RECOMMENDATIONS FOR PLAN SPONSOR AND FIDUCIARY EDUCATION

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Thank you for the opportunity to testify on this matter which is so crucial to the provision of a secure retirement to the many Americans who participate in defined contribution retirement plans.

We do not represent the interests of any client of either of our firms, nor has any party retained us to represent their interests. Instead, the following recommendations are solely based upon our long experience with insurance based retirement plan products and services, and what we see as helpful steps in the initiative to successfully re-establish the availability of guaranteed lifetime income into the retirement plan marketplace.

Both authors have significant experience in the issues involving the incorporation of lifetime income products into defined contribution plans. We have jointly published what appears to be one of the few legal analyses on the manner in which lifetime income programs can structurally be offered through defined contribution plans.[1]

In our view, a typical fiduciary of a defined contribution retirement plan that wants to select an annuity product to provide plan participants with the opportunity to receive lifetime income faces a daunting task. First, the fiduciary needs to develop and follow a prudent process for selecting an annuity provider. It has been our experience that it is a rare ERISA plan fiduciary that is equipped to analyze the financial strength and claims paying ability of insurance companies. Even many advisors to defined contribution plans have limited expertise in this area, and the information necessary to make an informed judgment is not always easy to obtain. Moreover, the existing guidance from the Department of Labor ("DOL") on this issue is at a very high level. The ERISA regulations at section 2250.404(a)-4 direct fiduciaries to consider a company's ability to

[1] *Regulatory and Fiduciary Framework for Providing Lifetime Income from Defined Contribution Plans* (New York University Review of Employee Benefits and Executive Compensation 2013)

make future payments and to consider the cost of the annuity, but do not offer any direction about how to conduct such an analysis. Given the potential consequences of choosing an annuity provider that later runs into financial difficulty, fiduciaries, even those with advisors, may be reluctant to take on the perceived risk of an imprudent choice of provider.

Once a fiduciary gets comfortable selecting an annuity provider, it still needs to exercise due diligence with respect to the specific product. Annuities are complex financial instruments that come in many forms and are likely to contain a variety of features. Even a relatively sophisticated fiduciary may find it difficult to understand and analyze how a particular annuity product works, whether its costs are reasonable, and to determine whether it is a prudent investment for its plan. The variations in annuity product design make it challenging to compare annuities across providers, a difficulty compounded by differences in the methods of interest crediting and incorporating expenses that different companies use in the construction of their products.

Finally, even if the fiduciary knew what information to look for and how to use it to complete these analyses, it may be difficult and time consuming to obtain the necessary data to compare companies and products. We are not aware of any easily accessible source that brings together the kinds of information that fiduciaries and advisors need to help make a determination about the choice of an annuity and annuity provider. And while fiduciaries could approach each company that is offering a product and request information, the quality and the format of the responses may make it difficult to directly compare the answers.

RECOMMENDATION #1

We suggest that the DOL take a leading role in helping to collect and disseminate information about annuities and their use in defined contribution plans for fiduciaries and advisors. Our recommendation is that the DOL partner with the Treasury Department to host a website that can serve as a clearinghouse for an extensive array of information about annuity providers, annuity products, and using annuities in defined contribution retirement plans. While plan participants could, of course, have access to this site as well, the site would be designed to address the needs of plan fiduciaries and their advisors. The advantage to working with Treasury to create such a site is that it can then include information about tax issues as well as fiduciary issues.

There is another reason why we believe the DOL is well positioned to create and maintain a website such as the one we are proposing. An important consideration in determining the risk of the failure of an insurance company that is issuing an annuity is the existence and coverage of a state guaranty association. Guaranty associations were created to protect state residents who are policyholders and beneficiaries of policies issued by a life insurance company that has gone out of business. All 50 states, the

District of Columbia, and Puerto Rico have a life insurance guaranty association. If a member company becomes insolvent, the state guaranty association obtains money to continue coverage and pay claims from member insurance companies writing the same line or lines of insurance as the insolvent company. There are differences in the amount of coverage available for different annuity products. While the existence of a guaranty association should be an important element in determining the risk of purchasing a particular annuity, insurance companies are generally prohibited by state law from advertising that their products are covered by a guaranty association (e.g., NY Insurance Law section 7718). As a consequence some fiduciaries may not be aware that an annuity has guaranty association protection. The DOL, obviously not constrained by the state statutes restricting the insurance companies, can heighten the awareness of guaranty association coverage.

