

Re: RIN 1210-AB33

## The Schwab Position on Lifetime Income Solutions

Charles Schwab & Co. Inc., appreciates the opportunity to comment on the Department of Labor's (DOL) request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans. The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services, with more than 300 offices and 7.8 million client brokerage accounts, 1.4 million corporate retirement plan participants, 768,000 banking accounts and \$1.49 trillion in client assets<sup>1</sup>.

Retirees today and in the future face many risks. Among them is the need to create a stream of income that replaces their employer paycheck and supports their financial needs throughout retirement. Just as important, they need to protect against the danger of outliving that income stream. Financial services companies and their insurance industry partners are in a unique position to offer market based lifetime income solutions.

Poised at the edge of tremendous need and opportunity, we believe demand for such lifetime income solutions will grow at a very strong rate in the very near future.

This need is being driven by several trends:

- Uncertainty surrounding the continued strength of government sponsored pension programs.
- Continued decline in private defined benefit plans coupled with continued increase in defined contribution plans.
- Increased expenses in retirement, including health care costs and extended family care costs.
- A large wave of baby boomers approaching retirement.
- Increasing life expectancies.
- Earlier individual retirements.
- Expanding emphasis on individuals taking on increased ownership and responsibility for their retirement security.
- For most individuals, the need for the retirement nest egg to constitute a large portion of total net worth and to serve as the primary source of income in retirement.

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[1] The Charles Schwab Corporation (NYSE: SCHW) is a leading provider of financial services. Through its operating subsidiaries, the company provides a full range of securities brokerage, banking, money management and financial advisory services to individual investors and independent investment advisors.

In our view, an ideal product solution which would be unique relative to annuity product offerings currently available in the marketplace will offer these features:

- Simple in structure and easy to understand.
- Transparent and fully disclosed fees.
- Flexible and easy access to investment balance without imposition of exit fees.
- Increased control of assets.
- Offers the financial support and backing of multiple insurance companies as opposed to the status quo of a single insurance provider.
- Is portable from a 401(k) plan to an Individual Retirement Account without additional cost.

The Federal government and its agencies can take several steps to encourage the adoption of lifetime income solutions:

- Encourage a shift in the national conversation from one focused primarily on wealth accumulation to one that includes lifetime income replacement.
- Promote improved product solutions offering simplicity, transparency and flexibility.
- Ease the financial and regulatory uncertainty for the employer.
- Develop a safe harbor solution for employer sponsored retirement plans whose employees meet certain qualifications.

Individuals need to take ownership of their retirement security and create a stream of income that cannot be outlived. This need will grow due to a convergence of demographic trends and the diminished strength of traditional retirement resources. By desire or necessity, we believe consumers will begin to demand creative, innovative product solutions. Now is a pivotal opportunity for the public and private sectors to work together towards this common goal.

### **Conclusion**

Again, Schwab appreciates the opportunity to provide information and comment on the subject of lifetime income during retirement. We welcome the opportunity to work with the DOL on this important initiative. If you have any questions or would like to discuss these comments further please contact James McCool at 415-667-9603.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. McCool', with a stylized flourish at the end.

James McCool  
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Charles Schwab & Co. Inc. Responses to the Department of Labor's (DOL) request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans:

***1) From the standpoint of plan participants, what are the advantages and disadvantages for participants of receiving some or all of their benefits in the form of lifetime payments?***

True retirement security requires that an individual have a sustainable strategy for converting accumulated financial savings and resources into a guaranteed income stream that will last a lifetime, regardless of how long one lives or how financial markets perform.

Retirees must balance two competing risks that arise from uncertainty about length-of-life. If a retiree consumes wealth too quickly, he risks outliving the available resources and suffering a decline in living standards late in life. If a retiree responds to this risk by consuming too slowly, he may subject himself unnecessarily to a lower level of spending and potentially lower living standards throughout retirement.

The primary advantage of lifetime income solutions is that they are designed specifically to help eliminate the need to balance these life longevity related risks.

Potential disadvantages include purchasing unsuitable products because of the financial sophistication required to understand complex product solutions, high costs, dependency on the financial strength of one or more insurance providers, lack of control and flexibility around the investment choice and the possibility of losing savings in the event a retiree dies before receiving the full benefit of his or her investment.

