The SPARK Institute, Inc.
Shaping America's Retirement

Written Statement of Tim Rouse
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For the ERISA Advisory Council
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My name is Tim Rouse, and I am the Executive Director of the SPARK Institute. Thank you for inviting me to testify today before the ERISA Advisory Council on the issues associated with recordkeeping lifetime income products. I am grateful for this opportunity to provide the Council with SPARK's perspective on some of the challenges recordkeepers face with respect to lifetime income solutions, and look forward to our discussion today.

SPARK represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third-party administrators, trade clearing firms, and benefits consultants. Collectively, our members serve approximately 95 million employer-sponsored plan participants. SPARK and its member firms recognize and applaud all efforts to improve the payout phase for Americans in retirement.

I. SPARK's Longstanding Support of Lifetime Income Improvements

I was invited to speak to the Council about the potential issues recordkeepers face when administering various types of lifetime income solutions and to highlight areas where recordkeepers see a need for additional guidance and clarity from the Department of Labor (DOL).[1] Before addressing those issues, however, I want to emphasize that SPARK has long supported efforts to make it easier for employer-sponsored retirement plans to offer lifetime income solutions and for participants to use them when appropriate for their needs.

In fact, SPARK's legislative and regulatory agenda includes **encouraging innovative ways to generate income in retirement.** To that end:

- **Fiduciary safe harbor**. SPARK supports the establishment of an improved fiduciary safe harbor for the selection of annuities in defined contribution plans, either through action by DOL or through the enactment of the Retirement Enhancement and Savings Act of 2018 (RESA).

[1] The Council is undoubtedly aware of the current limitations of the annuity provider selection safe harbor, as well as concerns regarding lifetime income solutions that have been raised by plan sponsors, the Government Accountability Office, and in a recent Treasury Department report. *See* Report GAO 16-433, 401(k) Plans: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants (2016); U.S. Dep't of Treasury, A Financial System That Creates Economic Opportunities: Asset Management and Insurance (2017). I will thus limit my testimony today to the concerns of recordkeepers.

- **Portability**. SPARK supports legislative efforts to address the problem of portability of lifetime income solutions. As noted below, RESA includes a provision that SPARK supports that would be very helpful in this regard, and we encourage the Council and DOL to do what it can to address the issues described below through guidance.
- **Data Layouts**. In 2011, SPARK spearheaded efforts to promote portability of lifetime income options through standardization, culminating in the publication of guidelines for standardized lifetime income solution data layouts. We would be happy to revisit these efforts in conjunction with DOL and our members.

Ultimately, SPARK aims to increase the number of options available to plan participants when they are planning for retirement, including options for lifetime income. Accordingly, although my testimony explains the various challenges associated with recordkeeping lifetime income solutions, these challenges are far from insurmountable and should not serve to discourage recommendations to facilitate and promote participant access to lifetime income solutions.

I also note that SPARK represents the interests of numerous providers in the retirement industry, each with a unique perspective on the best strategies for guaranteeing that retirees do not outlive their retirement savings. The Council heard from SPARK members in June, and a number will testify today. Some believe that default options should include some insurance guarantee, like a deferred annuity, guaranteed withdrawal option, or longevity annuity, and highlight the advantages of these approaches. Other SPARK members believe that lifetime income solutions are best approached through customized investment advice tailored to the participant's needs and that traditional target date funds continue to be the best practice for the plan's default investment. In light of the diversity of SPARK's membership, I am not here to favor any particular approach to lifetime income solutions. In fact, we use the phrase "lifetime income solutions" to be as agnostic as possible on the approach. Rather, the goal of the rest of my statement, per your request, is to describe our members' recordkeeping challenges to better inform whatever recommendations the Council makes to DOL regarding expanding the use of lifetime income solutions.

There are obvious benefits to offering lifetime income solutions within an employer-sponsored plan. As retirees' longevity continues to increase and the risks of outliving assets are increasingly recognized, lifetime income solutions are instrumental in helping savers plan for a financially secure retirement by generating steady streams of income.

