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The Hewitt logo consists of the word "Hewitt" in a white, serif font, centered within a dark blue square.

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Submitted electronically via the Federal Rulemaking portal @ www.regulations.gov

Attention: Lifetime Income RFI
Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Dear Sir or Madam:

Subject: Request for Information (RFI) Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans (RIN 1210-AB33)

Hewitt Associates welcomes the opportunity to submit for consideration our comments related to the RFI on lifetime income options, which was published in the *Federal Register* on February 2, 2010, in Vol. 75, No. 21, page 5253.

Who We Are

Hewitt Associates is a global human resources outsourcing and consulting company providing services to major employers in more than 30 countries. We employ 23,000 associates worldwide. Headquartered in Lincolnshire, Illinois, we serve more than 2,000 U.S. employers from offices in 30 states.

As one of the world's premier human resources services companies, Hewitt Associates has extensive experience in both designing and administering 401(k) plans for mid- to large-sized employers, including helping employers to communicate with their participants about this increasingly important benefit. We are the largest independent provider of administration services for retirement plans, serving more than 11 million plan participants. We do not manage funds and we have no affiliations with any investment management firms.

Introduction

Hewitt Associates is honored to provide the Department of Labor (DOL) and the Internal Revenue Service (IRS) (the "Agencies") with suggestions on how to enhance the retirement security of participants in employer-sponsored retirement plans by facilitating access to, and use of, solutions that can provide Americans with a lifetime stream of income after retirement.

Achieving income adequacy in retirement is becoming a growing challenge for many Americans and an increasing concern for employers that provide retirement programs to their employees. Recent Hewitt research¹ shows that fewer than one in five Americans will be able to meet 100 percent of their estimated needs in retirement. Many factors are contributing to this shortfall. Americans are living longer today than in prior decades, and many now rely solely on a 401(k) plan for their employer-provided retirement income, meaning they are at a far greater risk of prematurely depleting their existing retirement savings. In addition, the overwhelming majority of Americans either elect or are forced to take their savings out of their

¹ Hewitt Associates' 2010 Retirement Income Adequacy at Large Companies: The Real Deal Study.

retirement plan when they retire. Participants who take a lump sum are subject to inflation risk, longevity risk, and market risk. Few are equipped to independently manage that risk, so they reach to others for assistance. The dizzying array of options in the retail market to help deal with these challenges can be overwhelming, and retail fees are generally higher than what mid- to large-sized retirement plans can offer through their collective buying power. Consequently, fees erode savings, and participants are at greater risk of buying products that are inappropriate for their needs.

With Americans' retirement income needs in mind, we applaud the Agencies for soliciting input on this important topic, and we encourage employers, retirement plan service providers, regulators, and Congress to take a closer look at changes needed to make retirement plans effective vehicles for managing lifetime income streams after retirement. Our comment letter focuses on four topics:

- I. Current Retirement Plan Payout Options and Related Participant Behaviors
- II. Benefits of Lifetime Income Options Within Retirement Plans
- III. Why Fee Transparency Is Critical to the Success of Lifetime Income Options
- IV. Recommended Changes to Regulations and Agency Guidance

I. Current Retirement Plan Payout Options and Related Participant Behaviors

According to Hewitt's research,² the overwhelming majority of participants choose to move their money out of their retirement plan when they retire. All 401(k) plans currently offer lump-sum payments as a final distribution option, and 84 percent of terminating participants elect to take this option. More than half (54 percent) of retirement plans offer partial distributions, with 17 percent of participants electing this option when it is offered. Just 14 percent of 401(k) plans today offer a traditional annuity form of payment, and just 1 percent of participants in those plans elect the option when it is available. Hewitt's data shows similar lump-sum preferences among defined benefit plan participants, with 57 percent of pension plan sponsors offering a lump-sum option, and between 60 percent and 95 percent of participants electing the option when it's available.

