The 2018 ERISA Advisory Council

Executive Summary to
The Secretary of Labor
November 6, 2018

The 2018 ERISA Advisory Council

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Topics for 2018

Evaluating the Department's Regulations and Guidance
on
ERISA Bonding Requirements and Exploring
Reform Considerations

Lifetime Income Solutions
as a
Qualified Default Investment Alternative (QDIA) –
Focus on Decumulation and Rollovers

Evaluating the Department's Regulations and Guidance on ERISA Bonding Requirements and Exploring Reform Considerations

Background

- Temporary regulation derived from Welfare and Pension Plan Disclosure Act of 1962 (WPPDA)
  - Pre-ERISA language and concepts.
  - Many changes in 43 years – growth of plan assets, new risks (e.g., cyber risks).
- 2014 Council Report – Outsourcing Employee Benefit Plan Services
  - Documented confusion about distinctions between voluntary and mandated insurance coverage.
  - Recommended the Department consider updating bonding requirement guidance to reduce confusion.

Background (cont.)

- EBSA studies of fidelity bonding compliance
  - 2014 Philadelphia Regional Office study – 61% of closed investigations had a bonding violation.
  - 2015 National Investigation – sample of 1,200 plans with trusts but no bond in place. Only 35 plans were actually exempt.
  - Non-compliance includes failure to have a bond, language in bonds that is inconsistent with section 412.
  - Non-compliance seems to be greater in the small plan environment.

Council’s Approach – Five Inquiries

1. “Covered losses” – to what extent are bonds insuring against losses resulting from any act of fraud or dishonesty?
2. “Persons covered” – to what extent are bonds covering all plan officials who handle plan funds or other property?
3. “Adequacy of bond amounts” – to what extent are bonds providing sufficient recovery amounts to offset losses?

Council's Approach – Five Inquiries

4. "Coverage of participant contributions" – should definition of "plan funds or other property" be expanded to include participant contributions prior to their deposit in the plan?
5. "Need for additional education/guidance" – should changes to guidance clarify the value of, and the distinctions among, fidelity bonds and other types of insurance?

Witness Testimony – 1. Covered Losses

- The potential for losses to plan participants is escalating due to the emergence of social engineering and cybercrime, but not due to acts of fraud or dishonesty covered by fidelity bonds.
- Other insurance products are available to cover losses caused by social engineering, cybercrime, and breaches of fiduciary duty by plan fiduciaries that do not rise to the level of “fraud or dishonesty.”
- A fidelity bond is not intended to cover losses caused by negligent acts or as a substitute for inadequate internal controls of the employer.

Witness Testimony – 2. Persons Covered

- Confusion exists about coverage of third-party service providers. The market for providing third-party bonding coverage does exist, but plan officials are not always knowledgeable about it.

Witness Testimony – 3. Adequacy of Bond Amounts

- There was no testimony or research obtained that gave any indication of harm to participants caused by either the lack of a bond or an inadequate bond amount.
- The lack of data on this inquiry is in part a function of other available insurance products, which may include fidelity bond coverage, but such coverage frequently is not reported as a separate category.

Witness Testimony – 4. Coverage of Participant Contributions

- Witnesses differed on whether the scope of coverage of a fidelity bond should be expanded to include participant contributions prior to their deposit into the plan's trust.
- It does not seem reasonable to require insurers to pay for receivables where the dishonesty of the plan sponsor contributor is at issue.

Witness Testimony – 5. Need for Additional Education/Guidance

- The witnesses agreed that bonding requirements of section 412 of ERISA are not well understood, especially by small plan sponsors and their service providers.
- FAB 2008-04 predates new cybersecurity insurance products, which has added to confusion about products and policy coverage.
- Additional education would be helpful for plan officials, plan sponsors and service providers.

Council Observations

- The Council's work was limited by lack of access to national underwriting data on fidelity bonds.
- Fidelity bonds appear to be widely available, easily obtainable, and relatively inexpensive. The market is assumed to be efficiently providing coverage.
- The language mismatch between the temporary regulations and ERISA appears to be a factor contributing to confusion.
- The Council found no specific evidence that the language in fidelity bonds resulted in losses being left uncovered.

Council Observations (cont.)

- No specific evidence of widespread uncovered fidelity losses – due to the loss exceeding the required fidelity bond limit – was found.
- Of the small number of incidents that were reported, no evidence of harm to plan participants was found.
- Evidence indicates reported losses are mostly with small employee benefit plans. Lack of awareness of the fidelity bond requirements and confusion over which coverage is required appear to be significant factors.

