accompanied by a statement explaining that the illustration is merely an example of a lifetime income stream and that actual payments received will depend on numerous factors and may vary substantially from the amounts reflected in the illustrations.

We believe such an approach would provide plan sponsors the comfort they need to move forward with such disclosures, while avoiding a "one-size-fits-all" approach or methodology that could unnecessarily inhibit creativity and innovation in this area.

The second educational opportunity relates to how plan sponsors can best assist their employees in preparing for retirement. We believe plan sponsors want to play a role in helping their employees transition to retirement. However, as recognized by the Department of Labor's 2016 expansion of the investment education guidance originally set forth in Interpretive Bulletin 96-1 (29 C.F.R. § 2509.96-1),[28] plan sponsors continue to have concerns as to whether, and under what circumstances, the provision of

[27] 78 Fed Reg 26727 (May 8, 2013).
[28] See § 2510.3-21(a)(iv), 81 Fed Reg 20998 (April 8, 2016).

information relating to in-plan retirement alternatives and other pre-retirement considerations might be construed to be fiduciary advice – rather than education – and, thereby increase plan sponsor exposure to potential litigation and liability under ERISA.

With the vacatur of the 2016 fiduciary rule by the 5th Circuit Court of Appeals, it is important that this issue be revisited and that the Department be encouraged to issue guidance affirming that the providing of information and materials intended to assist participants in preparing for retirement is an educational, rather than a fiduciary, activity. We would welcome the opportunity to work with the Council, as well as the Department, in framing the scope of that guidance.

Addressing both these plan sponsor challenges will, in our view, remove key barriers to producing better retirement outcomes for participants.

FIDUCIARY CHALLENGES OF PARTICIPANT AWARENESS AND SOLUTIONS

Plan participant decisions within defined contribution plans are often made without awareness of income replacement needs and the challenges of managing investment and longevity risks through the retirement years. In the instances where participant awareness exists, complexity of the decision-making process or the underlying product, as well as participant inertia, often prevent the participant from taking needed actions in their best interest. These challenges are not dissimilar to that of the challenges faced by participants when making investment decisions during the accumulation phase, with respect to which the auto-enrollment and the Qualified Default Investment Alternative (QDIA) regulation have proven to be a solution for millions of participants.

Accordingly, while we believe that addressing the educational opportunities discussed earlier – lifetime income disclosures and retirement planning assistance – would represent a major step forward, we are not convinced that education will itself be sufficient to overcome the challenges of participant inertia. For this reason, we have identified two additional steps we would encourage the Department to take towards enhancing participant consideration of guaranteed lifetime income as a means by which to bring certainty to their retirement years. The first step is to provide much needed guidance on the application of the QDIA rules to new and innovative in-plan guaranteed lifetime income solutions, such as GLWBs and GMWBs. The second step is to extend QDIA-like relief to plan sponsors interested in allocating a portion of a participant's retirement plan contribution to a guaranteed lifetime income product. The following expands on both of these recommendations.

Needed Clarifications

First, we commend both the Department of Labor and the Department of the Treasury for their coordinated efforts to address impediments to the offering of guaranteed lifetime income solutions as part of a defined contribution plan. In this regard, the IRS issued guidance that facilitates the inclusion of guaranteed lifetime income offerings as part of target date fund investment options, even if some of those funds are available only to older workers.[29] And, in response to a request from the Department of the Treasury, the Department of Labor confirmed that the inclusion of such lifetime income solutions in target date fund investment options would not itself cause an investment to fail to be a QDIA.[30]

While the aforementioned guidance is helpful, we do believe further clarifications from the Department of Labor would serve to eliminate plan sponsor uncertainty or concern regarding the use of other in-plan lifetime income solutions as part of a QDIA. In the Labor Department's letter to the Department of the Treasury (hereafter "the Treasury letter"), the Department opined on the application of the QDIA regulation (29 CFR § 2550.404c-5) and the annuity safe harbor standards (29 CFR § 2550.404a-4) to a specific in-plan annuity product with respect to which Treasury requested guidance.[31] We are concerned that the limited scope of that letter, as defined by Treasury's request, has raised issues concerning the Department's views on in-plan lifetime income products generally; that is, those products that are not addressed by the letter.

For this reason, we request that the Council encourage the Department to issue guidance, possibly in the form of a Field Assistance Bulletin, which serves to affirm the application of the principles set forth in the Treasury letter to other guaranteed lifetime income products. We believe such guidance would go a long way toward providing needed comfort to plan sponsors offering or considering guaranteed lifetime income solutions as part of their plan design.

