

Department of Labor and Department of the Treasury
Joint Hearing on Lifetime Income
Statement of Paul Schott Stevens, President and CEO of the Investment Company Institute
September 14, 2010

I am Paul Schott Stevens, President and CEO of the Investment Company Institute,¹ the national association of U.S. investment companies. We appreciate this opportunity to share additional views with the Departments of Labor and Treasury as you examine how American workers can manage their retirement assets with a view to obtaining a stream of income over their retirement years. The Institute strongly supports efforts to help American retirees manage retirement savings, which will increasingly consist of assets in defined contribution plans. Members of the Institute provide investment management, recordkeeping and other services to these plans, and are dedicated to their continued success. The Institute's May 3 submission on the Agencies' Request for Information on Lifetime Income Options sets out our research and analysis on many of the questions the Agencies asked.²

This submission focuses on three areas the Agencies would like to explore further.

1. Specific concerns that may deter workers from selecting annuities rather than other distribution options;
2. What information would help participants make choices in managing and spending down retirement benefits; and
3. Disclosing account balances as monthly income streams.

The Institute's views on these topics derives from our extensive research in the retirement area and our insights on investor and participant preferences regarding disclosure.

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$11.66 trillion and serve almost 90 million shareholders.

² The Institute's May 3, 2010 letter responding to the RFI is available at www.ici.org/pdf/24278.pdf.

I. Specific concerns that may deter workers from selecting annuity distribution options

The Agencies specifically identified several factors that could deter participants from selecting an annuity, including inflation risk³ and lack of any (or any meaningful) death benefits or withdrawal options. We agree that concerns about inflation and withdrawal options are factors that influence retiree decisions, but they are not the only concerns. Others include the participant's desire to retain control over financial assets and the simple fact that many Americans are already highly annuitized. A continuum of financial products for managing retirement assets already exists that provide varying degrees of protection against the wide range of risks that retirees face, and individuals may create a strategy that combines products to meet their range of needs or may buy an insurance product that includes investment components.

Any analysis of factors that influence distribution choices should take into account economic distinctions among strategies for managing retirement assets. Every financial strategy on the continuum from inflation-indexed immediate life annuities to self-managed periodic withdrawals shares a common component: the return of principal and interest on a lifetime of retirement saving. The distinguishing feature of a life annuity is that consumers give up all further claims to their account balances in exchange for transferring investment risk to the insurer and receiving guaranteed payments as long as they live. They receive an additional incremental amount that the retiree can safely spend each year, which the insurance company provides by redistributing relinquished account balances from retirees who die at younger ages. The "cost" to the retiree for the incremental additional guaranteed income is giving up his or her retirement account balance when the annuity payments begin.

If the annuity product also contains death benefits or guaranteed payout periods, the product has moved along the continuum away from an inflation-indexed immediate life annuity and towards self-managed periodic withdrawals in order to address the risks retirees face in addition to longevity risk. Inflation-indexed annuities with death benefits or guaranteed withdrawal benefits will address risks or concerns in addition to longevity, but reduce the payments otherwise made to the annuitant. These are in effect "bundled" products. It is essential for the Agencies to recognize that a retiree can duplicate these features by other methods. For example, a retiree can set aside an amount to be passed on to a spouse or heirs and dedicate a separate portion of assets to obtaining a single life annuity. While insurance products are one useful way to address concerns beyond longevity, they are not the only way. Although some comments on the RFI focused only on longevity risk (and assumed that more

³ A nominal annuity does not fully manage longevity risk because the fixed payments will not adjust to retain purchasing power. To insure that inflation does not erode the purchasing power of an annuity, it is necessary to purchase an inflation-indexed annuity.

annuitization should be the goal of public policy), the Agencies' hearing notice recognizes participants have a range of concerns and priorities in making retirement distribution decisions. They also worry about needing access to retirement assets in emergency situations and leaving assets for surviving spouses or heirs, among other things.