There is another potential disadvantage in having a retiree potentially lock in a fixed payment stream based on current interest rate levels. Some degree of flexibility, even if limited, should be granted in order to allow a change to the income stream, as market rates change and or life circumstances require access to financial assets.

High fees and product complexity have traditionally also been further deterrents to usage.

***2) Currently the vast majority of individuals who have the option of receiving a lump sum distribution or ad hoc periodic payments from their retirement plan or IRA choose to do so and do not select a lifetime income option. What explains the low usage rate of lifetime income arrangements? Is it the result of a market failure or other factors (e.g., cost, complexity of products, adverse selection, poor decision-making by consumers, desire for flexibility to respond to unexpected financial needs, counterparty risk of seller insolvency, etc.)? Are there steps that the Agencies could or should take to overcome at least some of the concerns that keep plan participants from requesting or electing lifetime income?***

Based on feedback from our 1.4M retirement plan participant base, 863 employer sponsors of retirement plans and 3.8 million IRA and Keogh accounts we believe some of the reasons that individuals do not choose lifetime income options are summarized as follows:

- Lifetime income solutions have traditionally been expensive, complicated, and have allowed limited flexibility, control and access to funds.
- Most plan sponsors and participants have focused communication and education on savings and wealth accumulation and have largely ignored issues in the withdrawal or distribution phase.
- While many investors are knowledgeable about financial matters, some portion of the population continues to struggle with complicated financial matters. While financial literacy has improved, the majority of population struggles with complex financial instruments and related matters.
- Plan sponsors have worried about the fiduciary implications of offering such options, in particular in the event of a decline in value of the option (eg. provider insolvency).
- Lastly, the market has been subject to adverse selection, meaning that most products are purchased by individuals who believe they will experience a longer than expected life and not purchased by individuals who believe they will experience a shorter than expected life. This has the net effect of increasing product costs.

Certain actions taken by the agencies could increase the use of lifetime income solutions:

- Encourage plan sponsors to provide access to lifetime income products.
- Ease the regulatory environment and reduce fiduciary concerns that employers have around offering lifetime income solutions, by providing a safe harbor to employers who meet certain requirements. These same recommendations were contained in the November 2005 final report to the Secretary of Labor from the ERISA Advisory Council.
- Shift the dominant paradigm among plan sponsors and participants from one that is focused on the process of wealth accumulation to one that is focused more broadly on the objective of retirement income security. This recommendation is consistent with The 2007 ERISA Advisory Council final report on Financial Literacy of Plan Participants where the report recommended that the Department of Labor expand the reach of IB 96-1 to address information, education, and advice needs in the de-accumulation stage as well as the accumulation phase

***6) What types of lifetime income or other arrangements designed to provide a stream of income after retirement are available to individuals who have already received distributions from their plans (out-of-plan options), such as IRA products, and how are such arrangements being structured (fixed, inflation adjusted, or other variable, immediate or deferred, etc.)? Are there annuity products under which plan accumulations can be rolled over to an individual retirement annuity of the same issuer to retain the annuity purchase rights that were available under the plan?***

The marketplace currently offers a variety of annuity products, all promising a guaranteed income stream for life. Current products are multi-featured, including fixed, inflation adjusted, and variable annuities, both immediate and deferred. The challenge has not been a lack of products, but a lack of products offering simplicity, transparency, control, flexibility and the financial backing of multiple

insurance providers, all at a reasonable cost. We also support a plan/product that is portable between the plan and an Individual Retirement Account (IRA), is simple and operates under the same fee structure. The ability to roll plan accumulations into an IRA while retaining the annuity purchase rights gained under the employer is not common. The supply of these types of products is small and they are not generally offered by employers

***8) What are the advantages and disadvantages for participants of selecting lifetime income payments through a plan (in-plan option) as opposed to outside a plan (e.g., after a distribution or rollover)?***

There are potential advantages for participants to select lifetime income within the plan. These include:

- The plan may be in a position to conduct a more robust due diligence product search than an individual investor.
- The plan should be able to negotiate a lower cost as an institutional investor than an individual investor.
- The participant may benefit from a higher level of communication and education surrounding the product option(s) available.

