TESTIMONY OF PHYLLIS C. BORZI
ASSISTANT SECRETARY OF LABOR
EMPLOYEE BENEFITS SECURITY ADMINISTRATION
BEFORE THE
SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE

June 16, 2010

Introductory Remarks

Good afternoon Chairman Kohl, Ranking Member Corker, and Members of the Committee. Thank you for inviting me to discuss lifetime income streams and the Department of Labor's activities regarding lifetime income options for participants and beneficiaries in retirement plans. I am Phyllis C. Borzi, the Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). I am proud to represent the Department, EBSA, and its employees, who work to protect the security of retirement and other employee benefits for America's workers, retirees and their families and to support the growth of our private benefits system. Secretary Solis' overarching vision for the Department is to advance good jobs for everyone. A good job, no matter the type or pay level, includes a pension. EBSA is committed to promoting policies that encourage retirement savings and promote retirement security for American workers.

Many workers are able to achieve retirement security through their employer-sponsored pension plans. Defined benefit pension plans, in particular, are usually designed to provide lifetime income for workers, thereby protecting them against the risk of outliving their assets in retirement. However, as you know, there has been a trend away from sponsorship of defined benefit plans and a dramatic increase in the offering of defined contribution plans such as 401(k) plans, shifting a number of risks for retirement security on to the shoulders of American workers. This trend, combined with increasing life expectancies, significantly increases the risk that retirees will outlive their retirement income.

In response to these concerns, the Department shares the Committee's interest in examining the important issue of lifetime income. As baby-boomers begin to retire in larger numbers and as more retirees live longer and bear the risk for a secure retirement, it is important that we focus not only on the accumulation stage of retirement planning, but also on the decumulation stage. Accordingly, the Departments of Labor and the Treasury are currently reviewing the rules under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code to determine whether the retirement security of workers in employer-sponsored retirement plans could be enhanced by facilitating access to and utilization of lifetime income options. Our Departments jointly issued a Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans (RFI) on February 2, 2010. The purpose of the RFI was to solicit ideas on this important issue. We are now working through the comments and trying to discern the key trends and insights provided among the exceptional number of comments we received.

My testimony today will discuss a number of important considerations that have been raised by commenters as well as trends that suggest workers are increasingly bearing the risk for a secure retirement. I will also discuss the next steps we are considering regarding the use and accessibility of lifetime income stream offerings.

Shifting of Retirement Security Risks to Workers

EBSA is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of ERISA. EBSA oversees approximately 700,000 private pension plans, including almost 483,000 participant-directed individual account plans such as 401(k)-type plans and approximately 49,000 defined benefit plans. We also oversee millions of private health and welfare plans that are subject to ERISA.

Over the past three decades, there has been a trend away from traditional defined benefit pension plans, where workers accrue benefits based on years of service and earnings, and into defined contribution plans such as 401(k) plans, which provide a retirement benefit based on annual contributions and investment returns to an individual account. The number of active participants in defined benefit plans fell from about 27 million in 1975 to approximately 19 million in 2007. In contrast, the number of active participants in defined contribution plans increased from about 11 million in 1975 to 67 million in 2007.[1]

This trend away from defined benefit plans and towards defined contribution plans has resulted in a dramatic shift of risks from employers to workers. For instance, employers that sponsor defined benefit plans bear investment risk for the plan since the employer is responsible for making plan contributions to fund benefit payments during retirement. In contrast, workers in 401(k)-type plans now bear that investment risk because they do not receive a promised benefit or assurances as to the adequacy of their account balance. As we all know, poor investment returns and investment losses can devastate retirement savings in a 401(k)-type plan.

