November 17, 2020

Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N–5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Attention: Pension Benefit Statements—Lifetime Income Illustrations, RIN 1210-AB20.

Dear Sir or Madam:

The Lifetime Income Risk Joint Committee ("the Committee") of the American Academy of Actuaries[1] is pleased to offer the following comments to the Department of Labor's (DOL) Employee Benefits Security Administration (EBSA) regarding the Interim Final Rule on Pension Benefit Statements—Lifetime Income Illustrations (IFR) under ERISA Section 105 as amended by the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 ("the Act"). The Committee supports efforts to help participants understand the relationship between their accumulations under a defined contribution plan and the estimated retirement income that could be provided from those accumulations.

The benefit statement requirement is a valuable opportunity to provide education to participants about the challenges of building sufficient retirement income. Many participants may not know whether they are saving enough for their retirement. We appreciate EBSA's objective of minimizing the efforts and costs that employers will incur in satisfying this new requirement; however, we feel that a few changes can further the goal and at the same time improve the value of the lifetime income illustrations.

The Committee believes the IFR provides insufficient information to participants to achieve two of the goals stated in the IFR:[2] "(1) strengthening retirement security by encouraging those currently contributing too little to increase their plan contributions, and (2) saving some participants' time in understanding how prepared (or unprepared) they are for retirement by making lifetime income information readily available." Future contribution levels and the age at which an individual retires and begins to draw on their account(s) are the two factors that are

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
[2] *Federal Register*; September 18, 2020; page 59,145.

most directly within the individual's control to influence their ultimate amount of retirement income. The current IFR provides no meaningful information on the effect of either of these factors. We believe that the rules could be greatly improved by modifying the illustrations to take these factors into account and by coordinating with the EBSA Lifetime Income Calculator so that interested individuals could obtain additional modeling results consistent with the amounts shown on their statement.

Evaluating the lifetime income derived from only the current accrued benefit is a minor part of understanding retirement preparedness; benefits derived from future contributions are even more important in many circumstances. Also, the Committee believes that calculating estimated lifetime income only as if the participant is currently age 67 is of limited value and could be misleading. These issues are addressed below in addition to specific comments on other benefit statement elements.

Consideration of Growth in Account Balance

The IFR would require that the "total benefits accrued" be converted to an immediate age 67 lifetime income amount. As stated above, it is the Committee's consideration that this leaves most participants with inadequate information to know whether they are saving enough for retirement.

We believe assuming the participant is currently age 67 is misleading because it understates the potential lifetime income for individuals under age 67. In our view, as is calculated by the EBSA Lifetime Income Calculator, account balances should be accumulated until retirement at a moderate rate of return that the DOL should establish from time to time. As such, this rate should be based on current market returns and should not be a fixed rate, such as the 7% return in the current EBSA Lifetime Income Calculator

As assumed in the current EBSA Lifetime Income Calculator, account balances may grow with future contributions. To achieve the goal of providing useful information, the illustration should reflect this. It is not uncommon for future contributions to be recognized in income illustrations that employers currently provide to employees. We recommend that the benefit statement include both the amounts based on the "total benefits accrued" and amounts based on the total benefits accrued plus the benefits from anticipated future contributions, for example, an amount equal to the current employer and employee contributions, plus investment earnings. In this case, the IFR should provide employers with relief from potential liability if future contribution levels, as noted above, are assumed.

Providing information that illustrates the effect of future contributions, investment earnings and retirement age (discussed below) has a greater potential to inform individuals in a manner that promotes better retirement security.

If the illustration does not include future contributions and/or investment earnings prior to retirement, we recommend that the benefit statement include language such as:

> "If you are not close to retirement, your account balance will likely grow with additional contributions and/or investment earnings. You can estimate the potential impact of these

factors on your projected retirement income by going to the EBSA Lifetime Income Calculator.

As discussed below, the usefulness of the EBSA Lifetime Income Calculator in this regard would be greatly enhanced by using assumptions that are generally consistent with those used in generating these lifetime income illustrations.

Retirement Age

If the changes discussed above relating to future contributions and investment growth are adopted, then we believe it would also be valuable to provide information providing at least one other retirement age to more fully illustrate the potential effect of deferring retirement. If the additional age were 62, an additional five years' worth of investment earnings and in many cases additional contributions could be extremely significant, and would be appropriately captured if future contributions and investment growth are included in the calculations.