Potential disadvantages may include:

- The participant may be required to gather additional private or extensive financial information, such as specifics about their spouse's retirement plan. Also, they may simply be called upon to put more effort into the endeavor than anticipated.
- Portability to other retirement plans, or the ability to continue the option while breaking ties with the employer, may be cumbersome.

***9) What are the advantages and disadvantages from the standpoint of the plan sponsor of providing an in-plan option for lifetime income as opposed to leaving to participants the task of securing a lifetime income vehicle after receiving a plan distribution?***

There are potential advantages for employers to offer lifetime income within the plan and may include:

- Offering the option of a guaranteed income stream in retirement may ease the continuing transition away from traditional defined benefit plans.
- Substantial cost savings and / or product enhancements can be negotiated using the employer's leverage and passed on to an individual employee. While primarily an advantage to the employee, this may also benefit the employer in the form of enhanced goodwill, as participants may perceive the option to be a valuable extension of existing benefit offerings.
- Employers have the comfort of knowing that they have provided their employees with an important tool for their retirement years.

Potential disadvantages for the employer may include:

- The employer may lack the internal expertise, or be unable or unwilling to engage outside experts, to conduct a thorough due diligence search for product offerings.
- It may receive an undeserved and disproportionate share of the blame if the solution experience does not meet employee expectations.
- The duration of the employer / employee relationships may be extended beyond what is desired or considered optimal. In other words, the employer may want the relationship with the employee to end at the termination of employment and an income solution may serve to extend it.
- The employer may be subject to liability claims (legitimately or otherwise) related to product performance or benefits brought by employees. Employer liability concerns may discourage participation in in-plan option programs.
- There may be additional administrative burdens including increased recordkeeping and administration expenses and QJSA compliance requirements.

***10) How commonly do plan sponsors offer participants the explicit choice of using a portion of their account balances to purchase a lifetime annuity, while leaving the rest in the plan or taking it as a lump sum distribution or a series of ad hoc distributions? Why do some plan sponsors make this partial annuity option available while others do not? Would expanded offering of such partial annuity options -- or particular ways of presenting or framing such choices to participants -- be desirable and would this likely make a difference in whether participants select a lifetime annuity option?***

Plan sponsors do not commonly offer participants the option of purchasing a lifetime annuity, nor do participants elect an annuity option, in whole or part, for reasons detailed in prior answers. For example, within our own line of business, we examined a large sample of retirement distributions from defined contribution plans and a very small minority (only 4 of 100,000) elected an annuity option. Offering participants a solution for partial/future income represents additional flexibility of choice and thus would generally be viewed as a positive. The optimal method of framing a full or partial lifetime income option would be one that is focused on simplicity, transparency and flexibility.

***12) How should participants determine what portion (if any) of their account balance to annuitize? Should that portion be based on basic or necessary expenses in retirement?***

The Schwab Center for Financial Research generally believes that 20 – 25% of the final account balance should be annuitized. Alternatively, an annuity stream that roughly approximates the amount of fixed monthly or annual expenses can be considered. These guidelines should be considered in the context of other sources of retirement income available to the retiree and other retirement expenses that may arise.

***13) Should some form of lifetime income distribution option be required for defined contribution plans (in addition to money purchase pension plans)? If so, should that option be the default distribution option, and should it apply to the entire account balance? To what extent would such a requirement encourage or discourage plan sponsorship?***

Mandating or requiring of Lifetime Income adoption is not viewed as likely or practical. However, the goal should be to provide tools to the participant to determine the best form of distribution for their plan assets. The formation and creation of these tools should be encouraged by the government and its agencies. We do not believe that Lifetime Income option should be a default distribution option. This should be based on each individual participant's circumstances.

***14) What are the impediments to plan sponsors' including lifetime income options in their plans, e.g., 401(k) or other qualification rules, other federal or state laws, cost, potential liability, concern about counterparty risk, complexity of products, lack of participant demand?***

Impediments to employers offering lifetime income options have been:

- QJSA requirements which might be triggered by the mere presence of a lifetime income option within a plan.
- Employers have not had sufficient incentives along with many unanswered questions around the potential fiduciary and liability implications of offering in-plan annuity solutions.
- Such an option has not been viewed to have significant value as it relates to recruitment and retention.
- Employees have not demanded such options or even expressed strong interest.

