DrinkerBiddle&Reath LLP

Written Statement of
Fred Reish
Partner, Drinker Biddle & Reath, LLP
&
Bruce Ashton
Partner, Drinker Biddle & Reath, LLP

to the Employee ERISA Advisory Council
Lifetime Income Solutions as a Qualified Default Investment Alternative
Focus on Decumulation and Rollovers

August 15, 2018

WRITTEN STATEMENT TO THE EMPLOYEE ERISA ADVISORY COUNCIL
LIFETIME INCOME SOLUTIONS AS A QUALIFIED DEFAULT INVESTMENT ALTERNATIVE
FOCUS ON DECUMULATION AND ROLLOVERS

Thank you for the opportunity to appear before the Advisory Council. I am Fred Reish, and I am a partner in the law firm of Drinker Biddle & Reath, LLP. However, this written statement and my testimony are on behalf of my partner, Bruce Ashton, and myself as individuals.

Our law practice includes services to plan sponsors, which gives us insights into their concerns about the management and operation of their plans. However, we also provide services to insurance companies and investment managers, 401(k) recordkeepers, and other providers of services to plans and participants. Among those services are investment management and insured solutions for lifetime income for participants. As a result, the thoughts and recommendations in this statement reflect both perspectives on the same issue, that is, retirement income for participants.

While the focus of defined contribution plans has been primarily on the accumulation of retirement accounts, it is now shifting to "decumulation," that is, a stream of income after retirement—largely because of the aging of the baby boomers and their ongoing retirements. The demographic issues and participant needs have been well covered by other testimony to the Advisory Council and by industry and academic literature. There is no need to discuss that further. However, we would refer the Advisory Council to a white paper written by Bruce Ashton and myself, concerning these issues. The white paper, entitled "Lincoln Secured Retirement Income^SM Solution: Addressing Participant Retirement Income Risks," can be found at https://fulfillment.lfg.com/CF/LFG/EF/68955/DC-DBSRI-WPR001_Z06_VIEW.PDF.

We also authored a second white paper, which focuses on the fiduciary issues for selecting insurance companies to provide guaranteed retirement income for plan participants. It is entitled "Lincoln Secured Retirement Income^SM Solution: Fiduciary Process in Evaluating In-Plan Guarantees," which can be found at https://fulfillment.lfg.com/CF/LFG/EF/68954/DC-DBSRI-WPR003_Z04_VIEW.PDF. Those two white papers include numerous citations and authorities supporting the analysis and recommendations in this written statement.

The financial services industry has provided a wide range of "solutions" to fulfill the accumulation and decumulation needs of plans and participants. Those include: target date funds; managed accounts; managed payment funds; individual annuity contracts; and Guaranteed Minimum Withdrawal Benefits and Guaranteed Lifetime Withdrawal Benefits (collectively, "GWBs"). It is likely that other products and services will be developed in the future. As a result, recommendations by the Advisory Council should not prefer any product or service over another, nor should it be limited to current solutions; instead the recommendations should be neutral as to products and services and should allow freedom for new solutions to be developed.

With an appropriate foundation to enable the use and development of a wide range of products and services (including those not yet imagined) for the accumulation and decumulation of retirement income, the winners and losers will be determined by the needs and preferences of plan sponsors and participants, which is where the decision should rest.

Also, and as a general observation, we are in the early innings of the defined contribution/401(k)/403(b) “game.” While there have been significant developments on the accumulation side of the ledger, it is fair to say that the developments were largely “learn-on-the-job” propositions. There was little history to help with the development of concepts, products and services for the accumulation of adequate retirement benefits in participant-directed defined contribution plans. However, along the way, there have been improvements in the opportunities and outcomes for participants, for example, target date funds, managed accounts, automatic enrollment and automatic deferral increases.

On the other hand, there is little in the way of experience on the decumulation side. A few providers—particularly those who have a significant presence in the 403(b) space—do have experience, and we suggest that the Advisory Council make an effort to obtain the benefit of their perspective. More recently, some insurance companies have provided products that are focused on 401(k) plans and the unique attributes of participant-directed plans. For example, products for guaranteed withdrawal benefits, or GMBs, in combination with target date funds, have been offered by a number of insurance companies. However, there is little beyond those experiences to inform the Advisory Council or the Department of Labor on the solutions or, for that matter, of all of the problems. For example, we cannot turn to our parents and grandparents and ask about their experience in managing their defined contribution or IRA rollover money during their 20 or 30 years of retirement.

