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August 13, 2010

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

From: Josh Cohen, Defined Contribution Practice Leader
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RE: Request to testify at the Lifetime Income Joint Hearing
September 14, 2010, 9:00 a.m. EST

Russell Investments, a Tacoma, Washington based consulting and asset management firm, would welcome the opportunity to testify at the Lifetime Income Joint Hearing of the Department of Labor and the Department of Treasury on Tuesday September 14, 2010 at the U.S. Department of Labor in Washington, D.C.

Russell Investments provides strategic advice, state-of-the-art performance benchmarks and a range of institutional-quality investment products to U.S. and international clients including individual, institutional and advisor clients in more than 40 countries. Russell has more than \$140 billion in assets under management as of June 30, 2010; Russell Indexes have \$3.9 trillion in assets benchmarked to them as of December 31, 2009; Russell advises on \$903 billion as of December 31, 2009.

This business portfolio and reach provides Russell with direct knowledge, understanding and insight that we believe would be relevant and beneficial to the Department of Labor and the Department of the Treasury as these agencies further consider issues related to providing lifetime income to participants and their beneficiaries after retirement.

As a consultant to defined contribution fiduciaries and as a provider of services to defined contribution participants, Russell recognizes the need to provide products and solutions to help participant manage the various risks they shoulder at retirement, including longevity, market, and inflation risk. Our expertise in capital markets, asset allocation and liability management provides us with unique insights into this issue.

Russell has already contributed to this discussion through our participation in, and input to industry group responses, specifically the Defined Contribution Institutional Investment Association (DCIIA) and the Institutional Retirement Income Council (IRIC). I, Josh, also proudly testified at the Joint Hearing on Target Date Funds in 2009, which I believe is leading to outcomes to help the broader effort of providing greater retirement security for the American worker.

While there are many important issues, during the upcoming hearing Russell specifically requests to testify on topics related to question 3, "Disclosure of Account Balances as Monthly Income Statements". This is an idea that Russell has promoted for many years. I, Bob, and my colleagues Don Ezra and Matthew X. Smith wrote specifically about the need for such reporting in a recent book. Here is a brief excerpt.

An individual participant in a 401(k) plan has been accustomed to seeing a statement that might say: 'You have saved \$50,000.' A DB plan participant, in contrast, might see 'You have accrued an annual pension of \$5,000.' As the DC focus shifts to income replacement, the accrued value figure will need to be supplemented with more information – information that is relevant to what the plan is there for, perhaps something like 'This \$50,000 is likely to provide you with about \$X in monthly income, which should be enough to replace about X% of your salary, if you retire at age 60.'

From *The Retirement Plan Solution: The Reinvention of Defined Contribution* by Don Ezra, Bob Collie and Matthew X. Smith (John Wiley & Sons, 2009) pages 15-16.

The full section from which that is taken, and an example of the specific information that such a statement might include (taken from later in the same book) are appended to this letter.

We understand how critical the assumptions used to make these projections are. Russell highlighted this in a 2008 paper titled "Will I Have Enough to Retire?" (this paper is also appended to this letter). In that paper, we demonstrate the vastly different projections that can be derived from different retirement planning tools.

Finally, we are informed about these very issues as a Superannuation provider in the Australian Defined Contribution Market. Last year, the Australian Securities and Investment Commission (ASIC) developed regulations regarding providing these forecasts, which dealt with many of the same issues that have been raised in your request.

Our testimony would include the following key points:

- 1. Need for Income Based Reporting (1 Minute)**
 - a. Discuss why we believe participants are in great need of this type of reporting.
- 2. The Case for Standardization (2 minutes)**
 - a. Review the consequences of not standardizing
- 3. Accrued versus Projected Balances (2 minutes)**
 - a. Accrued balances should be the primary foundational starting point but with flexibility to show projected balances based on certain standard approaches.
- 4. Recommendations Regarding Other Assumptions (3 minutes)**
 - a. Contribution Rate
 - b. Return
 - c. Interest Rate
 - d. Mortality Rate
 - e. Quantifying Uncertainty

We hope to hear from you soon regarding the opportunity to testify at the Lifetime Income Joint Hearing on September 14. Our contact information is provided. Thank you for your consideration.