Specifically, we recommend the guidance acknowledge that, in addition to the product identified in the Treasury letter, there have been a number of new and innovative solutions introduced into the marketplace that are intended to better ensure that participants do not outlive their retirement savings by transferring investment and longevity risks to an insurer. Some of these solutions, like GLWBs and GMWBs, have

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[29] See IRS Notice 2014-66.

[30] See Letter from Phyllis C. Borzi, Assistant Secretary for Employee Benefits Security Administration to J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy, Department of the Treasury (October 23, 2014).

[31] Letter from Phyllis C. Borzi, Assistant Secretary for Employee Benefits Security Administration to J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy at http://www.dol.gov/ebsa/regs/ILs/il102314.html. The contract referred to in the letter and the IRS Notice 2014-66 was described as an "unallocated deferred annuity contract" that promises to pay income to covered plan participants at some date in the future on a regular basis for a period of time or for life. The description further indicates that units of the unallocated annuity generally are largely interchangeable among members of the covered group, which facilitates transferability and allocation within the group.

an annuity or annuity-like feature offered in connection with, or as an ancillary feature of, certain investment funds offered by a plan that may serve as a plan's QDIA.

Relevant to the QDIA issue, we note that, for purposes of ERISA section 404(c)(5), the Department indicated in the preamble to the final QDIA regulation that the definition of "qualified default investment alternative" be construed to include products and portfolios offered through *variable annuity and similar contracts* [emphasis supplied] . . . where the qualified default investment alternative satisfies all the conditions of the regulation."[32] In addition, the operative language of the QDIA regulation specifically provides, at § 2550.404c-5(e)(4)(vi), that:

> An investment fund product or model portfolio that otherwise meets the requirements of this section shall not fail to constitute a product or portfolio for purposes of (e)(4)(i) or (ii) of this section solely because the product or portfolio is offered through variable annuity or similar contracts or through common or collective trust funds or pooled investment funds and *without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment product or portfolio* [emphasis supplied].

The guidance should affirm that, while the Department did address the application of the QDIA regulation to a specific annuity product offered in connection with a target date fund, with respect to which the Department of the Treasury requested guidance, the Treasury letter should not be construed to supplant or narrow the application of 2550.404c-5(e)(4)(vi) and related preamble discussion to insurance contracts or features ancillary to an investment product or portfolio, including the application of the regulation to GLWB, GMWB and similar features, as part of a target date fund or balanced fund described in § 2550.404c-5(e)(4)(i) or (ii).[33]

We also suggest that such guidance, consistent with the principles set forth in the Treasury letter, affirm that where a plan's named fiduciary prudently appoints and monitors an investment manager (within the meaning of section 3(38) of ERISA) to manage investments of a plan's funds, including the selection of the annuity provider and contracts not identified in the Treasury letter, such as contracts with a GLWB, GMWB or similar features, the fiduciary will not be liable for the investment manager's selection of the annuity provider and contract, assuming no co-fiduciary responsibility.

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[32] *See* 7 Fed. Reg. 60460 (October 24, 2007).

[33] We acknowledge that issues relating to the treatment of GLWB, GMWB and similar features under the Internal Revenue Code of 1986 (the Code) are solely within the jurisdiction of the Internal Revenue Service and the Department of the Treasury. Accordingly, we would anticipate that any guidance would make clear that the Department would not be expressing any views on the treatment of GLWB, GMWB and similar features under the Code.

Such language is important to reinforcing the Department of Labor's view that nothing in the Treasury letter should be construed to limit the application of such principles to the selection of the annuity product described in that letter.

Auto-annuitization

In the same way that auto-enrollment and auto-escalation provisions have worked to increase plan participation and savings rates, we believe affording plan sponsors the ability to employ an auto-annuitization strategy will increase participant exposure to and appreciation for guaranteed lifetime income solutions. To this end, we encourage the Council to recommend that the Department issue regulatory guidance that would extend QDIA-like relief for a plan sponsor's decision to allocate contributions (participant and employer matches) to a guaranteed lifetime income solution. We believe such relief could be provided through an amendment to the current QDIA regulation[34] or as a standalone regulation under ERISA section 404(c)(5).

