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Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

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Request for Information Regarding Lifetime Income Options

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General Comment

See attached file(s)

Attachments

EBSA-2010-0007-DRAFT-0100.1: Comment on FR Doc # N/A

<http://www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=23512&AgencyId=8>

DATES: Comments must be submitted on or before May 3, 2010.

B. Request for Information

The purpose of this notice is to solicit views, suggestions and comments from plan participants, plan sponsors, plan service providers and members of the financial community, as well as the general public, to assist the Agencies in evaluating what steps, if any, they could or should take, by regulation or otherwise, to enhance the retirement security of participants in employer-sponsored retirement plans and IRAs by facilitating access to, and use of, lifetime income or other arrangements designed to provide a stream of lifetime income after retirement. To facilitate consideration of the issues, the Agencies have set forth below a number of matters and specific questions with respect to which views, suggestions, comments and information are requested. In addition to addressing any or all of the matters and questions referred to below, interested persons are encouraged to address any other matters they believe to be germane to the Agencies' consideration of lifetime annuities and similar lifetime income issues, particularly as they relate to defined contribution plans and defined benefit plans that distribute benefits as lump sums.

General

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?

Lifetime payments provide a steady stream of income in retirement years. However, the recent failures of financial organizations and corporations raise the question of whether a steady stream of income will truly be there. In addition, lifetime payments do not provide the flexibility that may be needed to deal with unexpected financial requirements. In addition, lifetime payments are based on average life expectancies and are not tailored to individual life expectancies which may vary drastically depending on health conditions. Participants may have uncertainty about their investments not being available for their heirs. In addition, some plans have extremely limited investment options (think Enron).

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?

The low usage rate is probably a combination of all of the factors listed in your question. However, I believe that another factor is that people want to have control of their funds. The **only** step that Federal Agencies could or should take is related to improved education. Knowledge is power that will give participants the ability to make informed decisions. Although some will make poor choices, it is not the Federal Government's role to intervene.

3. What types of lifetime income are currently available to participants directly from plans (in-plan options), such as payments from trust assets held under a defined benefit plan and annuity payments from insurance contracts held under a defined contribution or defined benefit plan?

4. To what extent are the lifetime income options referenced in question 3 provided at retirement or other termination of employment as opposed to being offered incrementally during the accumulation phase, as contributions are made? How are such incremental or accumulating

annuity arrangements structured?

5. To what extent are 401(k) and other defined contribution plan sponsors using employer matching contributions or employer nonelective contributions to fund lifetime income? To what extent are participants offered a choice regarding such use of employer contributions, including by default or otherwise?

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?

7. What product features have a significant impact on the cost of providing lifetime income or other arrangements designed to provide a stream of income after retirement, such as features that provide participants with the option of lifetime payments, while retaining the flexibility to accelerate distributions if needed?

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)?

A major disadvantage is the limited investment options in many plans.

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?

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?

11. Various "behavioral" strategies for encouraging greater use of lifetime income have been implemented or suggested based on evidence or assumptions concerning common participant behavior patterns and motivations. These strategies have included the use of default or automatic arrangements (similar to automatic enrollment in 401(k) plans) and a focus on other ways in which choices are structured or presented to participants, including efforts to mitigate "all or nothing" choices by offering lifetime income on a partial, gradual, or trial basis and exploring different ways to explain its advantages and disadvantages. To what extent are these or other behavioral strategies being used or viewed as promising means of encouraging more lifetime income? Can or should the 401(k) rules, other plan qualification rules, or ERISA rules be modified, or their application clarified, to facilitate the use of behavioral strategies in this context?

Rules should be modified to allow efforts to mitigate "all or nothing" choices by offering lifetime income on a partial, gradual, or trial basis as described above.

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?

This will vary based on individual choices and situations. Only the individual can determine what their basic or expenses are in retirement. Changing circumstances can cause drastic fluctuations in what that amount is.

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?

Some form of lifetime income distribution should **not** be the default distribution option. Having an option that allows a portion of the account balance to be paid as a lifetime income distribution and allows the participant to access the remaining portion of the balance on an ad hoc basis might encourage greater use of lifetime distribution options.

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?