Sincerely,



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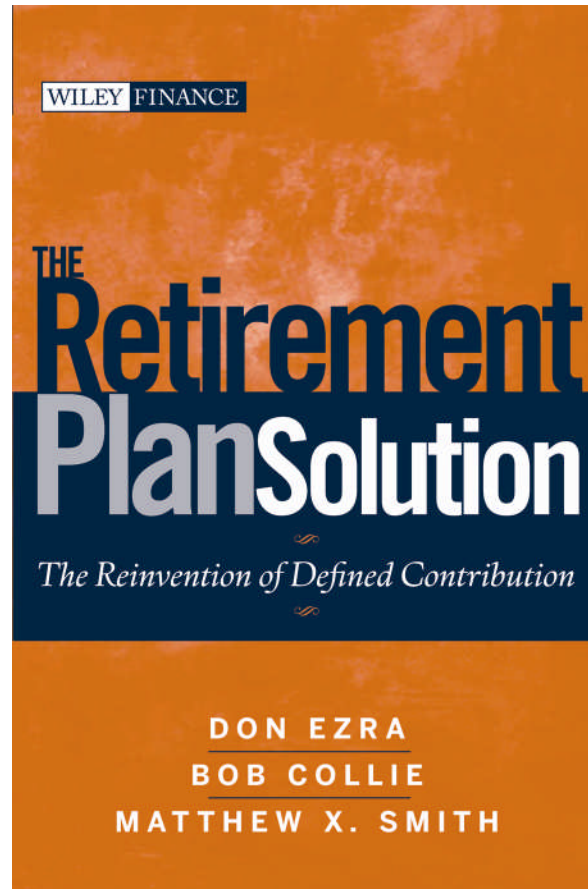


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Attachments:

Excerpts from *The Retirement Plan Solution: The Reinvention of Defined Contribution*. Don Ezra, Bob Collie, Matthew X. Smith. (John Wiley & Sons, 2009.)

Will I Have Enough to Retire? William Madden. (Russell Research, 2008).



Excerpts from:

- Income Replacement: pages 15-17
- Sample Participant Statement: pages 130-132

AT THE HEART OF VERSION 2.0: A DIFFERENT OBJECTIVE

Let's begin with the basics: What is the purpose of a 401(k)?

Ted Benna, who was involved in one of the earliest applications of the 401(k) provisions, describes becoming interested in the potential for Section 401(k) of the Internal Revenue Code to enable higher-paid employees to save their bonuses in a flexible, tax-efficient way. The fact that the saving was for retirement was largely incidental—and perhaps even a drawback in that “most of the employees weren't thrilled to have the cash bonus replaced by a plan that tied up their money for retirement.”¹⁰

But version 2.0 of the 401(k) can much more easily be understood if it is thought of as a pension plan, rather than as a savings plan. This is, for example, why participation is an issue: Wealth management is for the wealthy, but retirement planning should be for everyone. In Benna's world, broad participation was a hoop to be jumped through (“The one catch was that I had to get the lower-paid two thirds to put enough money into the plan.”) Broad participation was necessary in order to gain the tax break needed for the executive suite, but was not a basic principle, as it is for a DB plan.

The language we use can be revealing; it is still common in the United States to use the term *pension* to refer specifically to a DB benefit, but not to 401(k)s or other DC plans. Benna talks of a 401(k) savings plan, not a 401(k) pension plan. Indeed, the comments President Bush made when he signed the PPA included the term *pension plan* to refer to defined benefit plans. But terminology is changing. Internet searches show that the term *401(k) pension plan* is gaining ground in government and corporate web sites. This subtle change in language is one sign of the changing role that underlies the move to version 2.0.¹¹

INCOME REPLACEMENT

If a savings plan is about a pot of money, a pension plan is about providing income. In the case of a DB plan, the income replacement objective is obviously central to the whole design and operation. And many of the changes occurring today are driven by the growing realization that income replacement has become the name of the game for DC plans, too.