The risk of outliving one's assets in retirement, or longevity risk, has been placed squarely on the shoulders of workers. Defined benefit plans traditionally have offered benefit payments to participants in the form of a stream of lifetime income while 401(k)-type plans typically provide only lump sums. Today, however, many traditional defined benefit plans have converted to lump sum-based hybrid plans, such as cash balance or pension equity plans, while other defined benefit plans have added lump sum options. In fact, 52 percent of private sector defined benefit plan participants had the option of taking a lump sum distribution at retirement in 2005.[2]

When participants have a choice between an annuity and lump sum, they generally choose the lump sum option. A number of reasons have been given for this phenomenon, including the lack of information regarding annuity products, a perception that the

---

[1] The number of active participants in 1975 and 2007 are not directly comparable because of adjustments in the definition of a participant. See discussion in U.S. Department of Labor, Employee Benefits Security Administration, "Private Pension Plan Bulletin Historical Tables and Graphs," March 10, 2010.

[2] National Compensation Survey: Employee Benefits in Private Industry in the United States, 2005 U.S. Department of Labor U.S. Bureau of Labor Statistics May 2007 Table 51, page 66.

individual can invest better on his or her own, a misconception of the market risks associated with managing retirement assets for a lifetime, a preference for liquidity and the "all-or-nothing" nature of some employer annuity options, the costs associated with annuity purchases, and a belief that monthly Social Security benefits will be sufficient. While it is true that individuals who receive lump sum distributions may choose to purchase annuities, few households actually do. In 2008, only about 1 percent of adults age 65 and older reported receiving income from a private annuity.[3]

The Government Accountability Office (GAO) has highlighted the need to improve financial literacy, stating that aging workers must accumulate sufficient assets and learn how to manage those assets for a retirement in which "couples both aged 62 have a 47 percent chance that at least one of them will live until their 90th birthday."[4] The GAO notes that while ERISA provides a comprehensive regulatory framework over private pensions during the accumulation stage, once an individual withdraws his or her funds from either a defined benefit or defined contribution plan for retirement, they face a variety of risks. Typically, retirees must choose among a myriad of investment and/or insurance products without anyone, such as a plan fiduciary, acting on their behalf to screen the choices.

Concerned about the challenges now facing workers to manage these risks, in 2008, the ERISA Advisory Council assigned a Working Group to examine and review the spend down of defined contribution assets at retirement. The Working Group studied the types of guidance that could help plan sponsors and plan participants make better informed decisions regarding plan investment and insurance vehicles that provide periodic or lifetime distributions. The Working Group also provided recommendations on how Department guidance can enhance the retirement security of American workers by facilitating utilization of income stream distributions from defined contribution plans.

---

[3] Department of Labor tabulation of March 2009 CPS data.
[4] Government Accountability Office (GAO), "Retirement Income: Challenges for Ensuring Income throughout Retirement" (GAO-10-632R), April 28, 2010.

Request for Information on Lifetime Income Options

With the shift from defined benefit to defined contribution plans and an ever-increasing number of workers nearing retirement, it was clear that the Agencies – the Department of Labor and the Department of the Treasury – had an obligation to explore what they could do to ensure that all workers not only have the information and tools they need to accumulate adequate retirement savings, but also the information and tools they need to help ensure that those savings last a lifetime. We truly believe – and are guided by the principle – that today's workers both need and deserve an opportunity for a dignified and secure retirement. To that end, the Departments published a Request for Information (RFI) in order to start a dialogue around the challenges and issues facing today's workers at retirement. In this regard, we are committed to exploring what can be done through interpretation, regulation and legislation to address these issues. I am pleased that representatives of employees, employers, retirement plan service providers, academia and others have agreed to participate in this exploration.

The RFI asks a number of questions that are generally organized into categories under which we may, if appropriate, provide additional guidance. The responses to the RFI will further inform and define our analyses of a wide variety of issues relating to the offering and selection of lifetime income products by plan sponsors and plan participants and beneficiaries, as well as possible solutions to those issues.

Current Landscape

The RFI questions were designed to solicit information about the current landscape of lifetime income. We wanted to understand the products that are currently available to employers and workers, and the reasons that plan sponsors are reluctant to offer lifetime streams of income as a plan option. We also wanted to understand the choices that workers make and the reasons that workers, when given the choice to take their benefits in a lifetime income stream, typically select the lump sum option. Once we understand the current landscape, we can better evaluate steps we might take to assist plan sponsors and participants in having good choices and being able to make better decisions for their retirement security.

Would Changes to ERISA Guidance Enhance Retirement Security?