Similar to the relief currently provided plan sponsors under the QDIA regulation, such relief would be limited to the decision to invest contributions in a lifetime income solution and would not extend to the fiduciary's selection of either the particular solution or the issuer of such solution. In addition, such relief would be predicated on the defaulted participant having been provided advance notice explaining the nature of the investment and lifetime income features, as well as their right to opt out of such investment. Recognizing that investments with annuity features, like a GLWB or GMWB, or annuitization component might be most appropriate for older employees, such as those age 50 or older, relief could be further conditioned on a participant having reached a minimum age. And, recognizing that not all participants would opt to annuitize 100% of their contributions or retirement plan assets, relief could be further limited to only a percentage of a participant's contribution or account balance (e.g., 50%).

Expanding plan participant access to new and innovative lifetime income features and products, by providing the much-needed guidance referenced above, in addition to providing QDIA-like relief for plan sponsors interested in promoting annuitization among their employees, could, in our view, have a significant impact on savings rates and on the overall financial security of an employer's workforce. By way of example, data on our plan sponsor base has shown that participants investing in an in-plan guaranteed retirement income option contributed more —on average 38% more—than what the average 401(k) plan participant contributes.[35] We believe this is driven by a

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[34] 29 CFR § 2550.404c-5

[35] Industry average contribution rate 7.30% versus 10.13% for Prudential IncomeFlex participants, Aon Hewitt, 2010, Prudential Retirement, 2011. Study of nearly 20,000 Prudential Retirement full-service Defined Contribution participants, age 50 and older, researched during the period December 2007 through April 2011. Stat is inclusive of IncomeFlex Select due to the start date of the research. IncomeFlex Select is no longer available for new clients.

heightened awareness of a participant's post retirement needs when they focus on income versus an aggregate balance.

CONCLUSION

With today's workers becoming increasingly reliant on defined contribution plans for their retirement security,[36] it is an imperative that both employers and employees have the tools necessary to manage emerging risks to bring security and certainty to workers' retirement years. During the course of our testimony, we discussed the emerging risks facing workers, innovations taking place in the marketplace designed to address those risks, and proposals for guidance we believe are critical to expanding participant access to and understanding of guaranteed lifetime income features and products at the heart of these innovations. To summarize, we encourage the Council to support the following recommendations for Department of Labor action:

1. Improve access to guaranteed lifetime income solutions by amending the annuity provider selection safe harbor in a manner consistent with the Retirement Enhancement and Saving Act of 2018.

2. Encourage and promote plan sponsor efforts to assist participants with retirement preparedness by clarifying that retirement planning-related programs and materials are educational, not fiduciary, activities.

3. Encourage and promote employer efforts to assist their participants in visualizing their retirement savings as a lifetime income stream by clarifying that the furnishing of illustrations of participants' individual account balances, or projections thereof, as lifetime income streams are educational, not fiduciary, activities.

4. Facilitate the offering of new and innovative lifetime income solutions, such as GLWBs and GMWBs, by removing plan sponsor uncertainty resulting from the Department's 2014 guidance to the Department of the Treasury.

5. Facilitate participant investments in guaranteed lifetime income solutions by providing QDIA-like relief for plan sponsor allocations of participant contributions to such solutions, when, following adequate notice, the participant does not opt out of the investment.

While separate proposals, we encourage the Council, and the Department of Labor, to think about the proposals as necessary parts of an integrated effort to expand participant access to, and understanding of, guaranteed lifetime income features and

[36] *Supra* Note 9.

products and the role of such in providing certainty and security during the retirement years. And, finally, we would encourage the Council, and the Department, to act on these issues with a sense of urgency. We note that since the issuance of the Council's December 2012 report,[37] in which the Council addressed the challenges with the annuity provider selection safe harbor and retirement-related education, over 20 million working Americans have retired, most without access to guaranteed lifetime income solutions through their plans. In this regard, we offer to the Council and to the Department whatever support we can provide to ensure future working Americans have access to the tools they need to manage their retirement risks as they plan for and enter their retirement years.