II. Summary of Current Challenges

By their very nature, the design of many of these products varies from the design of investment vehicles traditionally offered in defined contribution retirement plans, such as mutual funds or other market-sensitive funds. Moreover, significant variations exist across the spectrum of products offered as lifetime income solutions.[2] These differences in product design may

[2] I categorize lifetime income solutions as one of three types of products: (1) annuities with an insurance guarantee; (2) purely investment solutions; and (3) hybrid products that wrap an investment portfolio with a

create several challenges with which recordkeepers may have to grapple when lifetime income solutions are offered in employer-sponsored retirement plans, including:

(1) **Less portability of lifetime income solutions.** Differences in recordkeeping platforms and product design may pose hurdles for recordkeepers that acquire new plans containing lifetime income solutions or whose plans receive in-kind rollovers or transfers of lifetime income solutions.

(2) **Uncertainty when communicating with participants.** Because of features of lifetime income solution product design and a lack of uniformity across recordkeeping platforms, recordkeepers may face uncertainty when communicating with plan participants about their accounts or future retirement benefits.

(3) **Added costs.** Offering lifetime income solutions may increase the cost of administering employer-sponsored plans, which can be passed onto plan participants.

(4) **Complexities because of regulatory requirements.** Lifetime income solutions can create complications under qualified joint and survivor annuity (QJSA) and Roth account regulations, as noted below.

I will discuss each of these issues in greater detail below.

III. Survey Data on Lifetime Income Solutions

Before describing the challenges inherent in recordkeeping of lifetime income solutions, I would like to first relay some recently collected data on the subject.[3] In the second fiscal quarter of 2018, SPARK partnered with Cerulli Associates to survey defined contribution recordkeepers on various topics. Overall, 26 recordkeepers representing $5.9 trillion in defined contribution plan assets, over 443,000 plans, and nearly 80 million participants participated in the survey. The recordkeepers surveyed include nine of the top 10 defined contribution plan recordkeepers.[4] In other words, the survey sample is highly representative of the recordkeeping industry nationwide.

Of the recordkeepers surveyed, **64 percent** indicate that they offer an in-plan lifetime income solution option on their recordkeeping platform.[5] (To be clear, this number refers to the percentage of respondents that offer a lifetime income solution option on their platform, not the percentage of plans that have implemented it as a plan option.) Of that 64 percent of

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longevity policy. My comments today predominantly deal with the complexities associated with recordkeeping the first category of products, annuities with insurance guarantees, but I will also touch on the challenges associated with recordkeeping lifetime income solutions generally.

[3] *See* Appendix A, Cerulli DC Recordkeeper Survey Results 2018.

[4] Recordkeeper size is measured according to recordkept assets as of the end of 2017.

[5] *See* attached Exhibit 17, Cerulli DC Recordkeeper Survey Results 2018.

recordkeepers, nearly **70 percent** offer annuity options.[6] Of the recordkeepers offering annuity products on their platforms, nearly **two-thirds** offer variable annuities with guaranteed minimum withdrawal benefits,[7] a daily-valued vehicle that allows participants to retain control over the underlying assets. And among recordkeepers surveyed that do *not* currently offer in-plan lifetime income solutions, **over half** indicated that they are considering entering this market in the next 12 to 24 months; another 44 percent of responding recordkeepers indicated that they do not offer lifetime income solution options because there is "not enough demand" for them. Clearly, it is becoming increasingly popular for providers to offer lifetime income solutions. Simultaneously, the survey results underscore the need for the Council to consider the challenges facing a growing number of recordkeepers as the use of lifetime income solutions expands.

IV. Portability of Lifetime Income Solutions

SPARK members frequently cite the portability of lifetime income solutions as the most salient issue they encounter with respect to recordkeeping lifetime income solutions. Portability may be an issue for recordkeepers on both the plan level and on a participant level. On the plan level, it is common for employers that sponsor workplace retirement plans, including plans offering lifetime income solutions, to change recordkeepers over time. New recordkeepers must decide whether to recordkeep these lifetime income solutions from another provider and whether to fully integrate those products into their services. On the participant level, when participants in retirement plans offering lifetime income solutions change employers, they often decide to roll over their account to an IRA or another employer-sponsored plan.