***17) What information (e.g., fees, risks, etc.) do plan participants need to make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement? When and how (i.e., in what form) should it be provided? What information currently is provided to participants, who typically provide it, and when and how is it provided to them?***

Participants need information regarding:

- Suitability.
- Product cost – including the allocation of cost between the various expenses associated with lifetime income solutions – especially investment management fees, mortality charges and administrative expense.
- Features and benefits.
- The significance of the insurance component.
- Risks and product limitations.

- Financial strength of provider(s); protections in the event of provider(s) insolvency.
- Guidance, advice and / or other tools to determine income needs in retirement.

The information should be presented twice: in a group or educational setting and again at the point of sale or enrollment. This redundancy will serve to enhance the message and reinforce product features, benefits and limitations. Again, few employers currently offer lifetime income options so there are not many examples of current materials from which to draw. Generally, the materials that have supported the product offering have been of the kind typically associated with a defined contribution education effort, i.e. product brochures and marketing materials.

***19) What specific legal concerns do plan sponsors have about educating participants as to the advantages and disadvantages of lifetime income or other arrangements designed to provide a stream of income after retirement? What actions, regulatory or otherwise, could the Agencies take to address such concerns?***

Legal concerns include the possibility that education and counseling about lifetime income arrangements could give rise to fiduciary status and/or the provision of investment advice, regulatory action with respect to the sponsor's choice of a provider or option and lawsuits from unhappy participants. Government agencies can diminish these fears by clarifying the investment education rules, providing a class exemption for counseling participants on the advantages and disadvantages of lifetime income options and offering fiduciaries a "safe harbor" from liability with respect to the selection and monitoring of lifetime income solutions. Certain protections could be offered in exchange for a properly executed, comprehensive due diligence search and selection process, in particular where there is diversification with respect to the underlying insurance providers so as to minimize risk of loss.

We again reference and support recommendations from The 2007 ERISA Advisory Council final report on Financial Literacy of Plan Participants where the report recommended that the Department of Labor expand the reach of IB 96-1 to address information, education, and advice needs in the de-accumulation stage as well as the accumulation phase.

***21) Should an individual benefit statement present the participant's accrued benefits as a lifetime income stream of payments in addition to presenting the benefits as an account balance.***

We believe that more accurate and timely calculations are available through many of the current advice programs offered through plans. We believe the focus should be on making current web tools more concise and easier for participants to understand their total benefits. However, great care should be taken with juxtaposing a current account balance (accrued benefit) in a 401k plan or IRA balance into a 'theoretical' lifetime payment stream that is not guaranteed.

***22) If the answer to question 21 is yes, how should a lifetime stream of income payments be expressed on the benefit statement? For example, should payments be expressed as if they are to begin immediately or at specified retirement ages? Should benefit amounts be projected to a future retirement age based on the assumption of continued contributions? Should lifetime income payments be expressed in the form of monthly or annual payments? Should lifetime income payments of a married participant be expressed as a single-life annuity payable to the participant or a joint and survivor-type annuity, or both?***

Answered within question 21

***33) To what extent are fixed deferred lifetime annuities (i.e., incremental or accumulating annuity arrangements) or similar lifetime income products currently used as investment alternatives under ERISA 404(c) plans? Are they typically used as core investment alternatives (alternatives intended to satisfy the broad range of investments requirement in 29 CFR 2550.404c-1) or non-core investment alternatives? What are the advantages and disadvantages of such products to participants? What information typically is disclosed to the participant, in what form, and when? To what extent could or should the ERISA 404(c) regulation be amended to encourage use of these products?***

In as much as the 404(c) regulation contemplates core investment alternatives, the regulation could be amended to make clear that 404(c) protection will apply to an otherwise eligible investment alternative regardless of whether or not a lifetime income feature is associated with the investment alternative. The safe harbor for default elections could be similarly amended. In addition, participants may desire (or need) personalized counseling for determining whether a lifetime income option is an appropriate choice. The 404(c) regulation and/or Interpretive Bulletin 96-1 could be amended to specifically include assistance provided by non-fiduciary counselors to participants with respect to selection among various plan distribution options, which might include a lifetime income option.