15. What are the advantages and disadvantages of approaches that combine annuities with other products (reverse mortgages, long term care insurance), and how prevalent are these combined products in the marketplace?

16. Are there differences across demographic groups (for example men vs. women) that should be considered and reflected in any retirement security program? Can adjustments for any differences be made within existing statutory authority?

Participant Education

The Department of Labor issued Interpretive Bulletin 96-1 (29 CFR 2509.96-1) to clarify that the provision of investment education, as described in the Bulletin, will not be considered the provision of "investment advice," which would give rise to fiduciary status and potential liability under ERISA for plan participants' and beneficiaries' investment decisions.

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 provides it, and when and how is it provided to them?

18. Is there a need for guidance, regulatory or otherwise, regarding the extent to which plan assets can be used to pay for providing information to help participants make informed decisions regarding whether to select lifetime income or other arrangements designed to provide a stream of income after retirement, either via an in-plan or out-of plan option?

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?

20. To what extent should plans be encouraged to provide or promote education about the advantages and disadvantages of lifetime annuities or similar lifetime income products, and what guidance would be helpful to accomplish this?

Plans should be strongly encouraged to provide or promote education about the advantages and disadvantages of lifetime annuities or similar lifetime income products.

Disclosing the Income Stream That Can Be Provided From an Account Balance

ERISA section 105 requires defined contribution plans to furnish to each participant an individual benefit statement, at least annually, that includes the participant's "accrued benefits," i.e., the individual's account balance.

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?

An individual benefit statement that presents the participant's accrued benefits as a lifetime income stream of payments in addition to presenting the benefits as an account balance should be beneficial to plan sponsors. Having that information available on a regular basis could very well increase the level of contribution.

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?

On the benefit statement, a lifetime stream of income payments should be expressed as if they are to begin immediately in the form of a monthly payment amount. This would remove the need to project based on any assumption of continued contributions. Lifetime income payments of a married participant should be expressed as both a single-life annuity payable to the participant and a joint and survivor-type annuity (similar to Social Security benefit statements).

23. If the answer to question 21 is yes, what actuarial or other assumptions (e.g., mortality, interest, etc.) would be needed in order to state accrued benefits as a lifetime stream of payments? If benefit payments are to commence at some date in the future, what interest rates (e.g., deferred insurance annuity rates) and other assumptions should be applied? Should an expense load be reflected? Are there any authoritative tools or sources (online or otherwise) that plans should or could use for conversion purposes, or would the plan need to hire an actuary? Should caveats be required so that participants understand that lifetime income payments are merely estimates for illustrative purposes? Should the assumptions underlying the presentation of accrued benefits as a lifetime income stream of payments be disclosed to participants? Should the assumptions used to convert accounts into a lifetime stream of income payments be dictated by regulation, or should the Department issue assumptions that plan sponsors could rely upon as safe harbors?

Caveats should be required so that participants understand that lifetime income payments are merely estimates for illustrative purposes. The assumptions underlying the presentation of accrued benefits as a lifetime income stream of payments should be disclosed to participants in laymen's terms. The Department should issue assumptions that plan sponsors could rely upon as safe harbors to provide consistency.

24. Should an individual benefit statement include an income replacement ratio (e.g., the percentage of working income an individual would need to maintain his or her pre-retirement standard of living)? If so, what methodology should be used to establish such a ratio, such as pre-retirement and post-retirement inflation assumptions, and what are the impediments for plans to present the ratio in a meaningful way to participants on an individualized basis?

401(k) and Other Plan Qualification Rules

Income Tax Regulations that apply specifically to lifetime annuities include: 26 CFR 1.401(a)-11, 26 CFR 1.401(a)-20, 26 CFR 1.401(a)(9)-1 through 26 CFR 1.401(a)(9)-9, 26 CFR 1.417(a)(3)-1, and 26 CFR 1.417(e)-1.

25. How do the 401(k) or other plan qualification rules affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income? Are there changes to those rules that could or should be made to encourage lifetime income without prejudice to other important policy objectives?

26. Could or should any changes be made to the rules relating to qualified joint and survivor annuities and spousal consents to encourage the use of lifetime income without compromising spousal protections?