As a general comment—and one which is obvious, but needs to be said—the benefit of providing retirement income through defined contribution plans is that the purchasing power of the plans is greater than the purchasing power of most participants. As a result, where benefits are purchased through retirement plans, the pricing tends to be much lower than whether those same benefits are purchased at retail, that is, in IRAs. As a result, the Advisory Council and the Department need to avoid the trap of forfeiting the good in search of the perfect. There is no perfect solution to the fiduciary concerns or to the options for participants. The best that can be done is to empower plans to provide good solutions to complex issues.

Because of those reasons, and others, we recommend that the Advisory Council focus on enabling a wide range of solutions and on creating flexibility for future developments. If allowed, the creative genius of the marketplace will provide solutions.

Executive Summary

With that background, here is a brief summary of our recommendations:

- **Change the Conversation.** Participant-directed defined contribution plans are, by and large, currently viewed as creators of wealth. For example, the plan document most widely read by participants is the quarterly statement, which shows a lump sum balance in the participant's account and the investments held by the participant—in other words, the participant's retirement "wealth." And, 401(k) plans are commonly referred to as 401(k) savings plans. The labels, and the conversation, need to be re-directed to 401(k) retirement income plans. That includes both a change in terminology and a change in presentation. We give specific examples later in this statement.
- **Addressing the Fiduciary Fear.** In our experience, the greatest impediment to the continuing inclusion of retired participants in defined contribution plans, and to the introduction of new products and services into those plans, is the fear that plan sponsors have of being sued for a fiduciary breach. That fear includes: possible increased damages where retirees continue to have money in a plan; claims of fiduciary breaches where a plan sponsor changes to another recordkeeper, resulting in a loss of guaranteed benefits; and litigation about annuities provided by insurance companies if their financial condition weakens. As a result, plan sponsors prefer safe harbors where compliance is objective and obvious. We provide specific recommendations later in this statement.

Change in the Conversation

In our experience, most participants view their 401(k) plan in terms of the account balances and their investments. Unfortunately, that easily leads to participant decisions to take lump sum distributions (and roll over to IRAs) without giving thought to the impact of the decision on lifetime income. In addition, participants generally have little or no concept of the monthly income value of an account balance, either in terms of payments in the short term (if the participant is close to retirement) or payments in the long term (if the participant is younger). (After all, the determination of the sustainable lifetime income from a plan involves actuarial calculations and assumptions about future investment earnings, life expectancy, inflation, and so on. Very few participants have the training to be able to perform those calculations or, perhaps, to even think in terms of present value/future value concepts.)

By and large, little has been done to provide the education and information necessary to change the "wealth" perspective and to enable participants to understand the retirement income equivalency of their account balances.

As a result, we suggest that the Advisory Council recommend that the Department of Labor begin actively discussing and presenting defined contribution plans as generators of retirement income. That is, the first step is to change the conversation, which will, in due course, impact the thinking of plan sponsors and participants. Also, where possible, the Department of Labor should encourage plan sponsors and participants, as well as the media, to view and consider defined contribution plans as vehicles for generating retirement income.

Our second suggestion is that the Department of Labor mandate the projection of retirement income on account statements. Based on our review of the responses to the Department's Request for Information of several years ago, plan sponsors generally requested a safe harbor approach, which is to say that they preferred that government-approved assumptions be provided. On the other hand, service providers by and large suggested that reasonable assumptions be used. While we understand the plan sponsor desire for certainty and for a fiduciary safe harbor, we believe that the better approach is the one preferred by most providers. The future is uncertain and a rigid, prescriptive approach would likely become problematic over time.

While there may be some resistance to providing projections due to the cost or due to the alternative of website calculators, those objections are not well-founded. Regarding the cost, most 401(k) providers already have the ability to perform the calculations and provide the projections. In any event, this would be an area where providers would need to compete in order to maintain their standing in the marketplace. The intense competition for providing recordkeeping services to retirement plans has proven to be effective in holding down costs. With regard to the availability of calculators, the experience of recordkeepers has been that participants seldom use tools that are available on their websites. As a result, in order for retirement income projections to provide widespread benefits, they need to be pushed out to participants through email or paper, rather than simply being made available on websites.

