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TESTIMONY OF DAVID L. WRAY, PRESIDENT, PROFIT SHARING/401k COUNCIL OF AMERICA, BEFORE THE DEPARTMENTS OF LABOR AND THE TREASURY JOINT HEARING ON LIFETIME INCOME PRODUCTS

SEPTEMBER 14, 2010

Overview

The looming retirement of the baby boom generation has resulted in an increased focus on the 401(k) "retirement distribution phase" by those in the employer-provided retirement plan community. At the same time, retirement plan participants continue to take their retirement distributions in lump sum form. Less than 1 percent of defined contribution plan participants select an annuity distribution option when one is offered. Defined benefit pension plans are experiencing a similar lack of participant interest. For the one-half of defined benefit plans that offer a lump sum payment, more than 90 percent of participants endure the cumbersome spousal waiver procedures to avoid the otherwise required annuity distribution.

A major factor in the limited usage of annuities in retirement plans is that average wage workers already are provided with a substantial annuity when they retire. According to the 2010 Social Security Trustees Report, the average 65 year old retiring in 2010 will receive an inflation indexed Social Security benefit that replaces 40.8 percent of pre-retirement income. Married couples can each elect to receive their own benefit or 150 percent of one spouse's benefit. Social Security provides a 100 percent survivor's benefit. In two-earner families, the surviving spouse can switch from their own benefit to the spousal benefit if it is higher. If an average retiree seeks to replace 80 percent of their working income in retirement, Social Security will provide half that amount, indexed for inflation.

In general, because participant interest is so low, defined contribution plan sponsors increasingly see no reason to accept the additional fiduciary exposure that comes with an in-plan annuity option. As a result, the availability of annuity options in employer sponsored defined contribution plans has been declining. In the Profit Sharing/401k Council of America's survey of 2009 plan year experience, 19 percent of plans offered an annuity distribution option. This is down from 23 percent in 2005 and 34 percent in 2000.

Notwithstanding the above, plan sponsors are becoming more interested is assisting their participants with the transition from accumulation to retirement. PSCA recently surveyed its plan sponsor members and found that 91 percent of respondents are aware of retirement income products and only 17 percent felt the employer had no role in assisting their participants with the retirement transition.

You have asked about participant concerns affecting the choice of lifetime income relative to other options.
I would summarize those concerns into three general areas: fees, flexibility, and confidence. PSCA believes that the market should be permitted to address fees and flexibility. The government has an important role in restoring and maintaining confidence in the financial services that support the annuity process.

Historically, fees embedded in annuity products, especially retail annuity products, have been sufficiently high enough to offset an annuity's benefit of long term security. Further, annuity solutions have been designed and marketed in a way that makes an apples-to-apples comparison difficult. Participants need access to institutionally/group priced options presented in a way that permits them to maximize their purchasing power.

Individual retirement situations vary widely and participants need the flexibility to tailor solutions to fit their individual needs. They need:

- Access to a broad range of annuitization options.
- The ability to annuitize only a portion of their retirement assets.
- Access to multiple providers so they can diversify their investment risk.
- The ability to make multiple annuity purchases over time.
- Access to annuities with inflation protection.

The provider community is well aware of the situation and has responded by developing and marketing many new lifetime income products. Some are "in-plan" products that permit investment during the accumulation phase. Others are distribution-stage products with much more flexibility than the traditional products. A significant portion of the industry is marketing their annuities on an IRA platform like that provided by the Hueler Companies Income Solutions® platform rather than as a direct plan distribution option. The market is delivering solutions to the concerns about fees and flexibility.

At the same time, confidence in our financial institutions has recently been dealt a significant blow. Annuities by their nature depend upon the ability of institutions to exchange dollars today for payments over decades. Unless plan sponsors and participants are confident that those selling an annuity today will be able to deliver the promised benefits tomorrow, they will be reluctant to annuitize plan assets. It is critical that the government continue to take whatever steps are necessary to rebuild and then maintain the confidence of working Americans in our financial institutions.