Reporting is going to be affected. An individual participant in a 401(k) plan has been accustomed to seeing a statement that might say something like: “You have saved \$50,000.” A DB plan participant, in contrast, might

see a statement that says: "You have accrued an annual pension of \$5,000." As the DC focus shifts to income replacement, the accrued value figure will need to be supplemented with more information—information that is relevant to what the plan is there for, perhaps something like: "This \$50,000 is likely to provide you with about \$X in monthly income, which should be enough to replace about 15 percent of your salary, if you retire at age 60."

Left to their own devices, most people do not make this connection between their savings and their retirement income needs. For example, the 2008 EBRI Retirement Confidence Survey (its 18th annual) reveals that 53 percent of respondents had not tried to figure out how much money they will need in order to live comfortably in retirement.¹²

This reframing from a savings perspective to a pension perspective applies to the plan sponsor, too. At present, plan sponsors have little real gauge of how effective their 401(k) plan is in terms of retirement income. They know how much money is going *into* the plan. They know the accumulated value of the assets. They know, usually, the return that has been earned on those accumulated assets. But they do not know how this all fits together—that is, how effective the overall program is in terms of its fundamental purpose. In version 2.0 of the 401(k) plan, plan sponsors will have a clearer view of this big picture.

Income replacement is a high bar to set. In our previous example, \$50,000 may well sound like a lot of money to the typical plan participant, but the implied level of income replacement may be much less reassuring. Income seems especially puny when interest rates are low and when life expectancy is increasing.

Income replacement in retirement for the many is a much tougher task than tax-efficient accumulation of wealth for the few.

IS THIS THE FIRST NAIL IN THE COFFIN OF DEFINED CONTRIBUTION?

Version 2.0 is being asked to do a lot more than version 1.0 and is going to be judged to a higher standard. In many cases, 401(k) plans will not compare favorably to DB plans. While DC plans *can* provide DB-like levels of benefit, they will require DB-like levels of contribution to do so. And the growth of DC has been driven in part by a desire to cut costs, so those DB-like levels of contribution are the exception, rather than the rule.

As a result, clearer reporting may lead to some dissatisfaction. When the question of income-replacement reporting first came up several years ago, one colleague, John Gillies, posed the question: "Is this the first nail in

the coffin for DC?" His point: Clear reporting reassures if projections are acceptable and provides advance warning if they are not. The arithmetic must be confronted and assumptions must be laid bare. If better income-replacement reporting throws light on low levels of contribution and other inadequacies in the system, it is better to do that today—unwelcome as that news may be—than to be confronted with the social strains it would produce in 15 or 20 years' time.

This is an important point. The twin realities that lie behind any retirement system are, first, that retirement provision is expensive and, second, that investment returns are uncertain. A key factor in the decline of the DB system was that these twin realities were for a long time not fully acknowledged, with neither the cost nor the uncertainty fully reflected on corporate balance sheets for many years. Reporting changes came after falls in equity markets and at a time when interest rates were low—so the system was less well placed to face what the reporting changes revealed than it would have been a few years earlier. There are lessons from DB about what *not* to do, and this is one of them.

Moving from DB to DC removes a significant source of uncertainty from corporate balance sheets but that uncertainty does not go away: It is moved onto the balance sheets of individuals. In the DC system, people do not know how much income their plans may provide. Similarly, retirement provision is expensive no matter which way you go about building it.

DC's eventual success may well depend on better reporting, even though in the short term that will draw attention to some inconvenient realities.

"HOLD ON A SECOND . . ."

Not everybody will agree with what we have just said. In particular, many plan sponsors will balk at the idea that 401(k) plans are now pension plans, designed for the provision of retirement income, rather than savings plans. Focusing on income replacement is more complex and demanding than focusing on savings. This new world would mean that plan sponsors can no longer just hire a record keeper, put in their company match, and call it good.