27. Should further guidance clarify the application of the qualified joint and survivor annuity rules or other plan qualification rules to arrangements in which deferred in-plan insurance annuities accumulate over time with increasing plan contributions and earnings?

I think clarification is crucial. Many retirees make choices without really understanding the survivor rules.

28. How do the required minimum distribution rules affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income? Are there changes to those rules that could or should be made to encourage lifetime income without prejudice to other important policy objectives? In particular, how are deferred annuities that begin at an advanced age (sometimes referred to as longevity insurance) affected by these rules? Are there changes to the rules that could or should be considered to encourage such arrangements?

29. Are employers that sponsor both defined benefit and defined contribution plans allowing participants to use their defined contribution plan lump sum payouts to "purchase" lifetime income from the defined benefit plan? Could or should any actions be taken to facilitate such arrangements? Should plans be encouraged to permit retirees who previously took lump sums to be given the option of rolling it back to their former employer's plan in order to receive annuity or other lifetime benefits?

Selection of Annuity Providers

The Department of Labor's regulation 29 CFR 2550.404a-4 contains a fiduciary safe harbor for the selection of annuity providers for the purpose of benefit distributions from defined contribution plans.

30. To what extent do fiduciaries currently use the safe harbor under 29 CFR 2550.404a-4 when selecting annuity providers for the purpose of making benefit distributions?

31. To what extent could or should the Department of Labor make changes to the safe harbor under 29 CFR 2550.404a-4 to increase its usage without compromising important participant protections? What are those changes and why should they be made?

32. To what extent could or should the safe harbor under 29 CFR 2550.404a-4 be extended beyond distribution annuities to cover other lifetime annuities or similar lifetime income products? To which products should or could the safe harbor be extended?

ERISA Section 404(c)

ERISA section 404(c) and 29 CFR 2550.404c-1 provide defined contribution plan fiduciaries with limited relief from the fiduciary responsibility provisions of ERISA where a participant or beneficiary exercises control over the assets in his or her account.

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?

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?

Qualified Default Investment Alternatives

ERISA section 404(c)(5) provides that, for purposes of ERISA section 404(c)(1), a participant in a defined contribution plan will be treated as exercising control over the assets in his or her account with respect to the amount of contributions and earnings if, in the absence of an investment election by the participant, such assets are invested by the plan in accordance with regulations of the Department of Labor. The Department of Labor's regulation 29 CFR 2550.404c-5 describes the types of investment products that are qualified default investment alternatives under ERISA section 404(c)(5).

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?

Comments Regarding Economic Analysis, Regulatory Flexibility Act, and Paperwork Reduction Act

Executive Order 12866 (EO 12866) requires an assessment of the anticipated costs and benefits of a significant rulemaking action and the alternatives considered, using the guidance provided by the Office of Management and Budget. In addition, the Regulatory Flexibility Act (RFA) may require the preparation of an analysis of the economic impact on small entities of proposed rules and regulatory alternatives. For this purpose, the Agencies consider a small entity to be an employee benefit plan with fewer than 100 participants. The Paperwork Reduction Act (PRA) requires an estimate of how many "respondents" will be required to comply with any "collection of information" requirements contained in regulations and how much time and cost will be incurred as a result.

The Agencies in this section of the RFI are requesting comments that may contribute to any analyses that may eventually need to be performed under EO 12866, RFA, and PRA, both generally and with respect to specific areas identified in questions 36 through 39.

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.

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?

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?

Making a lifetime annuity or other lifetime income product the default form of benefit payment would probably decrease the amount of participation because the Federal Government, banks, insurance agencies, Wall Street and corporations have lost the public trust.

39. For plans that offer lifetime annuities or similar lifetime income products, what percentage of eligible workers elect to annuitize at least some of their retirement assets and what percentage elect to annuitize all of their assets?

Additional comments:

Under no circumstances should the Federal Government take over any retirement accounts and guarantee a lifetime annuity. The Federal Government has showed time and time again that it is willing to dip into retirement funds rather than curb outrageous spending.

The current penalties and tax liabilities associated with early withdrawals should be reviewed. At a time when many are looking to the government to bail them out, honorable individuals facing unexpected financial events are forced to withdraw funds early and are then hit with tax consequences and penalties.