Absent these changes, however, we agree with the DOL's approach of using a single age and would not recommend the use of multiple retirement ages. The difference in the annuity amounts, for example between age 62 and 67, would be misleading if investment earnings and annual contributions are not recognized. Because the difference in income between age 62 and age 67 based only on the current account balance is approximately 15%, one might conclude that working an additional five years is of limited value when that is clearly not the case.

We appreciate the difficulty in selecting a single retirement age; however, age 67 will not be the most appropriate retirement age for all participants. We believe the benefit statement should state that values for alternative ages can be determined by using the EBSA Lifetime Income Calculator. In addition, if the specifications in the IFR are not changed, we believe it should be clearly explained that the use of age 67 is an assumption that the participant is **currently** age 67, so it is not subject to misinterpretation that the amount shown is available at their future attainment of age 67. For instance, the illustrative disclosure box in the preamble overview we suggest should read "Monthly payment if age 67 today" instead of "Monthly payment at 67." Additional language might also be considered to make clear that for those currently younger than age 67, the effects of future investment returns and contributions have not been reflected—again referring individuals to the EBSA Lifetime Income Calculator for more information.

Annuity Conversion Rates

Immediate annuity rates are typically based on an interest rate that is the expected earned rate (generally based on corporate bonds) minus a pricing margin for insurance company expenses and profit. The IFR directs the use of the 10-year constant maturity Treasury (CMT) securities yield rate to compute benefits. It implicitly assumes that the spread for corporate bond yields over 10-year CMT rates is equal to the pricing margin for a single premium immediate annuity, which is approximately 100 basis points (bps). During 2020, the spread[3] of corporate bonds over the 10-year CMT has ranged from approximately 100 bps to 200 bps, and in 2008 it was as high

[3] Corporate bonds from the St. Louis Federal Reserve, *Corporate Bond Spot Rates by Maturity, Monthly, Not Seasonally Adjusted.* 10YT rates from treasury.gov.

as 500 bps. A Society of Actuaries (SOA) study[4] illustrates the historic volatility of the spreads, showing the 10-year CMT rate to be an inappropriate choice for the purpose of determining immediate annuity values. An alternative approach is described below.

While using unisex tables provides some simplicity, few plans currently offer in-plan fixed income annuity options, which are required to be unisex. Thus, if annuities are purchased, they will most likely be purchased outside the plan on a sex-distinct basis. We are thus concerned that the proposed benefit statement may provide misleading information due to the understatement of income for male participants and overstatement for female participants.

The following suppositional examples illustrate the combined impact of the IFR hypothetical annuity method vs. market annuity quotes and unisex vs. sex-distinct benefit levels.

As currently proposed in the regulation:

Based on $125,000 account balance, 417(e) unisex mortality, age 67, and an assumed 10-year CMT of 0.70%:
Life annuity: $572/month
Qualified Joint and 100 percent Survivor annuity: $465/month

Average current quotations[5] from five large insurers for an age 67 immediate annuity purchased outside the plan:
Life annuity: Male $630/month (110% of proposed unisex) & Female $588/month (103% of proposed unisex)
Qualified Joint and 100% Survivor annuity: $511/month (110% of proposed)

In light of these differences between the hypothetical annuity in the IFR and annuity market rates, we recommend a different approach that can be used by plans that do not offer in-plan annuity purchases (or as an alternative for those that do). We recommend that the DOL periodically—e.g., monthly or quarterly—publish actual sex-distinct annuity purchase rates. These would be based upon the publicly available average rates being offered by the largest (by sales volume) providers of single premium immediate annuities. There are publicly accessible websites where quotes can be obtained on a daily basis. For participants where sex is not known, we suggest the employer use the average of the two rates. This approach would eliminate any questions about the use of a representative annuity interest rate, the use of §417(e) mortality rates, applying insurance company "loads" as well as making the benefit statement easier and less costly for employers (especially smaller ones) because the annuity conversion factors would be provided by the DOL.