The desire of plan sponsors for certainty could be satisfied by explicitly permitting the use of competent service providers to make the determination of the reasonableness of the assumptions. For example, if a plan sponsor engaged its recordkeeper to provide those projections, and the plan sponsor had no reason to doubt the competency of the recordkeeper, that should (with one caveat) satisfy the prudence requirement for the plan sponsor. Our one caveat is that the recordkeeper should agree to perform those services at a prudent level (but without necessarily becoming a fiduciary for that purpose) and should not have any exculpatory or limiting provisions on its liability for the failure to perform the services at that level of care. We suggest that the Advisory Council recommend to the Department that it issue guidance to that effect.

A concern about retirement income projections is that they may be inaccurate and may, therefore, mislead participants. In fact, the projections will almost inevitably be incorrect. However, if the assumptions and projections will be reasonable, any such issues will be remedied by the fact that the projections are provided at least annually. As a result, as participants age, and approach their retirement dates, the projections will be increasingly more accurate. Also, the risk could be mitigated by explanations on quarterly statements and by retirement income education for participants.

We suggest that the Advisory Council consider recommending that the Department encourage plan sponsors and providers to offer "gap analysis." If retirement income projections are mandated, service providers would be willing to provide participants with retirement income benchmarks and with suggestions for increasing deferrals, where needed, to close the gap between the benchmark and the participant's current status. However, it would be helpful if the Department clarified that the analysis and recommendations, if done reasonably, would be treated as education and would not pose fiduciary liability issues for plan sponsors or providers.

We understand that there is disagreement about whether retirement income projections should reflect only current account balances or whether they should take into account a continuation of participant deferrals and employer contributions. That should not be a problem. Both projections could be provided to participants and the participants could decide which offered the most valuable information. The only requirement should be that the assumptions are reasonable. Participants should be informed that the projections are intended to be helpful information, but should not view the results of the projections as being guaranteed.

Our third suggestion relates to plan design. Currently, most 401(k) plan documents only provide for lump sum distributions and required minimum distributions. They do not permit periodic distributions from a retirement income product held in a participant's account. This presents a significant barrier to the inclusion of retirement income solutions in most plans. While the design of a plan is a settlor function, fiduciaries are generally required to follow the terms of the plan. Accordingly, we suggest that the Department provide education to plan sponsors and providers to encourage a wide range of distribution flexibility in plan documents in order to facilitate the offering of retirement income solutions by the plan.

We also suggest that the Advisory Council recommend to the Department that it offer guidance—perhaps "soft" guidance—concerning education and information that can be provided to participants about retirement income, retirement needs, investments, products and services, and so on. There are a number of practical, and some perceived legal, barriers to new ideas in the retirement plan world. Some of those are based on an overblown fear of fiduciary liability. However, even though that fear may not be realistic, it is "real" to many plan sponsors. As a result, the retirement plan space can be very slow to embrace new concepts. It is more helpful than might be imagined if the Department provides rational discussion and information on issues. A good example is Interpretive Bulletin 96-1 and its impact on investment and plan education for participants. Similar guidance that focused on retirement and retirement income issues—and the plan design issue mentioned earlier—would be helpful.

Addressing the Fiduciary Fear

To solve the retirement income "problem," plan sponsors and fiduciaries need to embrace new concepts, products and services. Unfortunately, the initial reaction to new and different ideas is often based on an inordinate fear of fiduciary liability. It is perceived to be less risky to continue doing things the "old way," as opposed to making change. Because of that, there is a need for clear and definitive regulatory and/or legislative relief. In some cases, a regulator can provide "soft" guidance, such as information letters or FAQs, but in others, there needs to be change by regulation or legislation.