Council Recommendations

➢The Council recommends that the Department publish the following new guidance directed to plan officials, plan sponsors, and plan service providers:

1. A new Interpretive Bulletin, incorporating much of the content of its 2008 Field Assistance Bulletin 2008-04.
2. A summary of the requirements for securing a fidelity bond that complies with the Department's guidance. The Council has drafted a sample summary, which is included in the Appendix to the Council report.

Lifetime Income Solutions
as a
Qualified Default Investment Alternative
(QDIA) -
Focus on Decumulation and Rollovers

The 2018 ERISA Advisory Council
Goals

- Examine ways to promote Lifetime Income (LTI) options within DC plans via:
  - Guidance on annuity selection safe harbor, and
  - Modification of QDIA rule to enhance LTI usage.
- Analyze current state of LTI opportunities, needs and impediments from participant/beneficiary and plan sponsor perspectives.

Prior ERISA Advisory Council Reports

- 2008
  - Identified barriers to including LTI options in DC plans.
  - Recommended additional guidance and regulatory changes for the decumulation phase.
- 2012
  - Recommended developing educational materials for plan sponsors to select LTI options and for participants to choose LTI solutions.
- 2014 & 2016
  - Explored challenges of keeping assets in DC plans during retirement and portability issues.

Income Needs in Retirement

- Social Security retirement benefits are increasingly the only source of guaranteed income for many retirees.
- DC plan retirees are fundamentally responsible for transforming accumulated savings into income.
- DC plan retirees are now tasked with –
  - Managing investment, inflation and longevity risk.
  - Aligning their spending with income, and making critical decisions ahead of cognitive decline.
- Some retirees are underspending in retirement.

Focus on In-Plan Annuities
Benefits

- Ease of participant transition from accumulation to decumulation.
- Rigorous insurance carrier and product due diligence conducted by fiduciaries.
- Guidance on annuitization from the plan sponsor, a trusted source of information for participants.
- Pooling of plan participants' longevity risk.

Focus on In-Plan Annuities
Plan Considerations / Concerns

- Liability for selecting and monitoring insurance carriers.
  - Requires objective, thorough and analytic search.
  - Must appropriately conclude that the provider can make all future payments under the contract and cost is reasonable.
- Administration.
- Valuations.
- Fees.
- Participant suitability.

Lifetime Income Within Qualified Default Investment Alternatives

- QDIA regulations do not address:
  - The use of annuities as investment components within a default fund, or
  - Whether a qualified default fund may have distribution features.
- Differences in participants' individual characteristics and demographics challenge plans.

Lifetime Income Within Qualified Default Investment Alternatives (cont.)

- No transferability restrictions, fees or expenses for 90-day period.
- Flexibility for assets held in the QDIA
  - A participant must be allowed to transfer no less frequently than once within any three-month period.
- Transferability of living benefits without either a market or calculated value (e.g., GLWB).
- Potential imposition by carriers of charges that have the effect of restricting transferability.

Recommendations

Based upon Testimony and Research, the 2018 ERISA Advisory Council Offers Three Recommendations for the Department's Consideration

Recommendation # 1

- Amend the QDIA regulations to address using LTI in a QDIA. Such changes should:
  - Address the permissibility of including fixed annuities, living benefits and other LTI approaches in QDIAs;
  - Address the importance of tailoring QDIA options to affected participants, similar to rules applicable to QDIA balanced funds. Specifically, we recommend the Department clarify that sponsors may default participants into different options based on participant demographics because plan populations may not be sufficiently similar for a single default to be universally appropriate;

Recommendation # 1 (cont.)

- Maintain the current transferability and liquidity requirements, but clarify whether living benefits satisfy these requirements; and
- Address the extent to which charges may be imposed if they have the effect of limiting liquidity and / or transferability.

Recommendation # 2

- The Department should publish guidance confirming that a named plan fiduciary may appoint a 3(38) investment manager to select and monitor annuity and other LTI options for DC plan decumulation, as well as accumulation.

Recommendation # 3

- The Department should encourage plan sponsors to adopt plan design features that facilitate LTI, including, but not limited to: allowing participants to take ad hoc distributions, enabling installment payments, providing Social Security bridge options and allowing for payment of required minimum distributions.

Thank You