The market already offers several ways to accomplish retiree goals or meet retiree needs. Institute research shows that retirees exhibit a strong desire to retain control over their retirement wealth because they have other risks or objectives in mind. These competing risks and objectives explain why the retirement income market has evolved to address the concerns the Agencies raise. Because there are many different types of retirement income products and strategies spanning the continuum from self-managed periodic withdrawals to inflation-indexed immediate life annuities, public policy should not turn on how a product is labeled. Rather, it should recognize that different methods can achieve economically equivalent results.

The Agencies' analysis also must look at the extent to which Americans are already annuitized. Many individuals already are highly annuitized through Social Security, defined benefit pension income,⁴ and owner-occupied housing.⁵ For example, looking at individuals age 65 and older in 2006 who reported they did not work, 51 percent of all income received by the group came from Social Security benefits, 14 percent came from private-sector pensions (both defined contribution and defined benefit) and 12 percent came from government pensions.⁶ Ranked by income, *the bottom half of individuals in this group received 85 percent of their income from Social Security*— an inflation-indexed immediate life annuity.⁷

⁴ Although coverage of private-sector workers in defined benefit plans has declined, there still are many Americans who will retire with a defined benefit pension, especially if they spent all or part of their career in the public sector.

⁵ Owner-occupied housing wealth can be considered “annuitized” because if a household did not own its home, it would be required to pay rent to live in the home. The primary benefit of owner-occupied housing is that it provides imputed rental income in excess of expenses, which reduces the need for a regular stream of income from other sources.

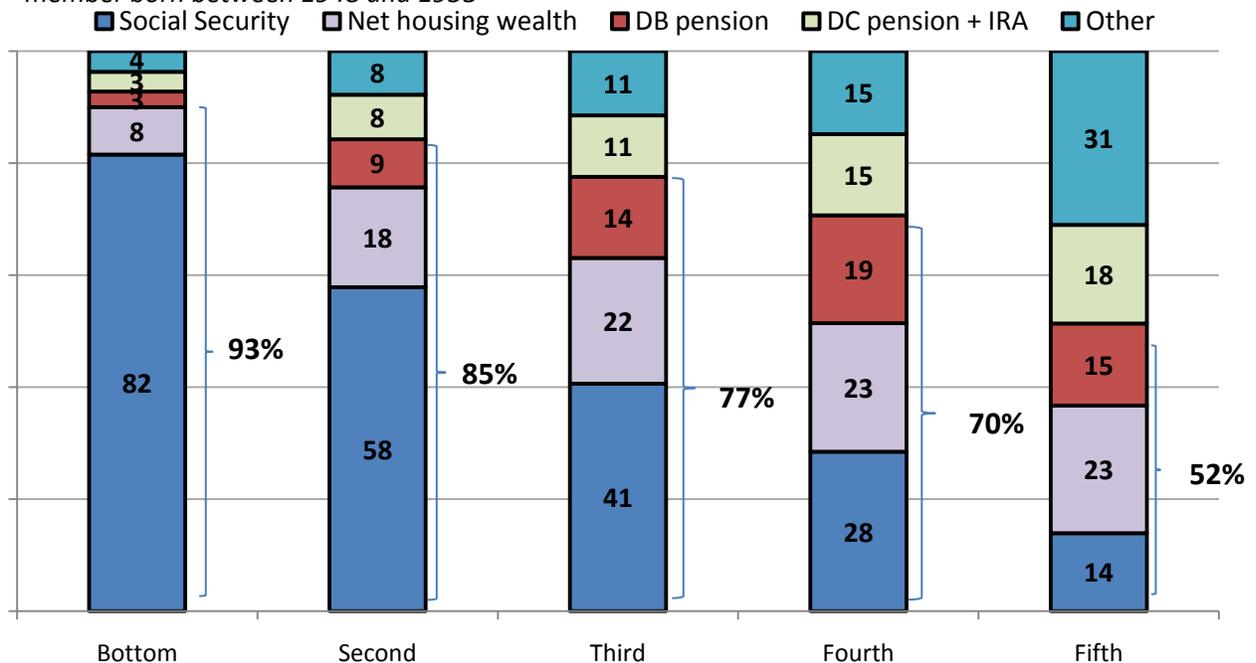
⁶ Statistics reported are ICI tabulations of Bureau of Labor Statistics, Current Population Survey (CPS) data. See Submission from Paul Schott Stevens, President and CEO, Investment Company Institute, to Honorable George Miller, Chairman, Committee on Education and Labor, U.S. House of Representatives (March 10, 2009), for the record in connection with Education and Labor Committee Hearing on February 24, 2009.