You have asked about information to help participants make choices regarding management and spend down of retirement benefits.
While virtually all sponsors provide some type of education to plan participants, practices vary widely. In PSCA's *53rd Annual Survey*, reflecting 2009 plan year experience, 33 percent of responding sponsors provide education specifically relating to retirement distributions. In some cases plan sponsors offer extensive pre-retirement education that addresses not only the employer's plan but Social Security and Medicare, and even estate planning. Other sponsors feel that education should be limited to the plan and its investment options.

PSCA believes that current guidance regarding the provision of education or advice about distribution-related issues, including the ability to use plan assets to educate participants about lifetime income or other arrangements, is sufficient. However, if some need the Department of Labor to expand and clarify Interpretive Bulletin 96–1 so they can rely upon the Bulletin in order to provide participants with information to help them make better informed retirement income decisions, then the Department of Labor should do so.

Also, retirement decisions regarding plan assets are not made in a vacuum. Guidance clarifying that it is an appropriate use of plan assets to provide for broad pre-retirement education that goes beyond issues related to the plan or investing of plan assets, such as Social Security, Medicare, general estate planning, eldercare, long-term care, etc., will encourage more plan sponsors to provide this type of education to plan participants.

You have asked about the disclosure of account balances as monthly income streams.
PSCA does not support a regulatory or Congressional effort to require individual benefit statements to present an account balance as a stream of future lifetime income payments. That said, some plan sponsors and service providers voluntarily offer this feature today. Once again, PSCA believes that plan design decisions such as these are best handled by individual plan sponsors.

Section 105 of ERISA requires that benefit statements provided to participants and beneficiaries in self-directed individual account plans include a notice directing the participant or beneficiary to an Internet website at the Department of Labor for sources of information on individual investing and diversification (http://www.dol.gov/ebsa/investing.html). The website includes a rich array of resources for participants. The Department should consider adding an income stream calculator to the site that participants could use if they want to make this calculation. If the Department agrees to this suggestion, the calculator should accommodate both insured products and non-insured structured payment products. S.3760, The Automatic IRA Act of 2010, sponsored by Senator Bingaman, includes a provision that closely tracks our recommendation.

You have asked about a fiduciary safe harbor for selection of a lifetime income issuer or product.
Fiduciary concerns are a major issue for plan sponsors that are interested in offering a lifetime income product. The current safe harbor guidance, while helpful, is not a safe harbor in the conventional sense. It merely lays out a subjective process that constitutes a prudent selection process for selecting an annuity provider. To effect a behavior change by plan sponsors, the government will have to take responsibility for the safe harbor status of certain decisions, particularly the long term viability of the product provider.

You have asked about alternative designs of in-plan and distribution lifetime income options.
We are pleased at the evolution in the philosophy regarding annuitization of plan assets. Rather than assume that full and immediate annuitization of plan assets at retirement is a best practice, it is now recognized that annuitization is a tool participants can use as they develop a custom designed best solution. This has opened the door to a wide range of innovative products and approaches. Some products have an insured or annuity feature, and others are pure managed payout funds. Longevity insurance that begins payments at an advanced age provides an interesting complement to the managed payout funds and some other insured products.

It is currently difficult to include an in-plan lifetime income product with the other investment options in a defined contribution plan that allows transfers between investment choices because of surrender charges and fees. It is also difficult to help participants understand how accumulation annuities work in relation to other investment options and hard to find an advice model that would meet the needs of the general population of participants. Compliance with the joint and survivor annuity regime and required minimum distribution rules may be difficult with some products. Portability issues arise when a participant severs employment.

These products are in their infancy, and questions about them so far have resulted in very low adoption rates by plan sponsors. PSCA believes that the market should be permitted to refine and improve these products without government interference that could hamper this important process. When products are developed that meet the needs of participants and plan sponsors, they will be included in employer provided plans. This "marketplace of ideas," combined with the flexibility of the defined contribution system, has resulted in continually improving retirement plans and we are confident it will soon bring attractive lifetime income products to American workers.