Traditional defined benefit plans with lifetime income distribution options have historically been more effective at achieving the goal of lifetime income in retirement than plans that distribute benefits as lump sums. For this reason, it is important for us to identify the most important elements, such as pooling of longevity risk, that make these retirement plans more effective in providing retirement income and determine whether those elements can be embedded within 401(k)-type plans. The RFI seeks information related to regulations and other guidance the Department has issued to help us evaluate which changes, if any, could be made to enhance workers' retirement security.

ERISA protects workers by providing standards of conduct for those who invest and manage the assets of employee benefit plans, who are called plan fiduciaries. Fiduciaries are required to discharge their duties solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits. In carrying out their responsibilities, fiduciaries must act prudently and in accordance with the documents governing the plan. If a fiduciary's conduct fails to meet ERISA standards, the fiduciary is personally liable for plan losses attributable to such failure. There are a number of ways that fiduciaries can reduce possible liability if a process is used that is protective of participants.

The Department has issued considerable guidance over the years designed to both facilitate compliance with ERISA's fiduciary standards and minimize the risk of liability for losses attributable to fiduciary breaches. One example of such guidance is a regulation that provides a compliance safe harbor for plan fiduciaries when selecting annuity providers in connection with their defined contribution plans (29 CFR 2550.404a-4). Recognizing the significance of this regulation in the offering of annuity products by employers, we specifically invited input on how this regulation is currently being used and whether it needs to be reviewed. We also asked for information about whether the safe harbor protection afforded by this regulation should be extended beyond distribution annuities to cover other similar lifetime income products.

Some plans, such as 401(k) plans, can be set up to give participants control over the investments in their accounts and limit a fiduciary's liability for the investment decisions made by participants (29 CFR 2550.404c-1). Plans designed to take advantage of this protection are typically called section 404(c) plans. Among the requirements, participants must be given sufficient information to make informed decisions about the investment options offered under the plan. We are reviewing whether section 404(c) plans currently provide lifetime income options which participants can select, and whether the regulation should be changed to encourage the inclusion of these products.

Plans that automatically enroll workers can be set up to limit a fiduciary's liability for any plan losses that are a result of automatically investing participant contributions in certain default investments. The types of investment alternatives for default investments are described in the Department's regulation relating to qualified default investment alternatives and the regulation requires that an initial notice and annual notice must be provided to participants (29 CFR 2550.404c-5). We asked whether plans are currently using default investment options that include lifetime income features. We also asked what action we should take to encourage the use of lifetime income features in default investment options.

Our review of responses to these questions and suggestions will help us evaluate whether changes to these regulations would facilitate use of lifetime income and enhance retirement security.

Is Additional Disclosure and Participant Education Needed?

Public policy initiatives have primarily focused on the accumulation stage of retirement planning. Only recently has there been a greater focus on the decumulation stage of retirement, and what workers and retirees do upon receipt of their retirement savings.

Given the potential utility of lifetime income to participants in efficiently constructing their personal retirement incomes, we will consider whether additional information could assist participants in this regard, and what impediments exist to providing such information. Some policy makers believe that providing participants with both the lump sum value of their accounts and the value of an equivalent income stream would be very valuable to workers who have to figure out how to make their savings last throughout their retirement years.

Chairman Kohl joined Senator Jeff Bingaman (D-NM) and Senator Johnny Isakson (R-GA) to introduce the bipartisan "Lifetime Income Disclosure Act" (S. 2832) on December 3, 2009. This bill would require 401(k) and other individual account plans to provide participants an annual statement providing estimates of how much their accounts would buy in lifetime monthly payments starting at normal retirement age. Plans would also be required to tell workers annually how much the money in their accounts would provide in monthly benefits (for both single and joint-and-survivor annuities) starting at age 65 if it were paid out as "a retirement paycheck for life." Under this legislation, the Department would also be required to issue tables that plans could use in order to convert account balances into annuity equivalents, along with a model disclosure for plans to use.