Various alternative lifetime income solutions for defined contribution plans have been introduced in recent years to appeal more broadly to participants by offering guaranteed payments from within the plan; however, few plan sponsors have implemented these emerging options. Hewitt research shows that only 7 percent of 401(k) plans currently offer an insurance or annuity solution within the construct of the plan itself.

Most defined contribution plans today fail to provide participants with the necessary tools to effectively manage postretirement risks, forcing them to look toward external, retail-focused options. When traditional features such as immediate rollover annuities are made available, few participants take advantage of them, suggesting that new solutions or strategies are needed in order for retirees to meet the challenges and risks faced in today's environment. We urge the DOL to encourage flexibility and to support innovative solutions—including insurance solutions, asset management solutions, and participant education and guidance—so that plan sponsors can offer the tools and features that are best suited for their own unique participant populations.

² Hewitt Associates' 2009 Trends and Experience in 401(k) Plans Study.

II. Benefits of Lifetime Income Options Within Retirement Plans

Most plan participants in a mid- or large-sized retirement plan are at a significant disadvantage if they roll over their plan balances to alternative retirement income options or cash out their accounts. By keeping their assets in the retirement plan, participants will benefit from:

- Lower fees;
- Fiduciary protection; and
- Improved participant utilization

Lower Fees

Many employers leverage the size of their retirement plans and choose low-cost non-mutual fund alternatives, including collective trusts and separate accounts, which are not available in the retail market. Participants cannot access these prices independently.

Similarly, we see much lower prices emerging for institutional annuity products compared to retail products. Retail annuity products are often two or even three times more expensive than rollover annuities available through certain retirement plans when institutional pricing is available. Other products available in some retirement plans include a guaranteed return with upside based on investment performance, a guaranteed stream of payments over the retiree's lifetime, and/or continued investment flexibility. Generally, prices for products in large plans range between 50 and 150 basis points, depending on the product and the underlying investments.

If an individual rolled over his or her 401(k) into an individual retirement account (IRA) prior to retirement, this pricing would not be available. Many retail options range in cost between 300 and 350 basis points per year, significantly eroding the probability of receiving higher payments resulting from positive investment performance. The combination of leveraging institutional investments and eliminating many of the sales and commissions can make a real difference to participants' savings levels.

Fiduciary Protection

In retirement plans, the fiduciaries of the plan are held legally accountable for making prudent decisions in the best interests of plan participants. This includes oversight of the investment options offered in the plan, including any annuity or retirement income solutions. It also includes ensuring that fees are reasonable for the services provided. The benefit of this oversight to participants is comfort that an expert is evaluating choices and selecting services with the needs of participants in mind.

Improved Participant Utilization

We believe the number of participants using lifetime income options will likely improve as more retirement plans offer such options, given the customized, unbiased education that plan sponsors can provide employees throughout all phases of the employment lifecycle. This ongoing and consistent communication can, over time, better educate participants about their plan options for retirement. Otherwise, participants may not focus on generating retirement income until their actual retirement, at which time retail organizations will be inundating them with conflicting and biased marketing information. Increased education on lifetime income options throughout plan participation will allow participants to see the benefits of each option, reduce fears of the unknown, and increase the likelihood of proper utilization.

All of these factors contribute to more adequate retirement savings. Thus, the Agencies should encourage plan sponsors to offer such plan options by eliminating legal hindrances to their adoption and permitting more robust education on these options in all phases of plan participation. We address these topics more fully in section IV.

III. Why Fee Transparency Is Critical to the Success of Lifetime Income Options

Despite the stock market's recovery, Americans are still struggling to recoup the historic losses sustained in their 401(k) plans over the past two years. One main obstacle is excessive 401(k) plan fees, which may be robbing participants of thousands of hard-earned dollars over the course of their career. Even with increased scrutiny of plan fees over the past few years, we believe more needs to be done to help plan sponsors and individuals receive better fee information from investment managers and other service providers. Such transparency will enable employers to better protect and enhance employees' retirement savings by providing a better climate for negotiating lower fees and offering competitively priced, best-in-class investments in their 401(k) plans.