When confronted with the notion of 401(k)-as-pension-plan, plan sponsors vary in their responses. Some welcome the idea: They view a Version 2.0 DBized 401(k) plan as a superior benefit, and they want to be part of it. Others wonder what is in it for them: After all, many of them have just closed their DB plans in order to get out of the business of providing retirement income, and they have no wish to be back in it. In part, this just

What defines success in this model? An adequate income to retire on, from all sources.

Hence reporting includes not only the much-appreciated transparency of a participant's account value (a transparency that DB never gave), but also the aspect of transparency in which DB has always been superior to DC: a projection of the likely postretirement income that the account value will generate. And education in this model can also show how this income integrates with various other sources of postretirement income: Social Security, any other employment-based plan, and other sources of savings or income. Eventually, if participants are to make informed decisions as to their risk tolerance, they need to be educated on the interaction of contribution rates, target returns, income goals, and risks.

In a sense, this short description of three ways of looking at plan design lies at the heart of the retirement plan solution promised in the title of this book. If the DC system is truly to meet its goal of providing secure income in retirement, then a conscious recognition of that objective would surely help. A reinvented DC system—DC version 2.0—should move beyond simply offering investment choices and toward the Retirement Income Model we have described in this chapter. This is the path to a more effective system.

AN EXAMPLE OF A PARTICIPANT STATEMENT IN THE RETIREMENT INCOME MODEL

We make no attempt to create a thing of beauty or to be definitive or to comply with any particular set of laws or regulations. This is simply an example to show the kind of things that can be reported on usefully. In every section of the report, add any other similar identifying information you find useful.

XYZ Defined Contribution Pension Plan

Annual Statement prepared for [Employee Name Here]
as of December 31, 20XX

Part 1: Personal Identification

Name:
Address:
Date of birth:
Plan ID:
Hire date:
Current annual pay:
Beneficiary:

Part 2: What Your Account Is Worth

Value as of [previous date]:
Your contributions since [previous date]:
Company contributions since [previous date]:
Investment return since [previous date]:
Value as of December 31, 20XX:
Your current asset allocation is:

Note: If on a target date path, indicate current allocation and also say "and this will change as you approach retirement, in accordance with the 'Target 20YY Plan'"

Part 3: What Your Account Might Provide after Retirement

Your normal retirement date:

If, in the future, you earn exactly the same pay as your current pay and contribute at your current rate and the company also contributes at the current rate; if your asset allocation is as listed here; and if you buy a fixed-dollar life annuity at retirement at roughly the price available on December 31, 20XX:

There is a 50% chance that your annual income will be at least:
This is [x%] of your current annual pay.
There is a 75% chance that your annual income will be at least:
This is [y%] of your current annual pay.

Above is a standardized estimate to give you some idea, in advance of retirement, about the income your account might be able to generate, since the main purpose of this plan is to give you a source of postretirement income. Of course, this is necessarily an estimate and depends on making assumptions on many uncertain things. That is why we also give you some idea about the probability that the income will be achievable. Please see your plan document for further details. These estimates are based on assumptions about asset class returns (and the degree of uncertainty of those returns) made by [whoever takes responsibility for making these projections].

Part 4: Other Sources of Postretirement Income

Remember that this plan is intended to be one of many possible sources of income for you. Others are Social Security, other retirement plans you may be or may have been a member of, and personal assets. Though we cannot estimate what those sources will generate, we encourage you to find out about them so that you can take comfort in your preparations or take action if it appears that your preparations may not achieve all that you want them to.

Note: Here add a call to action: a tear-off postcard, details of how to go online to find more information such as the Social Security web site, and so on.

Appendix:

Note: Here add (a) all sorts of disclaimers, (b) details of the returns earned by the employee's account, (c) a statement along the lines of "since you joined the plan, the average annual investment return earned in your account has been x.y%."

Russell Research

By: William Madden, Senior Investment Strategist

MAY 23, 2008

“Will I have enough to retire?”