⁷ The importance of Social Security has not changed much over time, as the story was much the same three decades ago (based on ICI tabulations of CPS data). Whatever changes may be made to Social Security in the future, we assume it will continue to provide significant income to lower-wage workers in retirement.

Another recent study looked at the components of wealth for households close to retirement in 2006.⁸ For most households, the bulk of wealth was already in annuitized form – that is, either Social Security wealth, net housing wealth, or accrued defined benefit pension benefits. For the bottom 20 percent of the wealth distribution, annuitized assets accounted for 93 percent of wealth. Even for households in the second highest wealth quintile, annuitized assets accounted for 70 percent of wealth. The top 20 percent of the wealth distribution had a comparably low proportion of wealth annuitized, with 52 percent. These statistics suggest that it is *higher-income* households that are most likely to desire supplemental annuity income, not *lower-income* households.

Most Retirees Already Hold Most Lifetime Wealth in Annuity-Equivalent Form

Percentage of wealth by wealth quintile in 2006 for households with at least one member born between 1948 and 1953



Note: Households with top and bottom 1 percent of total wealth excluded. Components may not add to 100 percent because of rounding. Source: Gustman, Steinmeier, and Tabatabai, "What the Stock Market Decline Means for the Financial Security and Retirement Choices of the Near-Retirement Population," Michigan Retirement Research Center Working Paper WP2009-206, October 2009.

⁸ Gustman, Steinmeier, and Tabatabai, "What the Stock Market Decline Means for the Financial Security and Retirement Choices of the Near-Retirement Population," Michigan Retirement Research Center Working Paper WP2009-206 (Oct. 2009). The specific population studied is households with at least one member born between 1948 and 1953, which means they were between 53 and 58 years of age in 2006. To calculate Social Security wealth, the authors used detailed data of each individual's earnings history to project future benefits and then calculated a present value for that stream of income.

II. What information would help participants make choices in managing and spending down retirement benefits

We applaud the Agencies for focusing on what information would help participants make choices regarding management and spend down of retirement benefits. An individual must consider his or her own needs in retirement and understand what tools can help meet those needs. To be effective and useful to Americans, information and education efforts must focus on both content and delivery.

In the Institute's view, the content should:

- Get Americans to identify the range of income and assets available to them to help fund their retirement. This range includes defined contribution plan balances, IRAs, any defined benefit plans, Social Security, owner-occupied housing, and income or assets provided by a spouse;
- Get Americans to identify their goals and anticipated needs in retirement, including normal living expenses, known health issues or financial responsibilities for children or others, and desire to leave assets to heirs. It should also encourage them to consider the impact that unanticipated medical or other expenses or economic developments might have on their retirement security;
- Inform Americans that there are various ways to structure their affairs to provide regular retirement income (including delaying Social Security),⁹ deal with contingencies or unanticipated financial demands, and achieve any goals to pass assets on; and
- Provide general information on the various types of products or strategies that are available and how they can be used, including information on the risks and tradeoffs the different options present and any limitations they involve. To this end, it is important to understand the objectives of the various distribution options or strategies available both in and outside the plan and how those options might address an individual's needs. Finally, information

