Oral Testimony of

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Before the

U.S. Department of Labor

And

The U.S. Department of the Treasury

For the

Hearing on Certain Issues Relating to Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

Wednesday, September 15, 2010

U.S. Department of Labor

Washington, DC

Good afternoon. My name is Martin Schmidt. I am a retirement plan consultant from Chicago with over 25 years experience in the institutional retirement space. I am here today in my capacity as a member of the Institutional Retirement Income Council (IRIC). IRIC is a non-partisan, tax-exempt, volunteer organization whose members consist of retirement plan advisers, consultants, and attorneys. IRIC's goal is to facilitate the culture shift of defined contribution plans from supplemental savings plans to programs that provide retirement security. I will share with you today our experiences in working with plan sponsors who have considered adding lifetime income options to their DC plans.

Over the next few minutes, I will provide the Agencies with some background on the new types of lifetime income solutions that are emerging in the market; what is hindering the adoption of these solutions; and offer recommendations which the Agencies may wish to consider.

IRIC considers a product "Institutional", as opposed to "Retail", if the product is purchased through the plan sponsor/participant relationship. When compared to similar retail products, an institutionally priced product will likely have lower fees, which will translate into higher retirement income and/or larger amounts of lifetime wealth. Institutional lifetime income products may be offered either "in-plan" through the DC plan or "out-of-plan" as an IRA rollover.

Lifetime income products may also be offered as an insurance based solution, which provides a guarantee of lifetime income, or an investment based solution, which provides retirement income but without the lifetime guarantee. Both solutions are becoming more common.

A new type of insured solution in a DC plan is a deferred fixed income annuity. This solution allows the participant to invest in guaranteed income over time while the participant is building their retirement savings, which we refer to as the accumulation phase. The product can be a stand alone investment in a DC plan or an asset class within an investment fund, typically a target-date fund. These products are liquid during the accumulation phase and require annuitization by the participant to receive guaranteed income payments.

A second type of insured solution is the guaranteed minimum income benefit. Similar to the deferred fixed income annuity, the participant purchases guaranteed income over time during the accumulation phase. The difference is the guaranteed income component is wrapped around an equity investment, typically a Balanced fund. If the equity investment appreciates over time, the amount of guaranteed income available to the participant will be higher at retirement. Similar to the deferred fixed income annuity, these products are liquid during the accumulation phase and require annuitization by the participant to receive guaranteed income payments.

A third type of insured solution is the guaranteed minimum withdrawal benefit. This solution allows the participant to purchase an equity investment, typically a target-date or Balanced fund, that is wrapped with insurance. The market value is tracked and the high-water mark is used as the benefit base. At retirement the participant has a right to a guaranteed withdrawal based on a percent of the benefit base, typically 5%. The guaranteed withdrawal is paid for the rest of the participant's life even if the market value falls to zero. Unlike the other two solutions, a participant does not annuitize their balance, and the amount they can withdraw may vary. However, if the participant takes more than the guaranteed withdrawal, their future payments will decrease.

We are also starting to see other retirement income solutions that are not insurance based but investment based. For example, there are managed payout funds that are designed to distribute balances over a certain time period, such as 20 years after retirement. We also expect to see more development of investment based solutions that offer balance protection during the accumulation phase and distribute income over time. Development of these solutions includes derivative based or other hedging strategies, similar to those found in other insurance products. Some early innovations in this area include structured notes offering principal protection as well as structured income payments. These notes become debt of the issuer and are subject to the debt hierarchy. While we expect to see continued innovation leveraging investment based concepts, at this time, none of the available solutions protect a retiree from outliving their assets while maintaining a fixed level of income.

These are the newer solutions that have been or will be introduced to the market. I emphasize "newer" because the immediate income annuity has been available as a plan distribution option to participants for decades. However, very few participants choose this option. Recent surveys by Hewitt Associates show when participants are offered annuities as a plan distribution option, the percent of participants annuitizing has dropped from 6% in 2005 to 1% in 2009. Because of this "Annuity Puzzle", we have seen the emergence of these newer options which are built to be more attractive to participants due to their added flexibility.

While plan sponsors have expressed interest in the newer solutions to help participants with their retirement planning, the current regulation and guidance for retirement income and DC plans is based on an old, one time annuitization election model. As a result, plan sponsors have been slow to embrace these new solutions.

One concern is about increased fiduciary exposure associated with adding a lifetime income product that requires a relationship between the plan and an insurance company over several decades, often referred to as counter-party risk. If a plan sponsor wants to change an investment option in their DC plan they can easily do so. But the process is much harder with an insured income solution. Even though some industry experts feel the fiduciary issues have already been addressed, the perception among most plan sponsors and their advisors is the counter-party risk issue still exits. A safe harbor here will help.

Plan sponsors are also confused as to the applicability of the current safe harbor rules when selecting an annuity provider for a DC plan since the current safe harbor rules apply to distribution annuities. There is a question as to whether these same rules apply for lifetime income products which are acquired during the participant's accumulation phase. We ask that the DOL consider providing more direction about the process for selecting an insurer. A step-by-step approach to how an in-plan product should be selected would be very helpful.

The DOL may also wish to clarify when and how ERISA fiduciary duties apply to participant communications for lifetime income products. It is our belief that these products often need to be sold to participants and clear education and communication is critical. Interpretive Bulletin 96-1 could possibly be expanded or separate guidance could be provided.

Another way to get participants to invest in lifetime income products is through defaults. The use of defaults has worked well to increase plan participation and improve asset allocation. However, there is still confusion as to whether lifetime income products can or should be embraced as QDIAs, especially since the products have higher fees for income guarantees that may not be utilized by the participant. Clarification and guidance in this regard would be helpful.

There is also a problem with how in-plan lifetime income products are covered by state insurance guarantees. Coverage varies by state, but even when coverage exists, insurers are restricted as to how much information they can disclose. Unlike bank products, which can be easily liquidated and refer to the FDIC protection in their marketing materials, lifetime income products require a much longer commitment and the state insurance coverage that will help participants gain peace of mind cannot be explained. Some guidance here would be helpful.

Finally, the long-term relationship between the plan and the provider of the lifetime income product creates a concern about plan level portability. The industry is in the process of developing recordkeeping data standards to help address this issue, but further work is required in this area. A common platform, or middleware solution, needs to be developed to make the integration with insurers and recordkeepers more seamless. Until this happens few recordkeepers will support multiple lifetime income products on their recordkeeping platform. As a result, plan sponsors have been reluctant to add a lifetime income product which may limit their ability to change recordkeepers. To help address this and other portability issues it would be helpful if the Agencies would consider allowing a distributable event to an IRA for the lifetime income products prior to participant termination. This would allow participants to maintain the insurance guarantees for which they have paid fees.

I have tried to hit the key issues that the Agencies can impact in regards to current plan sponsor concerns. There are certainly additional reasons that plan sponsors are not adopting these solutions, such as the need for product simplification, better fee transparency, and greater demand from participants. However, my limited time today prevents me from going into too much detail on these issues but I am free to answer any questions in this regard.

In closing, I would like to say there is growing interest from many plan sponsors in adding lifetime income solutions to their DC plans to help mitigate the risk their employees will outlive their assets. We are not in favor of mandates, but we do think that plan sponsors, especially those without defined benefit plans, should be encouraged to consider whether adding a lifetime income option is in the best interest of their participants. IRIC believes that the Agencies can help in this regard by providing clarification, guidance, and safe harbors where possible.

Having better ways for participants to manage the income they receive from their DC plans is critical to the future health of our nation's retirement system and we thank the Agencies for the honor of sharing our thoughts today.