***34) To what extent do ERISA 404(c) plans currently provide lifetime income through variable annuity contracts or similar lifetime income products? What are the advantages and disadvantages of such products to participants? What information about the annuity feature typically is disclosed to the participant, in what form, and when? To what extent could or should the ERISA 404(c) regulation be amended to encourage use of these products?***

In as much as the 404(c) regulation contemplates core investment alternatives, the regulation could be amended to make clear that 404(c) protection will apply to an otherwise eligible investment alternative regardless of whether or not a lifetime income feature is associated with the investment alternative and that a lifetime income feature does not otherwise impact availability of the 404(c) safe harbor. The safe harbor for default elections could be similarly amended. In addition, participants may desire (or need) personalized counseling for determining whether a lifetime income option is an appropriate choice. The 404(c) regulation and/or Interpretive Bulletin 96-1 could be amended to: specifically include assistance provided by non-fiduciary counselors to participants with respect to selection among various plan distribution options, which might include a lifetime income option.

***35) To what extent are plans using default investment alternatives that include guarantees or similar lifetime income features ancillary to the investment fund, product or model portfolio, such as a target maturity fund product that contains a guarantee of minimum lifetime income? What are the most common features currently in use? Are there actions, regulatory or otherwise, the Agencies could or should take to encourage use of these lifetime income features in connection with qualified default investment alternatives?***

Annuities, whether fixed or variable, are rare in 401(k) plans unless administered by an insurance company. Lifetime income options offered in conjunction with model portfolios or target date portfolios are also rare.

There are a number of actions the government and / or its agencies could do to encourage greater use of such products:

- First and primary, ease employer uncertainty over fiduciary responsibilities associated with including retirement income products within their retirement plan(s).
- Encourage employers to assess their employee population and, where appropriate, make a lifetime income option the default investment choice (for those participants over a certain age), while providing employers who meet certain qualifications with safe harbor protections.
- With respect to the above, the lifetime income options would have characteristics such as transparency, portability, multiple insurer backing, reasonable fees and ability to access account value if needed.
- Encourage the marketplace to develop creative product solutions that are affordable, transparent, flexible and secure.
- Encourage the shift of education from one focused primarily on wealth accumulation to one that includes the need to provide lifetime income.
- Provide safe harbor protections to employers meeting certain qualifications.
- Encourage decreased reliance on social security as a retirement income resource.

***36) What are the costs and benefits to a plan sponsor of offering lifetime annuities or similar lifetime income products as an in-plan option? Please quantify if possible.***

We expect higher recordkeeping costs, but this will vary by plan size and by service provider. In addition, there are certain to be wide ranging product costs, including the cost of the underlying investment vehicle and the cost of an insurance guarantee, if applicable. We encourage all costs to be fully disclosed and completely transparent.

***37) Are there unique costs to small plans that impede their ability to offer lifetime annuities or similar lifetime income products as an in-plan option to their participants? What special consideration, if any, is needed for these small entities?***

There are no unique costs to smaller plans. However, just as with the cost of offering a retirement plan, some fixed administrative costs must be distributed across a smaller employee base. This has discouraged many small employers from offering retirement plans and may have a similar effect on lifetime income options within such plans. Where small employers have adopted plans, they have done so at a higher cost, due to the nature of the products available in that space. We believe this trend, to higher costs, may continue for smaller plans that may offer a Guaranteed Income Solution.

***38) Would making a lifetime annuity or other lifetime income product the default form of benefit payment have an impact on employee contribution rates? If so, in which direction and why?***

It is difficult to impact employee contribution rates. The most progress in this area has been made by encouraging plans to sponsor automatic enrollment and, more significantly, automatic contribution increases. Continuing this trend is viewed as being the most impactful step that can be taken. Making lifetime income options a default benefit payment option is unlikely to impact contribution rates in any meaningful way. Nevertheless, we believe lifetime income options should be made more available to employees through employer plans.