We envision that this website have a number of discrete components:

1. A section containing important definitions and basic information about how annuities work, and how they can be used in conjunction with defined contribution plans. This section could be viewed as a primer on annuities for those sponsors and advisors who are less familiar with these products, explaining their strengths and weaknesses. It could also include illustrations comparing annuity payout streams against a systematic withdrawal from an account, building on the lifetime income calculator that the DOL has already made available to participants. We also suggest that it contain a discussion of how a fiduciary should realistically look at the risk of insurance insolvency, as discussed more fully in recommendation #2, including information about state guaranty associations.

2. A section that gives insurers the opportunity to post answers to a standardized list of questions about their financial condition, in order to give fiduciaries and their advisors a readily available source of information to draw upon when conducted their analyses. The participation of insurers would be completely voluntary, but we believe that the stronger insurers, at the very least, would find it advantageous to participate to communicate their presence in this market. By virtue of making this information available to both fiduciaries and the other competing insurers, the participating insurers will have a strong incentive to provide accurate information. Ideally, this section would be both self-populating and self-policing, with minimal involvement required by EBSA or Treasury.

   The information that we are suggesting for this section can be extremely technical and not easily understood even by many insurance professionals, so the questions would need to be crafted with great care. How useful this section proves to be would be a function of the specific information requested and the format developed to show the answers, as well as some explanation of how to interpret the answers. Due consideration would need to be given to, among other factors, what information would be useful (and not misleading), how the answers could give rise to meaningful comparisons between companies, and what state regulatory constraints apply to companies in the manner that they are permitted to display financial information. We are not in this paper at a point where we can suggest specific questions or a particular format, but we can suggest the types of information that we would like to see presented:

- Any assessment of the insurer's financial condition that independent third parties have provided to it or have been disclosed to a regulatory authority;
- The material outcomes of the most recent state insurance exam;
- Any material changes to the company's financial condition in the past five years, a description of the cause of those changes, and whether those changes affected the interest rate upon which annuity pricing is based;
- Any material changes to the company's financial condition in the past five years, a description of the cause of those changes, and whether those changes affected the interest rate upon which annuity pricing is based;
- The company's risk based capital ratio for the last three years.[2]

3. A list of suggested questions that a fiduciary should ask about the annuity products under consideration. Information that a fiduciary should consider about the annuity being offered includes:

- Product design
    - Individual or group annuity
    - Fixed or variable payout annuity
    - Deferred or immediate annuity
    - Forms of available payouts
    - Frequency of payout
    - Variable funds available for annuitization
- Annuity payout rates (obtain illustrations)
- If a deferred fixed annuity, current and historical interest crediting rates
- If a deferred variable annuity, historical fund performance
- If a fixed annuity, the interest rate credited
- If a variable annuity, the assumed rate of return
- If variable annuity payout is available:
    - How often does the payout amount change
    - Are transfers allowed to other available investment funds
- Fees

[2] The National Association of Insurance Commissioners ("NAIC") describes risk-based capital as a method of measuring the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. RBC limits the amount of risk a company can take. It requires a company with a higher amount of risk to hold a higher amount of capital. Capital provides a cushion to a company against insolvency.

- Compensation

4. A list of links to other resources, including:
   - The National Association of Insurance Commissioners (for background information and definitions) www.naic.org
   - The National Association of Life and Health Insurance Guaranty Associations (for information about Guaranty Association coverage in different states) www.nolhga.com
   - The state insurance departments (some states post the results of insurance company examinations)

RECOMMENDATION #2

In addition to providing the employer education we outlined in Recommendation #1, we also believe that it is essential that EBSA provide formal guidance to fiduciaries with regard to the risks related to insurer insolvency.

In our experience, the selection of an annuity provider is viewed as exceptionally risky by some fiduciaries in large part because of the belief that the fiduciary is exposed to liability for the entire annuity payout period which can last for decades. While a fiduciary must of course exercise the appropriate level of prudence in its selection of an annuity, we believe that the level of apprehension associated with annuities needs to be put in perspective. And we think that the DOL can play an important role in increasing fiduciaries' comfort levels with annuities.

Increasing this comfort level will require, we believe, the issuance of formal guidance that clarifies to fiduciaries EBSA's view of the current state of the law with regard to such matters. We understand that the EBSA has currently in progress a regulation project under its semi-annual agenda addressing the Selection of Annuity Providers for Individual Account Plans. Our recommendation is to not only address certain issues within that regulation, but to issue related guidance as well which will further put into context the manner in which the regulations may be applied. We recommend such guidance be given in the form of a Field Assistance Bulletin, which is given a high level of credibility in the market.

