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Testimony of Sheldon Smith, Esq., Submitted to the U.S. Department of Labor, Employee Benefits Security Administration, and to the U.S. Department of the Treasury

On Behalf of:

**The American Society of Pension Professionals and Actuaries
(ASPPA)**

September 15, 2010

Hearing on Lifetime Income Distribution Options

Thank you for this opportunity to testify on specific issues pertaining to Lifetime Income Distribution Options for Participants and Beneficiaries.

I am Sheldon Smith, a partner in the Compensation and Benefit Practice Group of the law firm of Holme Roberts & Owen LLP. Holme Roberts & Owen LLP is a 230 lawyer firm headquartered in Denver, Colorado with two additional Colorado offices and offices in Los Angeles, San Francisco, Salt Lake City, Phoenix, and three European cities. We represent several hundred companies that sponsor qualified retirement plans, and the seven members of our Compensation and Benefits Practice Group work regularly with issues pertaining to the types of defined contribution plans that are the subject of this hearing.

I am speaking today as President of the American Society of Pension Professionals and Actuaries (ASPPA). ASPPA is a national organization of more than 7,200 members who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including accountants, actuaries, administrators, attorneys, consultants, and investment professionals. Our large and broad-based membership gives ASPPA a unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-based retirement plan system.

ASPPA and its members are particularly interested and concerned about the issues that are the subject of this hearing. We previously filed more expansive comments on this subject in response to the joint Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans (RIN 1210-AB33). In addition, ASPPA, together with AARP and WISER, was the cosponsor of the recent Lifetime Income Summit held May 20, 2010, in Washington, DC.

Safe Harbor Issues and Recommendations

Our membership generally believes that a primary hindrance to the availability of lifetime income options in defined contribution plans results from the prospect of fiduciary liability attendant to selection and monitoring of lifetime income options. Notwithstanding the existing fiduciary safe harbor for selection of annuity products, it appears that the safe harbor is rarely used. It is the exception when an annuity is the form of distribution from a defined contribution plan. In fact, very few defined contribution plans offer this distribution option, and in the few that do, participants rarely select it.

There are many avenues from which fiduciary liability might arise in selecting lifetime income options under current rules. Fiduciary liability might arise from the selection of lifetime income options, the selection of providers of lifetime income options, dissatisfaction by participants, and the failure to meet statutory and/or regulatory guidelines. Currently, the safest path for plan sponsors to follow is to avoid consideration of lifetime income options and, by design, force participants to take a lump sum distribution. Although many of these lump sum distributions are rolled over to individual retirement accounts, our members detect a significant amount of “leakage” from the retirement system when participants take lump sum distributions. This erodes the prospect of workers having a sufficient savings pool to provide for a dignified retirement.

Issuer Solvency Standards and Safe Harbors for Both Annuity and Non-Annuity Products

In 1995, the Department of Labor issued Interpretive Bulletin 95-1. Interpretive Bulletin 95-1 instructed plan fiduciaries, when considering annuity providers, to select the safest available to fulfill distribution options in a qualified plan. This created uncertainty when applied to defined contribution plans. In section 625 of the Pension Protection Act, Congress addressed this uncertainty by providing that the “safest available standard” required by IB 95-1 applied only to the selection of an annuity provider for terminal annuities in a defined benefit plan. Further, Congress directed the Department of Labor to issue regulations clarifying that the selection of an annuity provider to fulfill distribution options in an individual account plan is not subject to IB 95-1, but rather is subject to ERISA fiduciary standards.

The Department of Labor then promulgated 29 CFR §2550.404a-4, 73 Fed. Reg. 5847 (Oct. 7, 2008) to provide a safe harbor for fiduciaries in selecting an annuity provider so long as certain requirements are met. The safe harbor effectively provides that the fiduciary who meets its requirements has fulfilled the duty of prudence attendant to making the selection. Of course, as can be seen from the responses to the RFI, there are a multitude of lifetime income options other than annuities in the marketplace today, and it is logically anticipated that there will be more going forward. Therefore, a broader form of safe harbor, potentially based on the requirements contained in the regulation, will be needed.

The current annuity provider regulations identify a number of requirements that a fiduciary must meet in order to obtain protection under the safe harbor. These include:

1. The fiduciary must engage in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities.
2. The fiduciary must appropriately consider information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract.
3. The fiduciary must appropriately consider the cost of the contract in relation to the benefits and administrative services provided.
4. The fiduciary must conclude that, at the time of the selection, (a) the annuity provider is financially able to make all future payments under the annuity contract, and (b) the cost of the contract is reasonable in relation to the benefits and administrative services to be provided under the contract.

Selection and monitoring of the provider of a lifetime income option, as with all other investment options in a defined contribution plan, should implicate fiduciary obligations. However, as expressed below, we believe that there must be a structure in place to allow for a safe harbor for fiduciaries that is neither burdensome nor expensive.