At the outset, I point out to the Council that it might take legislative action to fully address some of the complexities recordkeepers face with respect to portability of lifetime income solutions because of the way the Internal Revenue Code is currently written. The Internal Revenue Code prohibits plans from making in-service distributions of elective deferrals to participants unless certain exceptions apply. Failure to comply with these rules gives rise to a disqualifying event for the plan. At times, however, retirement plan investment options – including those that include lifetime solutions – might change. If a participant has to liquidate a plan investment because of a change in, or a limit on, the plan's investment options, the participant may not be able to preserve that investment through a rollover. This is particularly problematic if the participant must give up the valuable lifetime income protection that is built into a lifetime income solution.

To that end, SPARK supports the enactment of RESA, which contains a provision that would allow participants to take distributions of lifetime income solution investments without regard to any of the Internal Revenue Code's restrictions if (1) the lifetime income solution is no longer authorized to be held under the plan, and (2) the distribution is made via a direct rollover to an IRA or other retirement plan or through direct distribution of the annuity contract to the participant.[8]

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6 *See* attached Exhibit 18, Cerulli DC Recordkeeper Survey Results 2018.

7 *See* attached Exhibit 19, Cerulli DC Recordkeeper Survey Results 2018.

8 S. 2526, 115th Cong. § 111 (2018); H.R. 5282, 115th Cong. § 111 (2018).

I will now turn to some of the challenges with which recordkeepers are often confronted with respect to the portability of lifetime income solutions.

Variations in system and product design. Recordkeepers for employer-sponsored retirement plans are tasked with processing and maintaining an enormous volume of data. Recordkeepers track contributions to plans, assets in individual accounts, and distributions to plan participants, as well as maintain web portals, send account statements to participants, and request transactions within participants' accounts. To perform these tasks, recordkeeping companies design sophisticated recordkeeping systems that are programmed to track data in a particular manner.

The complexity of recordkeeping is often compounded when plans switch recordkeepers, as data must be transferred to the new recordkeeper and recordkeeping systems must be updated accordingly. It is thus not surprising that when an employer-sponsored plan contains products that are intended to be lifetime income solutions, a recordkeeper's chief concern is often the ability to pick up the administration of the plan from the previous provider. When a new recordkeeper takes over the administration of a plan, the new recordkeeper is tasked with capturing and programming all of the newly acquired plan's restrictions.

Plans offering annuity products present additional challenges for recordkeepers. Annuity products are provided by specific insurance companies, and typically have features and restrictions unique to products designed by those insurance providers. For instance, an annuity might have a surrender charge, subject to certain exceptions. The new recordkeeper's system, on the other hand, might not have been designed with any infrastructure for tracking data associated with surrender charges. To avoid this sort of problem, new recordkeepers are forced to build recordkeeping systems to account for potentially recordkeeping annuity products from multiple insurance providers, each with its own particular rules and restrictions. For some types of products, like guaranteed lifetime withdrawal benefits, we have heard the industry is moving towards alignment of features; as the market develops, we hope additional standardization emerges.

Rehired plan participants. We have heard that recordkeeping annuities for rehired plan participants poses another set of issues for recordkeepers. Generally, defined contribution plans permit the distribution of benefits in either a single lump sum payment or in installments when employees terminate their employment with an employer. Many plans also provide that these payments must cease in the event that the participant is rehired. Now suppose, for instance, that a plan has such a periodic payment feature that permits distributions in the form of monthly annuity payments, but a new recordkeeper acquires the plan and does not have the recordkeeping system in place to process data on whether periodic payments are occurring. Then suppose that the plan participant is rehired. If the annuity or installment payments have begun, the new recordkeeper may have a difficult time ensuring that the payments have ceased upon rehire. While this is largely an issue of proper data exchange between the recordkeeper and the employer, we understand that some recordkeepers find rehired employees challenging when employer-sponsored plans offer annuities.

Payments pursuant to QDROs. Similar concerns may arise when a qualified domestic relations order (QDRO) has been issued that divides retirement assets held in an annuity. Generally, for fully liquid assets like mutual funds, it is not particularly difficult for a recordkeeper to split the account according to the terms of a court order. When the account holds an annuity, however, complying with the court order may prove difficult. For example, assume a participant has an annuity with an accrued cash value, various guaranteed benefit riders, and enhanced death benefits. Imagine that a court order states the account is to be split in half based on the "current account balance." Tracking the relative amount of the annuity that must be paid to the ex-spouse in the future is often already a challenge. The problem can be compounded, however, when a recordkeeper must take over the administration of a QDRO from a prior recordkeeper. As a result of the lack of uniformity in recordkeeping systems, it is often difficult to transfer data from a previous provider's system to the new recordkeeper's system.