- **Selection of Insurance Companies.** DOL Regulation §2550.404a-4 provides a "safe harbor" for the selection of annuity providers for defined contribution plans. However, the private sector does not perceive that guidance as a safe harbor. Instead, it is a demanding description of a fiduciary process that is virtually impossible for any small- or mid-sized plan sponsor to satisfy—and is challenging for even the largest plan sponsors. The compliance problems are graphically illustrated in a white paper that we prepared entitled "Lincoln Secured Retirement Income[SM] Solution: Fiduciary Process in Evaluating In-Plan Guarantees." (https://fulfillment.lfg.com/CF/LFG/EF/68954/DC-DBSRI-WPR003_Z04_VIEW.PDF).

The obvious problem is that most plan sponsors (and particularly small- and mid-sized sponsors) are incapable of performing the analysis required by the regulation. And, unfortunately, there are a limited number of consultants who can provide this service to plans. That is particularly true for small- and mid-sized plans where the fees of most insurance consultants would be beyond their means. It is different than advice on securities investments, such as mutual funds, where the marketplace has an abundance of advisors to retirement plans. And, it creates a hurdle that is impossible for many plan sponsors to clear. As a result, thoughtful and innovative solutions are needed or, alternatively, a clear-cut checklist of objective criteria that can obviously be satisfied, with no remaining compliance issues, should be provided to plan sponsors as a safe harbor.

In the past, the Department has been able to provide guidance of that type. For example, see the regulation under ERISA §404(c). (DOL Regulation §2550.404c-1.) In that regard, the written testimony by Marc Pester of Prudential Retirement had a good discussion of the issues and possible solutions. See his written testimony beginning on page 9 (under the title "Assessing and Insurer's Long-Term Financial Liability"). Also see Appendix B of his written testimony, which provides sample language for an amendment to the safe harbor regulation.

We are concerned, though, about a safe harbor that has, as its foundational basis, a certificate of authority from the insurance commissioner of its domiciliary state. Unfortunately, the quality of State regulation and oversight varies. As a result, it is possible that an insurer could be domiciled in a state that does not have robust requirements and supervision of its insurance companies. That deficiency be offset in a number of ways. For example, we list a number of factors in our white paper on evaluating in-plan guarantees. (See Appendix A, beginning on page 12.)

Some specific examples are: an insurance company should have a history of providing annuity benefits of at least 10 years; there should be an absence of negative ratings of financial stability by any of the rating agencies; and annuities should be a core part of the insurance company's business. While Dodd-Frank prohibits the use of rating agencies standards for insurance companies as a requirement for compliance with a regulation, this proposal is somewhat different. It is an avoidance of any negative ratings.

However, if a safe harbor is created via legislation, information provided by rating agencies could be used (since, in effect, it would constitute an amendment to the Dodd-Frank provision). In that case, one of the standards could be that the insurance company be rated by at least one of the major agencies as being financially strong and that none of the rating agencies have a financial strength rating below their designation of good financial health.

In both cases (that is, the regulatory and the legislative alternatives), the ratings should be viewed for both the most recent completed year and for the preceding five or 10 years. In other words, the safe harbor should require that the financial strength be maintained for over a full economic cycle.

To meet the needs of plan sponsors, the criteria would need to be objective. Plan sponsors should be able to rely on information provided by the insurers (unless the plan sponsors independently have knowledge of factors that conflict with the information provided by the insurers).

As an alternative to the selection of insurance companies by plan sponsors, the Advisory Council should consider a process for using third-party consultants. For example, the Department could issue guidance similar to the SunAmerica Advisory Opinion (2001-09A), where an independent third party fiduciary can provide advice to plan sponsors about the financial stability of the insurance company. (While the SunAmerica Opinion covered advice to participants, our proposal is for advice to plan sponsors.) Or, alternatively, several insurance companies could engage a third party consultant, or panel of consultants, to evaluate and report on the financial stability of the insurance company (or insurance companies). So long as the consultant (or panel of consultants) is independent, and has the required expertise and experience, its status as an acknowledged fiduciary for this purpose should be adequate protection for plan sponsors and, therefore, allow for reliance by plan sponsors. A third possibility would be to adopt legislation or regulations that describe a process for advising plan sponsors that is similar to the exemption in ERISA Section 408(b)(14) and 408(g), as explained in Regulation Section 2550.408g-1 and other Departmental guidance. That is, the provision might provide for a modified level fee approach or a computer model advice approach similar to those set out in the participant advice exemption. Obviously, this would be particularly helpful to small- and mid-sized plan sponsors who cannot afford the consulting fees paid by very large plans.