The Annuity Safe Harbor

The most significant difficulty with the existing annuity safe harbor provision is the issue of issuer solvency. The current economic environment has highlighted the need to allow participants the opportunity to purchase properly priced lifetime guarantees inside a defined contribution plan as well as demonstrating that the pooling of risk and the undertaking of solvency risks are critical marketplace functions. In order to accomplish this, we suggest that the annuity safe harbor permit the fiduciaries to use and rely upon items 3 and 4(b) of the existing safe harbor described above¹, but that a safe harbor be provided for complying with items 1, 2 and 4(a). In our written comments, we suggested that fiduciaries be permitted to rely on existing state regulatory structures to protect against insurer solvency. The annuity safe harbor would provide that an adequate fiduciary review would have the fiduciaries acknowledge that: (a) the task they undertake is different from the mere investment of account balances; (b) the standard against which they will be judged necessarily has a stronger insolvency risk; and (c) they have addressed that risk adequately by understanding and relying on the state's regulatory role in managing the risk. However, this improved safe harbor would still leave many employers, especially small employers, without the means of complying with the requirements.

A meaningful safe harbor would provide plan fiduciaries, especially small plan fiduciaries, with reliance on solvency determinations made by EBSA and/or the Treasury Department. The

¹ In the case of item 3, we suggest that the Department of Labor should review whether additional guidance on fee transparency is needed with respect to these options to adequately allow a plan fiduciary to fulfill its obligations.

agencies could publish a list of providers determined to be solvent based on the considerations that would otherwise be pushed down to the plan fiduciary level.

The agencies' review would rely heavily on the determinations of state insurance regulators. An insurer's rating would be used as an element of this analysis, given the intensive reviews made by the rating agencies including interviews with management, coupled with a review of the underlying rating report and an understanding of the significance of the rating. Plan fiduciaries would be provided with a "pass" on the insolvency risk provided the insurance companies from which the guarantees are purchased are on the "approved providers' list." A fiduciary would be required to monitor that status in the same way that fiduciaries are required to monitor other individual account plan investments.

Hybrid Products Safe Harbor

Since guaranteed lifetime income products (referred to as GMWBs, GMIBs and various other names) and other hybrid products are not annuities, it appears they are not covered by the annuity safe harbor. Nevertheless, solvency concerns applicable to annuity purchases also apply to non-annuity products, and a fiduciary safe harbor similar to the annuity safe harbor should apply.

We believe that a new (or expanded) safe harbor would help facilitate the development and acceptance of new alternatives to traditional annuities, both now and in the future, by eliminating fiduciary uncertainty regarding the selection of these products. The failure to provide an additional (or expanded) safe harbor could inappropriately favor one form of lifetime income product over others, which we believe would be ultimately to the detriment of plan participants and beneficiaries.

404(c) Changes

We believe that the regulations under 29 CFR §2550.404c-1 should be amended to anticipate the addition in a self-directed investment defined contribution plan of one or more lifetime income options. Additional fiduciary protection must be provided to allow for this investment choice by the participants without burdening plan fiduciaries with any additional liability exposure so long as certain conditions are met.

The §404(c) conditions might include: (1) simple written explanations of each of the lifetime income options, (2) a description of the impact on diversification of the selection of a lifetime income option as part of the "investment portfolio" or as the sole investment option, (3) relevant information concerning each provider of a lifetime income option available under the plan, and (4) the extent to which guaranteed income is available under each lifetime income option.

Application of IB 96-1 to Investment Advice Rules

Investment education to participants concerning lifetime income options should fall under the ambit of Interpretive Bulletin 96-1 in order to allow plan fiduciaries to provide participants with necessary information regarding the decumulation phase of their defined contribution account balances. The Department of Labor should provide specific guidance to identify what types of educational information could be given to participants so that it would be considered "education"

rather than “advice.” This additional guidance should be cast in the nature of a safe harbor and should make it clear that it is merely educational and would not subject the provider to the prohibited transaction rules as an investment advice fiduciary.

Summary

Plan sponsors should be encouraged, but not required, to include lifetime income distribution options in defined contribution arrangements. One of the major obstacles to the offering of these options is the fiduciary burden that arises from selection of a provider for annuities, or other lifetime income option. To encourage provision of lifetime income options, future guidance must reduce the fiduciary burden with regard to the determination of a provider’s solvency. We recommend that any guidance dealing with the role of fiduciaries in selecting hybrid non-annuity lifetime income options and providers will be subject to a safe harbor that is similar to the relief applicable to the selection of a provider of more traditional annuity options. We further recommend that the Department of Labor modify rules regarding “investment education” to participants to include lifetime income option “education.”