Any future guidance on fee transparency should encompass all phases of plan participation, including the drawdown phase in 401(k) plans. We believe that such transparency is critical to the future success of lifetime income options in retirement plans. Fee transparency will make it more likely that plan sponsors will add such options to their retirement plans, and that plan participants will consider using such options.

From a plan fiduciary's perspective, fee transparency is necessary because it enables the fiduciary to make informed decisions on whether to add lifetime income options to their defined contribution plan, which options to add, which providers to select, etc. Fee transparency should also apply to lifetime income options offered outside of retirement plans (to the extent that the Agencies can require). This will permit plan participants to compare the costs of the options offered within their retirement plan with those offered outside of the retirement plan. It will also enable plan sponsors to compare the costs of the two options, which may influence their decision on whether to offer lifetime income options within their retirement plan (e.g., if the plan sponsor can negotiate lower fees on lifetime income options, it may choose to add such options to its plan to benefit retirees).

From a plan participant's perspective, fee transparency will help participants better understand the costs involved with lifetime income options, making it more likely that such options will be considered. This will reduce plan leakage, which can negatively impact retirement savings when participants' assets are rolled over into investments with higher fees. Fee transparency will also help plan participants make informed decisions about how to draw down their assets, whether to move assets to a lifetime income option, and whether to do so in or outside of the retirement plan. Finally, fee transparency will facilitate competition among providers of such lifetime income options, keeping costs down for plans and plan participants.

In short, Hewitt Associates believes that fee transparency for lifetime income options, offered both within and outside of retirement plans, is critical to the future success of those options. We therefore recommend that any future guidance on fee transparency specifically encompass such options in all phases of plan participation.

IV. Recommended Changes to Regulations and Agency Guidance

For existing retirement plans to become more attractive options for managing savings in retirement, Hewitt recommends that the Agencies focus on two key areas:

- Make certain regulatory changes and guidance that help facilitate the adoption and use of lifetime income options in qualified retirement plans.
- Make updates to DOL Interpretive Bulletin 96-1 to encourage the offering of expanded financial education, including education on lifetime income options.

Recommended Changes and Guidance to Facilitate Lifetime Income Options

It is important to make a distinction between annuities and other lifetime income solutions selected as a *distribution* option, and annuities and other lifetime income solutions selected as an *investment* option, as these options are quite different. A defined contribution plan participant can invest in the plan's core funds and then choose an annuity form of payment, either through an employer plan or, more likely, through a rollover to an IRA. There are also insurance or lifetime income products available in plans under which an individual can invest in the product but choose to take a distribution in the form of a lump-sum payment. If participants had had more access to lifetime income investments in their 401(k) plans over the past couple of years, many would have realized the potential advantage of diversifying into annuity and other lifetime investment options during the recent severe market downturn. We believe that regulatory guidance should encourage the inclusion of lifetime retirement income options in defined contribution plans as both an investment option and a payment option to meet the diverse needs and preferences of both plan sponsors and participants. Guidance should not favor one approach over another.

Qualified Joint and Survivor Annuity Rules

One of the biggest regulatory impediments to including income solutions in a defined contribution plan is the administrative complexity imposed by regulations under Internal Revenue Code (Code) section 401(a)(11), particularly as recently applied in Private Letter Ruling (PLR) 200951039. Again, it is important to distinguish between lifetime income options as an investment and as a form of payment. Code section 401(a)(11)(b)(iii)(II) excepts a defined contribution plan from the qualified joint and survivor annuity (QJSA) rules and the qualified preretirement survivor annuity (QPSA) rules if a "participant does not elect a payment of benefits in the form of a life annuity...." While we understand the basis in the Code for the regulatory requirement that the spousal consent, relative value, and other QJSA/QPSA rules apply once a participant elects payment in the form of an annuity, PLR 200951039 unnecessarily carries the application of those rules to a participant investing in an annuity, even if the participant never elects payment in the form of an annuity or another lifetime income option. Although a PLR applies only to the applicant taxpayer's specific set of facts, it is often viewed by plan sponsors as indicative of the IRS viewpoint on a particular tax issue. The PLR suggests that the IRS believes the QJSA/QPSA rules apply to a defined contribution plan at the moment a participant elects to invest in an annuity product rather than at the moment a participant elects distribution in the form of an annuity. We believe this interpretation will have a chilling effect on the use of annuity products and, potentially, other retirement income solutions in defined contribution plans.