Tracking longevity insurance. Longevity insurance poses a problem only if the participant's underlying investment portfolio is changed. In this case the new portfolio needs to be repriced and the required premium adjusted. This requires communicating with the participant, which I will address later. Similarly, pure investment solutions that include managed payout strategies, dividend income strategies, or bond ladders might change the expected payout if the underlying investments change. If, however, those investments remain the same the expected payout should also remain the same.

Consolidating assets from multiple employers. Sometimes when a plan participant changes jobs, he or she wishes to preserve the annuity or other guaranteed income solution with an in-kind transfer. This can present many of the same challenges described above, but in this case the new recordkeeper is administering a single contract unique to that individual. Some recordkeepers simply refuse to do so. Additionally, recordkeepers often find it difficult to consolidate these assets from multiple employers.

Loans. New recordkeepers will need to know how to account for accrued balances in an annuity as it relates to available balances for loans. Oftentimes recordkeepers automate loan processing online, so these rules will need to be built into all calculators.

Lack of standardized data format. To facilitate the portability of data related to lifetime income solutions across recordkeepers, SPARK has in the past recommended a standardized recordkeeping data format for lifetime income solutions.[9] While we believe our format has been a helpful tool to the industry, lifetime income solutions continue evolving as innovative new product features are created. As a result, despite the publication of SPARK's 2011 guidelines, portability of lifetime income solutions remains an ongoing challenge for recordkeepers. However, standardization in design could help achieve better outcomes for providers and plan participants. As a result, DOL could perhaps consider developing and periodically updating flexible guidance on standardization of recordkeeping data formats in order to encourage more

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[9] *See* THE SPARK INST., DATA LAYOUTS FOR RETIREMENT INCOME SOLUTIONS (2011), http://www.sparkinstitute.org/content-files/File/SI%20Lifetime%20Inc%20Best%20Pract%20v1%2001%2010-20-11%20FINAL.pdf.

harmonization and increase portability across recordkeeping platforms. SPARK would be happy to collaborate with DOL if necessary to develop such guidance.

V. Communications with Participants

Recordkeepers may face uncertainty when communicating with plan participants regarding features of lifetime income solutions, particularly annuities, because of the nature of products with lifetime income guarantees. As with portability of lifetime income solutions across recordkeeping platforms, these problems can be compounded by variations in product and system design.[10]

Communicating the basic features. An account balance is very easy to communicate to participants. Participants see their account balance whenever they log into their accounts and four times a year on their quarterly account statements. The "value" of a lifetime income solution can be much harder to communicate, especially on an automated basis. We should note, however, that SPARK's members that routinely offer annuities, such as those that are active in the 403(b) market, tell us that they are able to navigate this challenge without difficulty because of their longstanding familiarity with their products and their features.

Future income projections. It is now common for recordkeepers to offer a service whereby a participant is informed of the future income that their retirement savings will generate, because it helps participants to assess their readiness for retirement and adjust their retirement savings strategies over time. Some recordkeepers may face challenges when providing plan participants with projections of their future retirement income, particularly when their individual accounts contain a mix of fixed annuities and market-sensitive funds.

It is relatively straightforward to project the future account balance of a traditional retirement investment fund (e.g., a mutual fund). Recordkeepers will estimate a participant's future account balance based on assumptions on account earnings, inflation, and future contributions to participants' accounts over time. Then the recordkeeper can provide participants with their projected account balance at retirement.

On the other hand, it may be far more difficult for some recordkeepers to project future income from a retirement account where annuities are also involved, because supplying participants with a projected future account balance may not fully capture how benefits will be paid out during annuitization. To estimate a participant's future income during the annuity payout phase, a recordkeeper may also have to make assumptions about the income stream that will flow from an annuity. These assumptions include the frequency of future payouts, the participant's longevity, and whether the income must last over the life of a single annuitant or the lives of joint annuitants. Again, this is primarily a challenge when the product is not one that the recordkeeper or an affiliate designed or otherwise accommodated.

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[10] One SPARK member, on the other hand, indicated that the communication challenges noted here will lessen over time as lifetime income solutions become more standardized and participants become more familiar with them.