In particular, we recommend the following:

- That the guidance describe the manner in which ERISA's Limitations of Actions under Section 413 apply to a fiduciary's decision to purchase an annuity from any particular insurer, incorporating guidance under the recent ruling by the United States Supreme Court Ruling in Tibble v. Edson. Familiarizing fiduciaries with the fact that, under many common circumstances, their maximum period of liability for insurer insolvency may be limited to six years following the annuity purchase should relieve a great deal of the anxiety in the marketplace.

Much in the way that the Treasury Department issued its important guidance as to how to determine the "annuity starting date" in Revenue Ruling 2012-3, EBSA should identify the circumstances in the purchase of an annuity against which the statute of limitations will run. We therefore further recommend that EBSA work closely with the Department of Treasury in developing these standards, as application of the statute of limitations will often largely depend largely on the elements of an annuity contract which Treasury previously considered in their ruling. These elements include (but are by no means is limited to) factors such as the effect of a distribution of an annuity contract from the plan; the impact of an account balance within the annuity; and the irrevocability of the annuitization election.

By way of one example, we submit that once a plan participant has annuitized the full accumulation in his or her account, the six-year statute of limitations should begin to run on the selection of the annuity provider and annuity product with respect to that participant. At the point of annuitization, the participant's accumulation no longer constitutes plan assets and there is no longer a continuing duty to monitor. Moreover, once the annuity has commenced, even were it still considered a plan asset, the decision is irrevocable and the fiduciary no longer has the ability to replace the contract. It would be helpful if EBSA would issue guidance that would clarify how the statute of limitations applies in this and other situations where annuities are made available under the plan. We would also be happy to provide you with our views about how the statute of limitation should be applied in other scenarios using annuities in defined contribution plans.

- That the Safest Available Annuity Safe Harbor regulation take into account several key factors related to insurance.

    - Annuities, unlike any other form of investment, are a commercial pooling of interest of not only retirement plan participants, but that of the general population as a whole. The insolvency risk of an insurer is broad based, and has been successfully subject to substantial state regulation for a very long time. For example, state laws require the maintenance of adequate reserves for the risks taken on by the insurance company; the manner in which the reserves are invested are heavily regulated for investment risk and type under the risk-based capital rules; insurance companies are regularly and comprehensively examined by state insurance authorities, and must submit regular and substantial reports to their state regulators, with these examinations covering not only the level of a company's reserves, but also include many aspects of the company's operation to determine if it is being run soundly; insurers are required to participate in their state guaranty associations to protect the policyholders of all companies within the state; a review of marketing material of all insurance products is required; and insurance companies have the duty to supervise the activities of their agents.

The state regulation system is far from perfect. For example, the guaranty association rules suffers serious flaws including being unfunded and relying upon the cooperation of insurers. There also seems to be some validity in the eventual development in a form of federal FDIC type of insurance to protect these arrangements. Until then, however, plan fiduciaries should not be forced to alone bear what is essentially a societal risk. We do note, by the way, that while such changes to the existing system may have substantial merit and may strengthen the protection of participants and fiduciaries, the Department should recognize in its guidance that that the guaranty associations have proven over time to effectively protect annuitants..

We do not advocate that the mere state licensing of an insurer should suffice to pass fiduciary muster. We instead recommend that fiduciaries should be able to rely upon commonly available and understandable information. This could include, for example, a requirement that they have knowledge of the applicable state guaranty association rules; or representations related to regulatory actions against the insurer by the state, or commercially available warnings on an insurer's financial difficulties. This is some of the information that would be made available under recommendation #1.

- We also recommend that regulations recognize that annuities have been an integral part of retirement programs, and have been purchased by trustees of various trusts, for a very long time. The literature is replete with records of annuity laws and regulations being passed in the Colonies long before the Revolutionary War.

More recently, annuities have been the primary investment vehicle for IRC section 403(b) plans since the enactment of the statute in 1958. In fact, the issuance of annuities to employees of tax-exempt organizations has been in the tax code since 1939, though they were granted tax-favored status back to the initial imposition of the federal income tax. Section 403(b) plans for tax-exempt organizations are generally subject to ERISA and therefore have only since 1974 been covered by the fiduciary rules. Annuities were the only investment vehicles permitted in a section 403(b) plan prior to 1974; ERISA amended the tax statute to permit investments in custodial accounts that invested solely in mutual funds. However, even today, a large percentage of section 403(b) assets remain invested in annuity contracts whose normal form of benefit is an annuity payment. Thus, for almost 100 years, sponsors of section 403(b) plans have used annuities as their primary funding vehicles.

We therefore encourage the EBSA to not treat these important financial products as newcomers to the retirement market; to instead review the long recorded history of the success, occasional failures, as well as the potential abuses within the annuity market when constructing the safe harbor.

We thank this Council for the opportunity to offer to offer our recommendations.