Review of PLR 200951039 and Its Implications for Lifetime Income Options

The PLR applicant, an insurance company, intends to offer a group annuity contract held in the name of a qualified defined contribution plan as a plan investment option. Plan participants who invest in the contract can take distributions from the plan during two phases. During Phase One, the participant can start or stop periodic payments from the plan, make additional contributions, request a partial lump-sum payment, or

cash out the contract. The participant selects the length of Phase One. During Phase Two, the participant cannot make further contributions or elections. Unless the participant elects to take a lump-sum distribution of the entire amount invested in the contract prior to Phase Two, payments during Phase Two are made as a life annuity.

Phase One operates like many 401(k) plans that do not offer annuity payment options, permitting a participant to start and stop payments in varying amounts, receive installment payments, or take a lump-sum payment. Even though the PLR found that the rights under Phase One did not constitute the election of a life annuity, it found that the participant elected distribution in a life annuity form upon initially investing in the annuity contract. The PLR made this finding despite that the annuity contract might be only one of many investment choices under the plan and contributions might have been made many years before the start of payments under either Phase One or Two. This ruling will continue to impede the inclusion of annuity investment options, and potentially other lifetime income options, in 401(k) plans by imposing QJSA and QPSA requirements on a participant who never affirmatively elects an annuity form of payment. If a participant invests a portion of his or her contributions in mutual funds and the remaining portion in an annuity contract under a 401(k) plan, the annuity starting date with respect to contributions invested in the annuity contract should be the date distributions are to start under the Phase One. This would be consistent with the annuity starting date for 401(k) plans that offer annuity payment options but not annuity investment options.

The ruling of the PLR could have been different if the default form of payment at the start of the Phase Two was a lump sum rather than a life annuity. It would seem that default would entirely avoid the application of the QJSA and QPSA rules unless the participant affirmatively elected an annuity at the start of Phase Two. However, that default would also seem to be less effective at furthering the goal of encouraging lifetime income options for participants and beneficiaries. Therefore, we ask that the Agencies provide guidance indicating that the QJSA and QPSA rules are not triggered until the point in time at which a participant actually elects to receive distribution in the form of a lifetime annuity. Furthermore, guidance should clarify that lifetime retirement solutions that do not involve election of a lifetime annuity are not subject to the QJSA and QPSA rules.

Other Requested Guidance on Lifetime Income Options

In addition to the change in regulatory position regarding the application of the QJSA and QPSA rules described above, we request that the Agencies consider providing the following guidance:

- Guidance clarifying how including retirement income investment options, including but not limited to annuities and guaranteed minimum withdrawal benefits, interact with the safe harbor provided by CFR section 2550.404a-4 for the selection of an annuity provider for benefit distributions from an individual account plan. The preamble to the final regulations states “The Department does not intend, by virtue of the safe harbor, to establish different fiduciary standards for the selection of investment products. Rather, the safe harbor conditions apply solely to a fiduciary’s decision to purchase a distribution annuity for an individual account plan.” Such guidance should clearly indicate that the selection of lifetime income investment options offered under an individual account plan is subject to the same fiduciary standards as the selection of any other investment in an individual account plan. In addition, creation of a safe harbor for lifetime income options should be considered, including a safe harbor that would permit participants to leave prior contributions invested in a lifetime income option when that investment option is eliminated prospectively.

- Guidance to the effect that, if a plan otherwise satisfies the requirements of Employee Retirement Income Security Act (ERISA) section 404(c), the addition of one or more annuity or other lifetime income investment options under the plan will not affect the plan's satisfaction of ERISA section 404(c).
- Guidance to the effect that lifetime income options will not result in new requirements for the various participant statements required by ERISA or the Code.