Research shows answers vary widely depending on the investment calculation tools used

A number of tools are currently available to allow individual participants in defined contribution (DC) plans to measure their progress toward a secure retirement. In this research article, we examine the outputs of five such tools and find significant differences in the conclusions they reach.

How do participants know if their savings are on track?

Since 401(k)s and other defined contribution plans are now the main sources of retirement savings for a majority of private sector workers in North America, increasing attention is being paid to tracking the progress of DC accounts toward meeting retirement goals.

Most DC recordkeepers and investment providers have calculators or models which allow a participant to estimate how savings stack up against retirement goals. We refer to this process as on-track reporting – the process designed to help participants answer the big question, “Will I have enough funds to meet my retirement needs?”

A retirement goal is often expressed as a percent of final salary (the rule of thumb used most often seems to be 70-85%) but it could just as well be an estimate of retirement expenses – a budget.

Although the principles involved in developing tangible retirement goals and comparing them to one’s savings today are unambiguous, depending on the vendor, results from various on-track reporting tools can be very different, if not confusing.

Case study: Comparing five models of on-track reporting

For purposes of comparison, we ran simple retirement calculators or models from five providers – using the same data for the following hypothetical participant:

Sharon - Hypothetical participant

Age: 47

Years to retirement: 20

Current DC balance: \$54,000

Contributions:

Employee: 4% of pay

Employer: 2% of pay

Current salary: \$45,000

Annual Salary Growth: 3.0%

Projected investment return: 7.0%

Individual investors can't afford to be confused about retirement security.

Result summary: Models 1-5¹

1. The first report said that Sharon needed \$910,280 at retirement and that, with her current rate of savings and earnings, she would be only \$9,500 short of this goal. On this basis, she has a sound plan, and only needs to save a bit more to be exactly “on track.”
2. The next calculator showed that at retirement, Sharon would need \$3,188 per month in today’s dollars and that her current balance and projected contributions would only yield \$2,200 per month.
3. This model reported that Sharon had a 95 percent chance of being able to spend \$15,000 in today’s dollars per year at retirement.
4. According to this report, at retirement, Sharon would be short anywhere from \$676,000 (given poor markets) to \$444,000 (given average markets) of a total retirement goal of \$945,000.
5. The final model projected an \$859,400 shortfall at retirement and would require Sharon to save an additional \$21,000 per year (about 44% of Sharon’s current salary) to make up the difference.

Explaining some of the differences

The table following restates the output for each of the models in terms of income replacement at retirement—note that Sharon’s final salary is projected to be \$81,275. The principal differences are as follows:

- Models 1 and 2 incorporate Social Security, while 3, 4 and 5 do not.
- Model 5 bases retirement income on the growth of today’s account balance, ignoring future contributions
- Models 3 and 4 are based on simulations of ranges of market outcomes. This is very helpful in assessing the chances of meeting one’s retirement goals.

Projected retirement needs and expected income						
Annual amounts in dollars at retirement						
	Model 1 80% replacement	Model 2 85% replacement	Model 3*	Model 4 83% replacement	Model 5 94% replacement	
Amount needed at retirement	\$65,020	\$69,100	-	\$67,500	\$76,310	
Social Security (20 years)	(\$39,120)	(\$33,510)	0	0	0	
Net needed	\$25,900	\$35,590	\$27,090	\$67,500	\$76,310	
Retirement income from current and future savings	\$25,220	\$14,260	\$27,090*	Poor Markets \$19,210	Avg. Markets \$35,290	\$14,930
Shortfall	\$680	\$21,330	-	\$48,290	\$32,310	\$61,380

*Model 3 does not have an income replacement target, but calculated that Sharon would have a 95% likelihood of reaching an annual amount of \$27,090—equivalent to 33% income replacement.