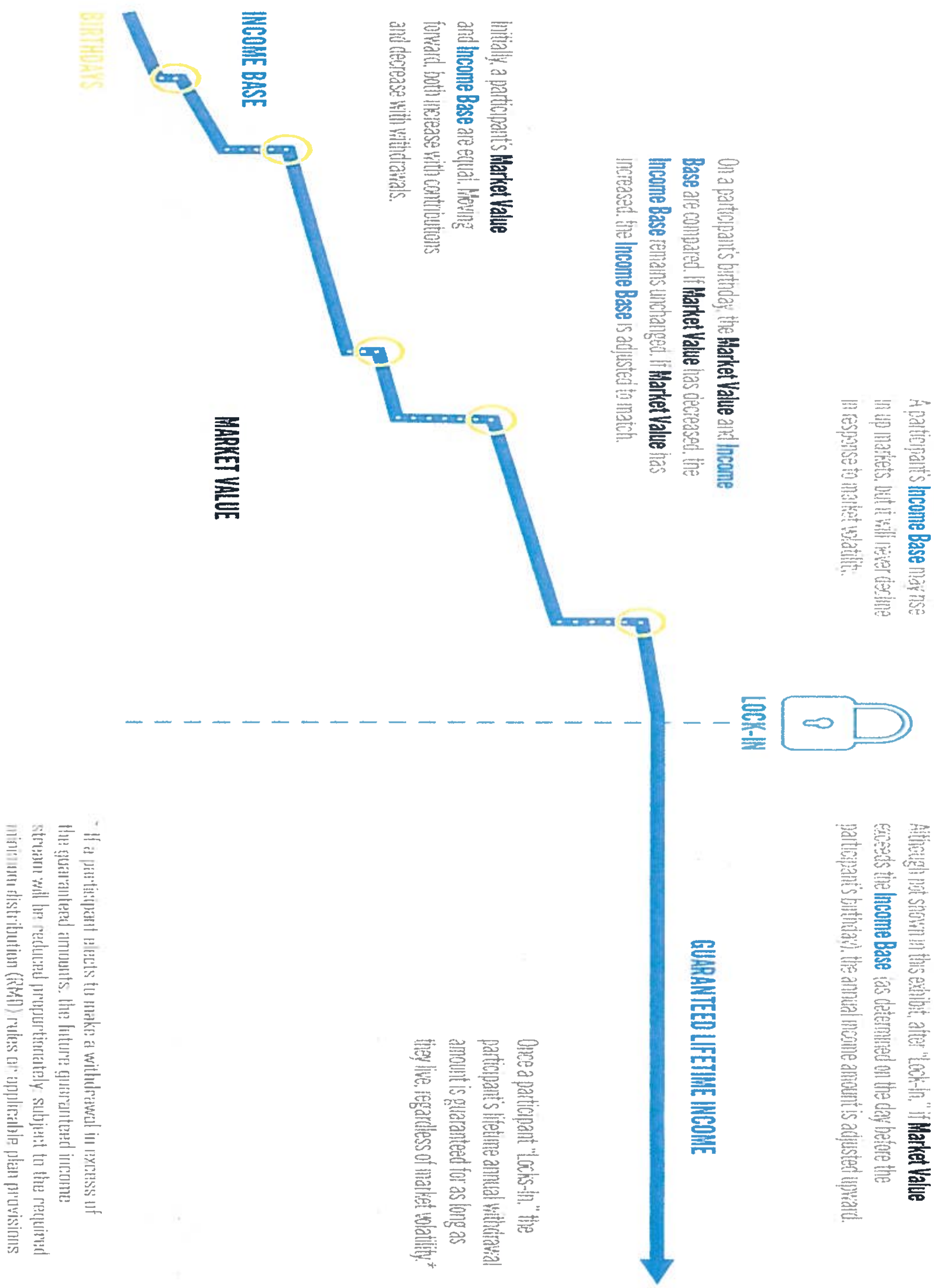
We appreciate the Council's review of these important issues and look forward to working with the Council and the Department in addressing the changes necessary to better ensure that all working Americans have access to guaranteed lifetime income solutions and an opportunity for a secure retirement.

Again, thank you for the opportunity to share our views.

[37] See Advisory Council on Employee Welfare and Pension Plans reports entitled *Examining Income Replacement During Retirement Years in a Defined Contribution Plan System* (December 2012)

Appendix A

GLWB Product Illustration



Appendix B

§ 2550.404a-4 Selection of insurers to provide guaranteed retirement income — safe harbor for individual account plans.

(a) *Scope.* (1) This section establishes a safe harbor for satisfying the fiduciary duties under section 404(a)(1)(B) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1104-1114, in connection with the selection of an insurer for a guaranteed retirement income contract within the meaning of paragraph (g)(2). For guidance concerning the selection of an annuity provider for defined benefit plans see 29 CFR 2509.95-1.

(2) This section sets forth an optional means by which a plan fiduciary will be considered to satisfy the responsibilities set forth in section 404(a)(1)(B) of ERISA with respect to the selection of insurers providing guaranteed retirement income contracts. This section does not establish minimum requirements or the exclusive means for satisfying these responsibilities.