Recommended Changes and Guidance to Facilitate Employee Education

Hewitt Associates also recommends updates to DOL Interpretive Bulletin 96-1 (IB 96-1). Over the past decade, employers have increasingly shifted away from offering defined benefit pension plans in favor of participant-directed defined contribution plans. Employees continue to assume increased responsibility for ensuring the adequacy of their retirement income.

IB 96-1 was issued 14 years ago to help plan sponsors provide plan participants with education to better equip them to handle this increased responsibility. Although IB 96-1 provided helpful guidance on what constitutes "investment advice" under section 3(21)(A)(ii) of ERISA, that guidance focuses primarily on educational activities related to investment decision making.

There is now a greater need for more robust education. Today, plan participants and beneficiaries must decide how to contribute (e.g., Roth 401(k) versus traditional 401(k)), when to take a distribution, what form of payment to receive, how to draw down an account, whether to keep assets in the plan or roll them over, etc. If the Agencies are successful in finding ways to encourage implementation and use of lifetime income options, participants and beneficiaries will also benefit from education regarding the use and selection of such new options. Thus, the DOL should expand its guidance to address other types of general financial education that may assist participants and beneficiaries in making the types of necessary decisions to ensure retirement income adequacy.

As it did for IB 96-1, the DOL should review the educational materials currently being provided by plan sponsors and service providers to participants and beneficiaries. Such materials have undergone major changes and improvements in the past 14 years, and flexibility for future innovations should also be considered.

Specifically, Hewitt recommends that the DOL make the following modifications to IB 96-1:

- Expand the scope in subsection (a) to cover all retirement plans, not just participant-directed individual account plans.
- Expand the category of information described in subsection (d)(1) to include a description of the potential advantages and disadvantages of forms of benefit offered under a retirement plan. This should include descriptions for lifetime income options, the advantages and disadvantages of Roth 401(k) contributions and traditional 401(k) contributions, and the advantages and disadvantages of keeping money invested in the retirement plan instead of rolling it over.
- Expand the category of information described in subsection (d)(2) to include educational information on inflation risk and longevity risk. It should also include information on the features of purchased annuities, including the insurance components, risks, ratings of insurers, and the impact of current interest rates on annuity purchases.

- Broaden the scope of subsection (d)(4) to cover interactive materials that focus on retirement plan decisions that go beyond investment of plan assets during the accumulation phase. For example, this subsection should cover modelers that allow participants and beneficiaries to enter their own unique circumstances and preferences and obtain individual assessments on:
 - The impact of contributing to a Roth 401(k) account versus a traditional 401(k) account;
 - The advantages and disadvantages of drawing down an individual account under the various options within the retirement plan, or outside the plan (e.g., a rollover or purchase of a lifetime income product offered outside the plan);
 - The advantages and disadvantages of each optional form of benefit offered by a defined benefit plan;
 - The retirement needs of different people, including surviving spouses and children; and
 - The potential advantages of rolling other assets into the retirement plan.
- Address what constitutes a “recommendation” under 29 CFR 2510.3-21(c). Specifically, IB 96-1 should address how interactive materials under subsection (d)(4) of IB 96-1 can provide individual assessments that suggest one option above others without the assessment being considered a recommendation that is understood by the participant to serve as a primary basis for his or her decisions.

Conclusion

Hewitt commends the Agencies for their ongoing efforts to help Americans achieve income adequacy in retirement. Plan sponsors have a unique opportunity to influence the decisions of millions of Americans when it comes to lifetime income options. Additionally, they can leverage their size, scale, and fiduciary prudence to deliver cost-effective solutions designed with the participants’ best interests in mind. We encourage the Agencies to empower plan sponsors to take the appropriate steps by addressing the issues noted above in future guidance. If you have any questions or comments, please contact the undersigned at the telephone number or email address provided below.

Sincerely,

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