As another alternative, the Advisory Council should consider recommending a retirement income platform exception that is similar to the exception from the designated investment alternative rule for brokerage accounts. Under this alternative, a retirement plan provider could offer a platform of retirement income services, investments and annuities. If adopted by a plan sponsor, it would be part of the plan and generally available to participants. The platform would include a range of retirement income vehicles, such as individual annuities, GMBs, managed accounts, managed payout funds, and so on. If there is a wide range of alternatives offered by the platform provider, the plan sponsor should not be viewed as selecting the individual designated retirement income options (that is, they would not be considered to be designated investment alternatives). Instead, plan sponsors would be selecting the platform (similar to a brokerage account in participant-directed plans). In other words, a plan sponsor would be a fiduciary for determining whether the provider of the platform is capable, whether the services and costs of the platform are reasonable, whether the platform services are implemented properly, and so on. However, the plan sponsor would not be a fiduciary for the retirement income options on the platform.

Under this alternative, the platform provider could offer a fiduciary consultant similar to the 3(21) platform investment advisers and 3(38) platform investment managers that are offered by 401(k) recordkeepers. The fiduciary consultant would be independent of the platform provider and would help participants make decisions about the options on the platform. In that regard, the role of the platform fiduciary consultant would be analogous to the role of the independent fiduciary advisor in the SunAmerica Advisory Opinion.

The Department should clarify through guidance that the selection of a fiduciary consultant (on a platform or for individual plans) is similar to the selection of a 3(21) or 3(38) fiduciary. Plan sponsors should be entitled, in appropriate cases, to protection that is analogous to the 3(38) safe harbor. However, insurance consultants are not one of the categories of advisors that qualify for 3(38) protection. The guidance could be similar to what the Department has done for selecting 3(21) advisors, where the selection and monitoring process of the advisor (but not the recommendations) was prudent. See Field Assistance Bulletin 2007-01.

<u>Guaranteed Retirement Income Portability</u>

Another concern of plan sponsors is that, with the passage of time, they may need to change providers to obtain additional services or benefits for their participants. The worry is that, if the guaranteed benefits cannot be carried over to the successor recordkeeper, the plan sponsor fiduciaries will have breached their duties of prudence and loyalty and will be potentially liable for claims by participants. In that regard, we have two recommendations. The first is that the Department clarify that it is not a breach of fiduciary duty to change providers, even if it results in a loss of benefits for some participants, where the fiduciaries determine that it is in the best interest of the participants as a whole that the change be made. In other words, the guidance could clarify that fiduciaries need to consider the needs and circumstances affecting the participant population at large and those factors can outweigh detriments to some participants. The Department should, at least, clarify that the concept is valid.

We also recommend that the Advisory Council and the Department support legislation pending in Congress concerning the ability to distribute guaranteed lifetime income benefits where there is a change in recordkeepers, even if there is not a traditional distributable event. That would protect participants from the loss of guaranteed benefits in the event of a change of providers. The rationale and the support for the legislation has been explained and supported in several of the written statements filed with the Advisory Council. For example, see the Written Testimony of Mark Pester of Prudential Retirement (page 12).

The QDIA Issue

We are aware of testimony requesting guidance clarifying that the inclusion of retirement income guarantees in a plan's QDIA is permissible. In our view, this issue has already been resolved. As discussed in our white paper, "Lincoln Secured Retirement Income^{SM} Solution: Fiduciary Process in Evaluating In-Plan Guarantees", cited earlier, there is guidance issued by the Department indicating that QDIAs may include annuity features (*see* the discussion at page 10 of the white paper). Nevertheless, it appears that there is still confusion on this issue. Therefore, we suggest that the Advisory Council encourage the Department to issue a further clarification to give comfort to plan sponsors and advisors.

Thank you for the opportunity to present this testimony.

Fred Reish
Partner
fred.reish@dbr.com
(310) 203-4047

Bruce Ashton
Partner
bruce.ashton@dbr.com
(310) 203-4048

Drinker Biddle & Reath, LLP
1800 Century Park, Suite 1500, Los Angeles, CA 90067
www.drinkerbiddle.com