(b) *Safe harbor.* A fiduciary will be deemed to satisfy the requirements of section 404(a)(1)(B) of ERISA with respect to the selection of an insurer and a guaranteed retirement income contract if the fiduciary:

(1) Engages in an objective, thorough and analytical search for the purpose of identifying insurers from which to purchase such contracts;

(2) With respect to each insurer identified under paragraph (b)(1) of this section –

(i) Considers the financial capability of such insurer to satisfy its obligations under the guaranteed retirement income contract; and

(ii) Considers the cost (including fees and commissions) of the guaranteed retirement income contract offered by the insurer in relation to the benefits and product features of the contract and administrative services to be provided under such contract; and

(3) On the basis of the foregoing, concludes that:

(i) At the time of the selection, the insurer is financially capable of satisfying its obligations under the guaranteed retirement income contract; and

(ii) The relative cost (including fees and commissions) of the selected guaranteed retirement income contract as described in paragraph (b)(2)(ii) is reasonable.

(c) *Financial capability of the insurer.* For purposes of this section, a fiduciary will be deemed to satisfy the requirements of paragraph (b)(2)(i) and (b)(3)(i) of this section if –

(1) The fiduciary obtains written representations from the insurer that:

(i) The insurer is licensed to offer guaranteed retirement income contracts;

(ii) The insurer, at the time of selection and for each of the immediately preceding seven years:

(A) Operates under a certificate of authority from the insurance commissioner of its domiciliary State which has not been revoked or suspended;

(B) Has filed audited financial statements in accordance with the laws of its domiciliary State under applicable statutory accounting principles;

(C) Maintains (and has maintained) reserves that satisfies all the statutory requirements of all States where the insurer does business;

(D) Is not operating under an order of supervision, rehabilitation, or liquidation; and

(iii) The insurer undergoes, at least every 5 years, a financial examination (within the meaning of the law of its domiciliary State) by the insurance commissioner of the domiciliary State (or representative, designee, or other party approved by such commissioner); and

(iv) The insurer will notify the fiduciary of any change in circumstances occurring after the provision of the representations in paragraph (c)(1)(i) through (iii) which would preclude the insurer from making such representations at the time of issuance of the guaranteed retirement income contract; and

(2) After receiving such representations and as of the time of selection, the fiduciary has not received any notice described in paragraph (c)(1)(iv) of this section and is in possession of no other information which would cause the fiduciary to question the representations provided.

(d) *No Requirement to Select Lowest Cost.* Nothing in this section shall be construed to require a fiduciary to select the lowest cost contract. A fiduciary may consider the value, including features and benefits of the contract and attributes of the insurer (including, without limitation, the insurer's financial strength) in conjunction with the cost of the contract.

(e) *Time of selection.* (1) For purposes of paragraph (b) of this section, the "time of selection" may be either:

(i) The time that the insurer and contract are selected for distribution of benefits to a specific participant or beneficiary; or

(ii) If the fiduciary periodically reviews the continuing appropriateness of the conclusion described in paragraph (b)(3) of this section with respect to a selected insurer, taking into account the considerations described in such paragraph, the time that the insurer and the contract are selected to provide benefits at future dates to participants or beneficiaries under the plan. Nothing in the preceding sentence shall be construed to require the fiduciary to review the appropriateness of a selection after the purchase of a contract for a participant or beneficiary.

(2) For purposes of paragraph (e)(1)(ii) of this section, a fiduciary will be deemed to have conducted a periodic review if the fiduciary obtains the written representations described in paragraph (c)(1)(i) through (iii) of this section on an annual basis, unless the fiduciary receives any notice described in paragraph (c)(1)(iv) or otherwise becomes aware of facts that would cause fiduciary to question the such representations.

(f) *Limited liability.* A fiduciary which satisfies the requirements of this section shall not be liable following the distribution of any benefit or the investment by or on behalf of a participant or beneficiary pursuant to the selected guaranteed retirement income contract for any losses that may result to the participant or beneficiary due to an insurer's inability to satisfy its financial obligations under the terms of such contract.

(g) *Definitions.*

(1) *Insurer.* The term "insurer" means an insurance company, insurance service or insurance organization, including affiliates of such companies.

(2) *Guaranteed Retirement Income Contract.* The term "guaranteed retirement income contract" means an annuity contract for a fixed term or a contract (or provision or feature thereof) which provides guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant or the joint lives of the participant and the participant's designated beneficiary as part of an individual account plan.