⁹ We have proposed that as one component of an education campaign, individuals nearing retirement should be advised of the benefit of delaying receipt of Social Security payments. For those who have assets available and who want to increase the share of their wealth that is annuitized, this is an efficient way to increase annuity income. (Other factors, such as how long the individual expects to live, will impact whether delaying Social Security benefits makes sense.) For example, every month that an individual delays receiving Social Security benefits after age 62 and before reaching age 70, his or her monthly benefit is increased by anywhere from half of 1 percent to three-quarters of 1 percent, or about 7 percent to 8 percent per year. One advantage of this strategy is that, because benefit adjustments are approximately actuarially fair, a dollar spent delaying Social Security receipt buys more annuity income than a dollar spent purchasing a private-sector annuity. An individual can, in effect, purchase annuity income by delaying receipt of Social Security benefits.

and education should help workers understand the costs, fees and expenses of the various strategies and products.

How information is delivered is just as important as the content. Institute research shows disclosure is effective and useful when it is clear and concise, makes use of graphics, provides layers of information, and makes effective use of technology.¹⁰ Participants today tend to make contact with their retirement plans through the Internet.¹¹ When seeking information electronically, they want to be able to click through easily to additional relevant information.

After a lengthy process to improve mutual fund disclosure, the SEC recently adopted the summary prospectus rule, which incorporates these delivery principles. We recommend the same focus on these principles in developing retirement information and education programs. We also recommend improving disclosure about all retirement income products. Providing accessible, clear and comprehensive disclosure about annuities, for example, may be particularly challenging because buying an annuity is a complex financial decision. Behavioral finance principles tell us that financial decisions can be influenced by the way in which the decisionmaker is confronted with the choice. It is for this reason that the presentation of information on any product must be accurate and complete. Participants need to know the trade-offs involved in selecting any retirement income product and should not be induced to make a decision by failure to disclose, or shifting attention away from, pertinent facts.

Providing effective and useful information and education to help equip Americans to make choices on managing and spending down retirement benefits must be a joint government and private-sector responsibility that extends beyond the workplace. Many employees will receive retirement benefits from several jobs over the course of their careers. Therefore, we should not look solely to the employer or workplace plan from which the employee retires to meet education needs. At the same time, employer programs will continue to play an important role in helping employees transition into retirement. Our May 3 statement describes two steps the Agencies can take to facilitate this. The

¹⁰ For survey results summarizing mutual fund-owning households' views on information presentation, *see, e.g.*, Sabelhaus, *Investor Views on the U.S. Securities and Exchange Commission's Proposed Summary Prospectus*, Investment Company Institute (March 14, 2008), available at www.ici.org/pdf/ppr_08_summary_prospectus.pdf; and West and Leonard-Chambers, *Understanding Investor Preferences for Mutual Fund Information*, Investment Company Institute (2006), available at www.ici.org/pdf/rpt_06_inv_prefs_full.pdf.

¹¹ For the experience of the defined contribution plan participants in Vanguard's recordkeeping system, *see How America Saves 2010: A Report on Vanguard 2009 Defined Contribution Plan Data*, Valley Forge, PA: The Vanguard Group, available at <https://institutional.vanguard.com/iam/pdf/HAS.pdf>.

Department of Labor should extend Interpretive Bulletin 96-1 or provide other guidance that makes clear that sponsors and service providers may convey the general advantages and disadvantages of various distribution forms without triggering fiduciary liability. The Department also should provide guidance allowing the appropriate use of plan assets to pay for these educational efforts.

The Institute is and always has been a strong proponent of providing meaningful disclosure that is useful and effective, uses graphics and a layered approach and makes efficient use of technology. We stand ready to work with government to develop a standard unbiased curriculum, using the principles described above, that could be made available through various sources to educate and inform Americans regarding management and spend down of retirement benefits.

