

Alternative Designs of In-Plan and Distribution Lifetime Income Options

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On behalf of AllianceBernstein, I appreciate the opportunity to testify today. We're a global asset management firm headquartered in New York with approximately \$500 billion in assets under management, and we'd like to share our views on how to enhance the retirement security of participants in employer-sponsored retirement plans—namely, by facilitating arrangements that provide a lifetime stream of income after retirement.

A convergence of powerful forces has triggered the need to address this important issue. Defined Benefit plans, once the main source of secure retirement income for many workers, have become too expensive for most sponsors.

Meanwhile, DC plans have traditionally not been designed to deliver secure lifetime income to participants. This creates a potential retirement income gap for future generations of retirees.

Of course, DC plans do have many excellent features of their own—most notably portability, participant control and access to funds.

And US DC plan sponsors have invested an enormous amount of time and effort to improve their plans in recent years. Mostly, that was motivated by the desire to enhance employee benefits, but it was also encouraged by the protections and incentives afforded through safe harbor, offered in the Pension Protection Act of 2006 (PPA).

We believe that DC plans can preserve their beneficial aspects while also replicating the core benefits of DB plans—including widespread employee participation, expert investment design, low cost, and provisions for lifetime income. I'll briefly describe an alternative design for an in-plan lifetime income option,... outline some of the current obstacles to adoption,... and then suggest policy changes to remove these obstacles.

A DC plan can achieve widespread employee participation by automatically enrolling new and existing employees and requiring them to proactively opt out of the plan, rather than proactively opt in.

Expert investment design can be provided by using target-date portfolios as the QDIA. Of the available QDIA choices, plan sponsors have already shown an overwhelming preference for target-date portfolios. Seeking greater flexibility, transparency, investment manager diversification and lower cost, sponsors of large DC plans are increasingly adopting custom or “open-architecture” target-date portfolios. All of these recent advancements are positively impacting participants.

However,... with so much being done to help participants to save and invest until retirement, why has there been so little progress in helping them beyond retirement?

While delivering secure retirement income to participants appeals to many DC sponsors, to date they've been reluctant to provide such products due to a lack of adequate incentives and protections. I'll discuss this further, but first, let's review what participants might want and need in terms of secure lifetime income in their DC plan.

Many academic papers make a persuasive case that a traditional annuity offers much higher income potential and security than giving participants a lump sum at retirement. But when DC plan sponsors offer participants the choice between a lump sum with complete control ... and an income stream with no control, virtually all participants choose the lump sum. ... Why?

Academic papers on annuities typically assume that the sole motivation of retirees is to maximize their annual income for the rest of their life. But it is well documented that retiree needs and circumstances are far from uniform:

How much retirement income participants require, when they require it, and whether they would like to leave money to their beneficiaries vary widely from participant to participant. It also varies widely for any one participant over time, since unexpected health issues or other life events can radically alter a participant's financial circumstances.

As a result, most retirees or near-retirees simply don't want to lose control of their investments or access to their cash. Buying a fixed annuity requires the participant to make an extremely complicated and difficult emotional decision to surrender lifelong savings. ... This is perhaps the most important financial decision of their lives ... and one that most are unwilling to make.

And whether the annuity is purchased automatically or by choice, waiting to annuitize until retirement creates enormous timing risk: Participants who are unlucky enough to retire just after a market drop or at a time when interest rates are low, would obtain much lower guaranteed income than participants with similar contribution and investment histories who were lucky enough to retire after a period of strong market returns when interest rates are high.

Fortunately, it's not necessary to choose between giving participants full control of their savings (with no secure income) ... versus an irrevocable annuity (with no liquidity or control).

There's a range of annuity contracts that offer varying degrees of control ... typically with some reduction in the level of guaranteed benefit. This would seem a sensible balance to meet the needs of DC plan participants who desire a baseline of secure retirement income but also value control and cash access.

We believe that one such benefit, known as a Guaranteed Lifetime Withdrawal Benefit, is particularly appropriate for use in DC plans. A withdrawal benefit provides annual lifetime income, preserves participant control and allows participant assets to remain invested in the capital markets, providing the potential for capital appreciation.

We believe that combining a target-date portfolio with a withdrawal benefit can create an attractive QDIA — one that provides secure lifetime income similar to what's offered by a traditional DB plan, but with the control and upside potential of a DC plan. I'll refer to this alternative design as a “secure income target-date portfolio.”

Here's how it works:

In “secure income target-date portfolios”, the guarantee is a component of the target-date portfolio's asset allocation. Starting at around midlife, more and more of the portfolio's assets are automatically covered by guarantees.

And the guarantees can be backed by multiple insurers.

What this helps do is promote price competition. ... It also addresses the risk that any one insurer might default or run out of capacity to guarantee more assets.

In our conversations with sponsors, they felt that having the guarantee backed by multiple insurers was more than nice ... it was a necessity.

Also, quarterly statements for participants could include two other items along with their current account balance: the annual lifetime income they've accrued so far ... and estimates of the annual income they might accrue by retirement. DC plan investing and communications would move from a focus on account value alone toward focusing on retirement income. This could help participants gain a sense of retirement security.

We believe DC plans should consider automatically enrolling employees into a QDIA that incorporates lifetime income guarantees — such as secure income target-date portfolios. We believe this can offer workers the best attributes of DB plans within a DC plan framework

Despite these potentially transformative advantages for DC participants, very few plans today offer investment strategies with lifetime income guarantees as their plan default option.

We believe there are two primary ways that policymakers could help promote wider use of lifetime income strategies within DC plans:

First, concerning safe harbor provisions: It's unlikely that plan sponsors will adopt in-plan lifetime income solutions without safe harbor protection should an insurance provider fail. Of course, this safe harbor would require that the fiduciary who selects the annuity provider conducted appropriate due diligence in selecting the insurer.

Right now, the safe harbor that protects fiduciaries who select annuity providers for DC plans only seems to apply to traditional annuities ... and it doesn't clearly extend to other types of guaranteed lifetime income products.

We feel the rule should be revised to explicitly incorporate a broader class of guarantees.

Along with this, policymakers should clarify that QDIAs can include a broader class of guarantees. We recognize that current regulations contemplate the incorporation of guarantees within a QDIA, but the DOL could remove any uncertainty by clarifying the various forms of guarantees that a QDIA could provide, and also that safe harbor extends through the payout phase of such a QDIA.

Second, the rules related to qualified joint and survivor annuities and spousal consent need clarification. When retired participants make irrevocable decisions to annuitize benefits over their lifetime, the qualified joint and survivor annuity rules ensure that surviving spouses have a meaningful opportunity to protect themselves against loss of income. But with the type

of secure income target-date portfolios I described, participants retain control and therefore don't make irrevocable elections.

We feel the Department should remove any ambiguity in the qualified joint and survivor requirements when providing secure income target-date portfolios and other guarantees that do not entail irrevocable decisions. Critically, the administrative requirements for sponsors should be clear and simple. For example, it would help if the regulations clarified that a simple, one-time waiver with no additional elections or waivers be required.

We've seen extraordinary advances in DC plans over the past decade, especially since the PPA and your department's further clarifications. The next step is to help Americans achieve sustainable sources of income through retirement.

We believe that the actions we've outlined offer significant and meaningful ways to help DC participants ... and AllianceBernstein would be happy to assist the Agencies in any way to further advance the retirement security of US workers.