



AMERICAN BENEFITS

COUNCIL

TESTIMONY OF

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ON BEHALF OF THE

AMERICAN BENEFITS COUNCIL

FOR THE

ERISA ADVISORY COUNCIL

**WORKING GROUP ON SPEND DOWN
OF DEFINED CONTRIBUTION ASSETS
AT RETIREMENT**

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My name is Allison Klausner and I am the Assistant General Counsel – Benefits for Honeywell International, Inc. (“Honeywell”). I am here today on behalf of the American Benefits Council (the “Council”). The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council’s members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans. Honeywell serves on the Council’s Board of Directors and actively participates both directly and through the Council in public policy discussions regarding benefits issues confronting our country.

Thank you for the opportunity to testify on this critical retirement security issue, i.e., the so-called “decumulation” issue. Once an individual has accumulated retirement savings, he or she faces another set of challenges in determining how to spend those savings. Attention to this issue is very much needed to ensure that retirement savings lead to retirement security, which is, of course, the goal.

Background

All of us are quite aware of the continuing decline of the defined benefit plan system. This decline has been going on for more than two decades. Alongside this decline has been tremendous growth in the defined contribution plan arena, especially 401(k) plans. In short, there has been a dramatic shift from defined benefit plans to defined contribution plans as the primary source of private retirement security for Americans across the country.

In addition to this shift, there has been a very significant change in the manner in which defined benefit plans are providing benefits. Traditionally, plans maintained by large companies generally paid benefits in the form of an annuity, but today a large number of the private defined benefit plans offer benefits in the form of a lump sum distribution. Where such an option exists, the vast majority of participants choose it.

In addition, life expectancies continue to grow longer. As Americans live longer, the period of retirement is also growing, putting more pressure on retirees to manage their retirement savings in a prudent way.

The combination of these three factors creates a clear public policy challenge. Imprudent management of savings in defined contribution plans and IRAs could result in retirees outliving their private retirement savings, obviously a very undesirable result.

The above is a short summary of certain key elements of the public policy challenge that we face. I now turn to possible solutions.

Possible Solutions

As discussed in more detail below, the key to addressing the decumulation issue is education. The more that individuals understand the risks and challenges involved in the decumulation phase, the more prepared they will be to address these challenges successfully. The Department can play a critical role in this education process. In addition to helping with education, it would be extremely helpful if the Department could continue working on establishing a legal environment in which employers can broaden the decumulation tools available to their employees without triggering increased liabilities or burdens.

Education

The most important thing that can be done is to educate Americans about the decumulation challenge. This means first educating them about the facts and the issues. Americans need to understand what the average life expectancy is, as well as their chances of living far beyond the average life expectancy. Also, what Social Security benefit can they expect? How will the amount of this benefit be affected by their decision as to when to start receiving payments? How much more might they need to maintain their standard of living? How do the various annuity options work? What installment payment options are available and how do they work? What factors should be used to determine how much of one's retirement savings to take in the form of an annuity and how much to take in the form of installment payments? How should one decide how much should be kept aside for unexpected expenses? How might different rates of inflation affect one's decumulation strategy? How can the risk of health and long-term care needs be most effectively addressed? How could market volatility affect the achievement of one's financial goals and how can one reduce that volatility?

This education can and should come from various sources. As we have testified before this Advisory Council on a previous occasion, there is a critical need for financial education in the schools. But there is also an enormous need for education in other settings, including the workplace. Here are some things the Department could do to help:

- Interpretive Bulletin 96-1 could be expanded or supplemented to identify a range of educational services that could be furnished to participants with respect to decumulation without triggering fiduciary liabilities. For example, retirement income models could be provided based on various life spans and various distribution strategies. The illustrations could, for instance, show the effect of different levels of annuitization and installment payments on retirement income and access to cash. The models should be flexible enough to permit alternative illustrations to be run based on different inflation rates, different rates of return, and different needs for cash to address, for example, health or long-term care needs.