¹ Note that all five of these models provide fairly simple approaches to retirement planning. Many more comprehensive systems are available which allow for inclusion of non-retirement assets, health insurance, taxes, treatment of longevity issues, decumulation, etc. Russell does not have a proprietary interest in any of the models used as part of this case study or use them on a regular basis. Additional simulation descriptions for Models 3 and 4 are highlighted on page 4.

What are the factors that matter most?

Despite these differences in the basic output, on-track reporting is an important part of a sound retirement planning process. Each of the systems we tested can provide valuable information over time to individuals in DC plans. However, there are a number of points that users of these retirement models need to keep in mind. Among the most important are:

1. UNDERSTANDING THE UNDERLYING PROJECTIONS AND CALCULATIONS

Participants should understand how the calculator (or any planning tool) works – how estimates are developed and what is included or excluded before acting on the results. Similarly, if plan sponsors offer modeling tools from an advisor or provider to help participants plan for retirement, it's important to understand the tools' underlying assumptions and to clearly communicate this information to participants. For example, the \$61,380 annual shortfall of Model 5 is nearly 100 times the \$680 annual shortfall of Model 1—a huge difference—due to different treatments of Social Security benefits and future DC contributions.

2. DETERMINING THE NEED AT RETIREMENT

All of these models use a percent of final salary as a rule-of-thumb to determine retirement needs. This is a convenient method of estimating retirement income, but it may be quite different from one's actual expenditures or even different from one's own assumptions about replacement income.

Another approach is to prepare a consumption budget by downsizing today's spending patterns, but including expenditures unique to retirement. Laurence Kotlikoff points out that a target of 70% to 85% of final salary, in many cases, is more than what is needed to support retirement needs. For more details on Kotlikoff's assumptions and observations, see his article, "Economics' Approach to Financial Planning."²

3. PROJECTING ASSET RETURNS – CONSTANT OR VARIABLE?

Projecting total assets based on a constant asset return over your working career leads to one very easy to understand answer. But what if actual returns are worse than the assumption? You only have one retirement to plan for and you don't want to get it wrong.

It is important to demonstrate the risk of a particular investment program by calculating at least a "poor" outcome along with the straight line average. Many systems use more robust risk measures incorporating simulation.

4. FREQUENCY OF REPORTING

An on-track reporting system should be part of (preferably the lead page) of a benefit summary package for participants. Retirement needs and projected income from current DC balances should be compared at least annually. Changes in excess or shortfall from one period to the next should be explained by either changes in future retirement needs or changes in current and projected savings. This is analogous to explaining changes in defined benefit pension plan surplus by increases/decreases of liabilities or assets.

Conclusion

For many individual investors, the simple question, "Will I have enough to retire?" is not easy to answer. A number of calculators and "on-track" reporting tools offer some guidance—but the wide variety of outputs they provide can be confusing. It's important for individuals to understand the factors impacting their savings and "on-track" status. Investors can't afford to be confused about retirement security.

² Kotlikoff, Laurence J. "Economics' Approach to Financial Planning." *Journal of Financial Planning*. November 8, 2007.

Simulation descriptions – Models 3 and 4

Model 3 places an individual on the glide path of a target date fund based on his or her current age. Monte Carlo simulation is used to estimate the final retirement fund values. Model 3 does not include Social Security income or simulate outcomes relative to an income replacement target. It provides an estimate of retirement income based on current assets, contributions and simulated returns.

Model 4 asks users to choose an investment style preference, varying from conservative to very aggressive. Each level is associated with a target return. For our trial, a target return of 7% was selected. Given the target return and the standard deviation around it (based on a combination of equity and debt investments), Model 4 estimates average and poor outcomes.

Russell Investments offers defined contribution solutions designed to provide better outcomes for participants. Our broadly diversified target date, target risk and asset class investment products offer participants access to some of the world's best money managers.

Russell also provides a range of services including glide path and allocation advice, target date plan default options, single asset class, commingled and separate account solutions to help meet the unique needs of DC plans.

For more information about our defined contribution services:

Contact your Russell representative, call Russell at **800-426-8506** or visit **www.russell.com/dcinsights**

Important information

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