Inflation Adjustment

The Committee believes that it is important for participants to consider the impact of inflation, both before and after retirement, in order to understand the impact of purchasing power on their retirement income. Illustrating an annuity that increases each year based on an assumed cost-of-

[4] *Annuity Market Pricing Approaches*, Society of Actuaries, March 2019, https://www.soa.org/globalassets/assets/files/resources/research-report/2019/annuity-market-prices.pdf.
[5] Immediateannuities.com, September 2020.

living adjustment increase is valuable for understanding retirement readiness. We would recommend using the cost-of-living adjustment assumptions, currently 2.4%, used by the Social Security Administration in its most recent annual Trustees Report. If it is not possible to obtain annuity quotes with increasing benefits based on the inflation assumption to be used, a simple adjustment factor could be applied to the level annuity quotes described above. For example, the adjustment to determine the reduced initial benefit for 2.4% increases would be a decrease of approximately 23%.[6] It is suggested the benefit statement explain that the illustrated income is based on an annuity that increases annually, similar to Social Security, for example:

> "The estimated initial monthly payment for an inflation-indexed annuity would be increased each year by an assumed cost-of-living adjustment equal to __ percent."

Additionally, like in the EBSA Lifetime Income Calculator, an allowance for the impact of inflation is recommended to be included prior to retirement age if a change is adopted that considers investment earnings up to retirement age. This would adjust the income amounts to current purchasing power. The benefit statement would include two sets of values, one with nominal income and one with inflation-adjusted income.

Spouse Age

We recommend the following be added to the benefit statement:

> "If your spouse is older or younger than you, the Qualified Joint and 100 percent Survivor benefit will be approximately 1.4 percent higher/lower[7] for each year your spouse is older/younger than you. For example, if your spouse is five years older than you, your benefit will be approximately seven percent higher. If your spouse is 10 years younger than you, your benefit will be approximately 14 percent lower."

Updating the EBSA Lifetime Income Calculator

We believe the EBSA Lifetime Income Calculator should be updated to be consistent with the benefit statement assumptions in order to offer participants a more robust modeling tool. These are some suggested changes:

1. Retirement Age input be allowed for ages 60 to 72.
2. Years to Retirement be changed to Current Age, from which the years would be calculated.
3. The Joint and 50 percent Survivor form be changed to the Joint and 100% Survivor Form, but with an option to calculate the benefit under the 50 percent form.
4. There be a selection of sex.
5. Allow for a specified contribution increase percentage as opposed to 3% fixed.
6. Allow for a specified investment return rate as opposed to 7% fixed.
7. Allow for a calculation with an inflation adjustment for the pre-retirement period, post-retirement period, or both.
8. For annuity purchase rates, use actual quotes based on values from age 60 to 72 on a sex-distinct basis, updated periodically.

[6] Immediateannuities.com, September 2020. Value interpolated between annuity quotes with 2% annual increase and 3% annual increase.

[7] Immediateannuities.com, September 2020. Current annuity quotes were calculated for various age differentials.

The Committee would be available to assist EBSA in updating the calculator.

Additional Disclosure Information

We believe clarifications are needed in the benefit statement information:

- The description of the qualified joint and 100 percent survivor annuity in the first model notice be modified to match the language used in the second model notice.

- The comment concerning the 10-year constant Maturity U.S. Treasury securities rate would be clearer if it stated: "The lower the interest rate ***at the time of annuity purchase***, the smaller the monthly payment…" Similar wording would be appropriate if current annuity quotes were used.

Other Savings: It is unlikely that a participant has all of his or her retirement savings with their current or prior employers. Savings also can be allocated to individual retirement accounts (IRAs), including rollover IRAs, or other savings vehicles. We suggest adding language in the benefit statement that refers participants to the EBSA Lifetime Income Calculator to estimate the projected income value of IRAs or other savings.

Taxes: The benefit statement should include a general explanation of the taxation of retirement benefits because participants might overstate the value of the lifetime income projections if they do not account for taxes. It should explain the relationship between pre-retirement take-home pay and after-tax retirement income.

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The Committee appreciates the opportunity to comment on the IFR and would be happy to discuss any of these items with you at your convenience. Please contact Philip Maguire, the Academy's pension policy analyst (maguire@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

Noel Abkemeier, MAAA, FSA
Co-Chairperson
Lifetime Income Risk Joint Committee

Mark Shemtob, MAAA, FSA, EA, FCA
Co-Chairperson
Lifetime Income Risk Joint Committee