We appreciate Chairman Kohl's leadership in putting a spotlight on the disclosure of lifetime income. We believe that this type of information is potentially very useful for workers facing critical decisions concerning their retirement accounts. At the same time, providing such a comparison may be complex and raises practical and legal issues, which is the reason we asked for input regarding these issues. We are reviewing the comments submitted in response to our RFI to better inform us regarding the feasibility of providing participants with this type of information.

The Department believes it is important to educate participants about saving for a secure retirement and has a dedicated education campaign that uses publications, online tools, videos, PSAs, and outreach as methods to provide the information. The Department's

Saving Matters Retirement Savings Education Campaign includes a focus on participants nearing retirement which highlights the importance of not only saving but having a strategy for ensuring that retirement savings last throughout a potentially long retirement. In particular, our publication entitled "Taking the Mystery Out of Retirement Planning" addresses not only saving for retirement, but discusses the decumulation phase and includes a description of annuity-type products and how they might be utilized in this context. The RFI comments will help the Department review our existing publications to see if there are additional areas where we think education would be helpful.

We are also reviewing the Department's guidance on participant education to determine what information participants need to make informed decisions regarding whether to select lifetime income options. The Department issued Interpretive Bulletin 96-1 to clarify that investment education, as described in the Bulletin, will not be considered the provision of investment advice, which would otherwise give rise to fiduciary status and potential liability under ERISA for participants' investment decisions. We asked what, if any, legal concerns plan sponsors have about educating participants as to the advantages and disadvantages of lifetime income that might be serving as an impediment. As the financial marketplace changes and retirement risks shift more to workers, educational initiatives may need to address items not previously anticipated as well as the decumulation stage of retirement planning.

RFI Comments and Next Steps

The RFI has generated nearly 800 public comment letters, all of which are posted on EBSA's Web Site. Some of these are detailed letters with appendices well over 100 pages in length. We and our colleagues at the Department of the Treasury are still in the process of reviewing these letters. And even though we have not yet finished analyzing all of them, I would like to make a few observations about these comment letters.

First, I am very pleased that so many thoughtful responses, with different perspectives, have been submitted in response to the RFI. As a general overview of the types of commenters, we received more than 600 letters from ordinary citizens, and approximately 10 more comment letters from organizations, such as labor organizations and consumer groups, representing workers, retirees, and plan participants. Approximately 40 letters are from representatives of the financial services industry, including insurance companies, investment companies and banks. About 30 letters are from plan service providers, including third-party administrators, record keepers, actuaries, consultants, and lawyers. About 10 more are from representatives of employers, plan sponsors, and plan administrators. And, finally, approximately 10 comment letters are from governmental officials and members of academia.

Second, we have received a number of letters from individuals who are very concerned that the RFI is the first step by the government to take over their 401(k) plans. For the record, let me state clearly that nothing could be further from the truth. We do not support a government takeover of private retirement plans and I have said repeatedly and publicly that the RFI is intended merely to start a national dialogue on whether a lifetime income stream is a good thing, and if it is, whether and how the Department can facilitate access to, and use of, lifetime income streams. Now that we have begun analyzing the comment letters, I am even more convinced that this discussion is worth having.

Even though it is still early in the review process, many of the commenters believe that the government can, and should, do more in this area; others disagree that there is problem at all. Perhaps the biggest disagreement among the commenters centers on whether the government should mandate lifetime income as a distribution option. Far less disagreement exists on educational initiatives; many commenters believe that the interests of participants as a whole will be best served by educating employers and employees on the benefits and features of lifetime income.

The number and scope of the comments reinforces our prior sense that providing for lifetime income raises many different issues and tradeoffs. We are carefully weighing the full range of comments that we have received. The information from commenters will inform the process and provide a basis for determining what future actions we may take in this important area.

Of course, we continue to look forward to the participation and support of Chairman Kohl, Ranking Member Corker, and Members of the Committee as we pursue these issues so important to today's workers and retirees. We are also happy to work with the Committee on possible legislative solutions.

Conclusion

Chairman Kohl and Members of the Committee, thank you for the opportunity to testify before you today. The Department is committed to its mission to protect the retirement security of America's workers. We are working to ensure that workers have the information and tools that they need to enjoy a dignified and secure retirement.