III. Disclosing account balances as monthly income streams

The Agencies have posed a number of questions on disclosing account balances as monthly income streams. Information that translates a worker's defined contribution plan account balance into an estimated monthly income amount in retirement is useful information for retirement savers. The market has begun to provide this information. In many cases, providers and plans developed this income stream disclosure after extensive research into what information participants would find valuable and how they would like to see it presented. The Institute recommends that the Agencies let the market continue to develop but require providers and plans to make clear that income stream information is only an estimate and to disclose the key assumptions underlying the calculation. As we said in our response to the RFI, the Institute does not support mandating this disclosure or codifying a single approach to providing the information. The particular methods and specific economic assumptions for calculating an income stream are better left to the discretion of the plan and its provider – those who best know the participant population and plan features.

If, however, the Agencies determine to embark on requiring this information, they first need to be clear what their objective is. We think a proper objective would be to help Americans understand what monthly benefit they might expect from their account if their current elections stay in place. It also would be appropriate to seek to help workers analyze whether their retirement savings is on track. If these are the identified objectives, any lifetime income calculation should include projections – for continued contributions and asset growth in the account. The projections should specify the assumptions used regarding future contributions, investment returns, and rate of inflation. These are relatively simple assumptions that a layperson is likely to understand. This approach also follows the lead of Social Security statements, which provide estimated benefits based on the assumption that an

individual will continue to work and earn the same salary until certain specified retirement ages.¹² Moreover, assuming asset growth is consistent with the approach the SEC has taken for over 20 years in connection with illustrating the impact of mutual fund expenses in the prospectus.¹³

Additionally, if a specific methodology for estimating an income stream is mandated, guidance should not require presentation of the income stream in the form of an immediate life annuity. It would be inappropriate to require disclosure of only the annuity value of the account balance at the exclusion of other methods when characterizing income streams, especially if those other methods are easier to explain and convey the same basic principles to participants. An annuity is a financial product that differs from issuer to issuer and depends on complex assumptions about the life expectancy of the pool of annuitants. Disclosure in the form of an annuity could be misleading to many participants. As we know, individuals who purchase annuities tend to select features that dilute the annuity's insurance component and reduce the payments, which makes these calculations more complex. Keeping in mind the purpose of the income stream disclosure – to help participants determine whether their retirement savings is on track – it would seem more appropriate to use a simple calculation with fewer assumptions.

If the Agencies are going to prescribe a method for the disclosure, a simpler approach would be to divide the projected account balance by the life expectancy stated on IRS tables at a certain age, such as age 65. Another approach would be to use 3 percent or 4 percent of the projected final account balance at age 65, the approach some financial planners use. These approaches require interest rate assumptions, but not the more complicated mortality and pooling assumptions involved in the annuity calculation.¹⁴

IV. Conclusion

The current market for retirement income products and strategies offers a wide range of solutions for retirees addressing a variety of needs and risks. Product development in this area is sure to continue. Along the continuum, there already are numerous different approaches to achieve

¹² For the contents of the current Social Security Statement, see the sample statement available at www.ssa.gov/mystatement/currentstatement.pdf.

¹³ Since 1988, the SEC has required a mutual fund prospectus to include a table setting out information on costs associated with an investment in the fund. To allow investors to see the impact of costs over time, the SEC requires funds to provide an example using a hypothetical account of \$10,000 and assuming market growth in the account of 5 percent each year.

¹⁴ If a plan has an annuity distribution option, the plan should be permitted to provide the annuity value of the account (based on the plan's annuity option) in addition to the stream of income based on systematic withdrawals.

economically equivalent results. Public policy should not confer advantages to one product or approach based merely on how that product or approach is labeled. Policymakers also must recognize that most individuals already are highly annuitized, and that, broadly speaking, if any group could benefit from additional annuitization, it is higher income retirees.

The primary concern for policy in the realm of lifetime income should be ensuring that participants and other retiring individuals have access to clear, concise and comprehensive information about their options and the tradeoffs involved in their choices. We all need to think about new ways to educate American workers about financial decisions as they near retirement. The Institute intends to be proactive in partnering with the government and with others in the private-sector to move this goal forward.