QDROs. Plan sponsors and recordkeepers taking over the recordkeeping of annuity contracts may struggle when communicating with plan participants about how vesting and forfeitures of benefits will be determined under a QDRO. For example, recordkeepers might not know whether there will be surrender charges from the insurance company when there is a QDRO in effect. This creates uncertainty when plan sponsors must communicate to participants about their benefits under the QDRO.

VI. Added Costs

The added costs associated with recordkeeping lifetime income products are borne across plans and passed onto plan participants. These costs are attributable to several factors. For instance, when lifetime income products are added to employer-sponsored plans, a recordkeeper's call center may, depending on the permitted scope of such services, have to comply with appropriate state licensing requirements in order for call center workers to discuss annuities with its participant-callers. Additionally, because of variations in how files are formatted within recordkeeping systems, it is often expensive to integrate daily file transmissions from multiple insurance providers into a recordkeeping system.[11] As a result, recordkeepers will need to invest in building new systems or manually input data, increasing the plan's administrative costs. We originally put together our Lifetime Income Data Standards to help provide some uniformity in this regard, and while we believe it has been helpful to the industry, we have been told that lack of uniformity both in design and data continues to be a challenge.

If this issue is left unaddressed, some recordkeepers might be encouraged to affiliate with only a few specific insurance providers to contain these potential additional costs. Such efforts to mitigate costs would diminish the benefits associated with open investment architecture, ultimately reducing plan participants' investment choices and chilling competition among providers in the retirement industry. As a result, we suggest that the Council consider ways to reduce these added costs when developing its recommendations for DOL, including by encouraging standardization of data.

V. Regulatory Challenges

Let me close by mentioning a few recordkeeping challenges that stem from regulatory requirements. These challenges are created by Treasury regulations implementing the Internal Revenue Code; the IRS would need to amend the regulations to fully resolve these issues. Although I recognize that these challenges are not within DOL's jurisdiction to address, it is important to understand the impact they have on recordkeepers.

QJSA rules. When a 401(k) plan offers an annuity distribution option, the plan must comply with the QJSA requirements. This entails two broad rules. First, the plan must offer an annuity payout that includes a survivor annuity of at least 50 percent. For some annuity designs, this is straightforward, but for others, like longevity insurance or withdrawal guarantees, it is not

[11] We note that some of these costs may be borne by the recordkeeper as part of its overall systems design enhancements, ultimately to be utilized by multiple plan clients.

straightforward. Second, the plan must obtain notarized spousal consent for a married participant. This process is very manual, hard to automate, and expensive. This challenge likely requires legislative changes to address completely, but DOL should consider if there are other ways to address it. One possible solution is for DOL to encourage the IRS to address this problem.[12]

Designated Roth accounts. Increasingly, 401(k) plans now offer a Roth savings option. Under this savings option, contributions are made on a post-tax basis but then distributions, subject to certain requirements, are tax-free. The Internal Revenue Service (IRS), however, has taken the position that Roth contributions and traditional pre-tax contributions cannot be held and accounted for under the same annuity.[13] The IRS's apparent concern is that this could have the effect of transferring value from one account to the other, which could be used for tax evasion. The IRS promised further guidance on this issue in 2007, but has yet to issue any further guidance. In any event, this means that when an annuity is offered under a 401(k) plan that offers designated Roth accounts, additional recordkeeping is required to ensure that the "separate accounting" rule for Roth features is not violated. We recommend that DOL encourage the IRS to provide guidance on this subject.

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The challenges noted above are, of course, not insurmountable. Improved solutions for portability, which likely require help from Washington and ongoing efforts by industry participants, would be very helpful. To conclude my remarks, I reiterate SPARK's support for expanding access to lifetime income solutions for retirement savers, and urge the Council to consider the challenges facing recordkeepers while studying this subject and crafting its recommendations to DOL. Addressing these concerns will reduce barriers to offering lifetime income solutions in plans, putting a more secure retirement within reach of millions of defined contribution plan participants. I appreciate the Council's thoughtful review of these issues, and I look forward to my discussion with the Council today.

[12] The IRS has issued one revenue ruling (Rev. Rul. 2012-03) on the topic, but that ruling addressed the application of the QJSA rules to only one specific kind of annuity.

[13] 72 Fed. Reg. 21,103, 21,107 (Apr. 30, 2017).