- The Department could develop educational materials like those described above. These materials would be available to individuals and would also provide employers with easy access to models for developing their own educational materials.
- As in the case of investment education, there are many participants who want more than education; they want specific advice. We urge this Advisory Council to explore decumulation analogues to the SunAmerica advisory opinion and to the recently proposed investment advice class exemption. For example, it is possible that computer models could be generated that would recommend a combination of annuity payments, installment payments, and asset reserves based on a participant's asset, risk, health, insurance, and demographic profile. Or advisors could make similar recommendations, if such advisors are compensated on a flat fee basis (even though the advisors' employers may receive different fees based on the participant's elections). Such computer models and advice would develop far faster if the Department were to issue guidance clarifying their legal status. We think this Advisory Council and the Department have a unique and exciting opportunity to do much good by taking the lead on these types of new ideas.
- The Department could take steps to facilitate the inclusion on defined contribution plan benefit statements of an estimate of the age 65 annuity payments attributable to a participant's vested benefit. Such facilitation could take the form of guidance protecting employers from any liability with respect to the accuracy of an estimate, as long as it was prepared in good faith and the assumptions were disclosed. If the employer also provides the type of education described above, the benefit statement could cross-reference the manner in which such education can be accessed.

Removing Obstacles

Currently, most employers' defined contribution plans do not offer annuity distributions. Many plans only offer a lump sum distribution. Why is this? There are probably four main reasons why plans limit their distribution offerings.

- Lack of employee demand. Why add options, with their corresponding costs and burdens, if employees do not want them (or need them in some cases)? Currently, employee interest in annuity distributions or other extended payment options is relatively low, even taking into account recent signs of growth (as reported by our members). A significant part of this problem can and should be addressed through education, as discussed above.

- Lack of employee understanding. Employees often do not understand annuity options, nor do they understand some of the developing installment payment options. Employers worry about overwhelming employees with information when most employees are still trying to understand the accumulation phase. Again, a national education campaign would be helpful in this regard.
- Fiduciary burdens. Companies are generally quite concerned about the increase in potential liabilities with respect to defined contribution plans. Accordingly, especially in the absence of employee demand, many companies will be quite hesitant to incur additional potential liabilities by selecting annuity providers for purposes of plan annuity distribution options. We urge this Advisory Council and the Department to explore means of reducing or eliminating those potential liabilities. Here are possible areas for this Advisory Council and the Department to explore:
 - Simplify and clarify the proposed regulation regarding the selection of an annuity provider. The fiduciary duties involved in selecting an annuity provider should be set forth in the same manner and in the same detail as the duties involved in selecting an investment option, which companies are quite accustomed to.
 - Provide that a plan's designation of one or more direct rollover options does not constitute a fiduciary act if the fiduciary clearly states that it is not endorsing such options. This rule, which would not apply in any case where a direct rollover option designated is clearly imprudent, could lead to an enormous increase in the easy availability of well-priced annuity and installment options.
 - Provide that if a fiduciary offers a reasonable range of annuity and/or installment options provided by designated providers, the fiduciary shall not have any liability for any loss attributable to an employee's choice of a particular product or provider. This would be a decumulation analogue to section 404(c), and could become similarly successful.
- Administrative burdens. A very significant impediment to offering annuity options directly under a defined contribution plan is that the selection of an annuity option triggers the spousal consent requirements, which are administratively burdensome. We urge the Department to explore means of reducing these burdens, including the increased use of electronic media in complying with the spousal consent requirements.

Other Issues

Default distribution options. This Advisory Council asked about the barriers that would prevent defined contribution plans from voluntarily offering annuity and/or installment payments as a default form of distribution (subject, of course, to a participant's right to elect a different form of distribution). Others have raised the possibility of requiring such a default distribution regime (again subject to a participant's right to opt out).

- The key issue is employee demand. Companies would not be interested in such a default distribution regime if their employees want lump sums. There is little reason for companies to bear the costs and liabilities associated with a default distribution option that their employees are not interested in. Thus, again, education is the key; as employees understand more about the value of annuity and installment payments, their interest in such forms of distribution may well grow. As employee interest grows, company interest in the type of default distribution regime described above may also grow. Of course, companies would be concerned about a mandated default distribution regime and would certainly want to retain the flexibility to determine if a default distribution regime is appropriate for their workforce.
- Another barrier to default distribution regimes is that they are not the right answer for all employees. For example, companies would generally want to limit any such default distribution option to older participants with a significant account balance. It would, for example, make little sense to default a 29-year-old with a \$7,000 account into an annuity product. Companies may also want to make any default option inapplicable when a distribution occurs automatically (such as when a terminated employee attains age 65 or 70½ under some plans).
- In general, companies will strongly prefer structuring any such default distribution regime as a direct rollover option, rather than as a direct plan distribution option. A direct rollover structure would make a default distribution regime much easier for plans, since it avoids the spousal consent requirements and could reduce the fiduciary burden. As discussed above, reduction of the fiduciary burdens associated with direct rollovers could be extremely helpful.
- We believe that any default distribution option should be structured appropriately so that it includes, with respect to a participant, a combination of annuity and installment payments. The default option should not be based exclusively on installments or annuities with respect to any participant.

Product innovation. As the decumulation phase grows in importance, new distribution products are being developed in response to the needs and preferences expressed by plans and participants. The Department and others in the government can help this development process by reacting quickly with clear simple guidance that addresses critical issues that arise with respect to such products.

The Advisory Council asked about what types of income streams should be available. We believe that the market can and should answer that question. The role of the Department is not to identify favored types of income streams but rather to (1) allow the market to determine what participants want and need, (2) remove barriers to the offering of appropriate annuity and installment payment products, and (3) help educate participants so that they can identify the combination of products best suited to their own needs.

For example, one new product is longevity insurance, which is generally an annuity that commences payments at the end of a participant's life expectancy. This provides a very inexpensive means for a participant to ensure that he or she does not outlive his or her retirement savings. Longevity insurance also fits well with a number of the new managed payment products being developed by the mutual fund industry. Such managed payment products can be used to provide retirement income prior to the end of a participant's life expectancy, at which time the longevity insurance kicks in. In order for longevity insurance to be offered in the retirement plan and IRA arenas, however, modifications to the minimum required distribution rules are needed. If such needed modifications could be made quickly, progress in meeting the decumulation challenge could be greatly accelerated.

In addition, annuity products have evolved in response to consumer preferences and financial needs. Annuities continue to provide guaranteed lifetime income. Some also provide for access to cash under the contract if needed. Other products help fund long-term care expenses, for example, by paying an increased stream of guaranteed lifetime income when the annuitant either enters a nursing facility or is unable to perform certain activities of daily living. Participants can also choose an annuity product that provides a guaranteed return of principal to the beneficiary if the participant dies prior to receiving the full amount contributed to the annuity. These are just a few of the annuity products available that provide consumers with guaranteed income and increased flexibility.

The Advisory Council asked about another relatively new product: investment options that purchase specified annuity payments. Again, we urge this Advisory Council and the Department to ensure that artificial barriers do not prevent the development of such products. For example, the recently proposed participant-level fee disclosure regulations are not workable with respect to certain of these products that are based on a fixed promise. It is critical that those regulations be modified and that

future guidance provide flexibility for these and other new products while at the same time providing important participant protections.

Broader education. We want to emphasize that the need for education is not limited to the defined contribution plan decumulation phase. Continued education is very much needed regarding the defined contribution plan accumulation phase, including, for example, target savings amounts, contributions needed to achieve those targets, investment strategies, and the effects of plan loans and/or withdrawals on the achievement of retirement goals.

As raised by this Advisory Council, there is also a need for similar work and education with respect to the decumulation phase in the context of defined benefit plans.

Conclusion

We applaud the Advisory Council for addressing this critical issue, which we believe will be one of the key public policy issues for the next 10 years. We look forward to working with this Advisory Council and the Department in addressing the challenges raised by this issue.