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**Statement before the ERISA Advisory Council on
Model Notices and Disclosures for Pension Risk Transfers**

Presented by:

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On behalf of the American Academy of Actuaries¹ Pension Committee, thank you for the opportunity to offer testimony regarding model notices and disclosures to assist defined benefit plan participants in understanding the options available to them when offered a lump sum distribution as part of a pension risk transfer transaction. My name is Ellen Kleinstuber and I serve as the vice-chairperson of the Academy's Pension Committee and a member of the Pension Practice Council.²

Executive Summary

The decision of whether to accept the offer of a lump sum distribution in lieu of a life monthly pension check involves many complex personal, financial considerations, and there is no one size fits all answer to the question of whether a participant should elect a lump sum distribution or retain the right to future monthly income payments.

In making recommendations for additional required notices and disclosures, or modification to existing notices and disclosures, it would be prudent for the Department of Labor (DOL) to strive for a relative balance between the amount of information that is provided and the amount of information that can be reasonably be expected to be processed by participants. Finding ways to communicate information in a clear, concise, and efficient manner will be critically important to ensuring that the information participants need for their retirement planning is rendered in way that remains useful and facilitates the goal of improving their basis for decision making regarding lump sum or annuity income.

¹ The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists 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 The Pension Practice Council's mission is to serve the public and the United States actuarial profession in matters of retirement policy and Social Security.

When disclosures are required, it is helpful to plan fiduciaries to have access to model notices and sample language that can be used to fulfill the disclosure requirements that afford safe harbor protection with their appropriate use. Many participants will also value the objective, independent perspective that comes from using language developed by regulatory agencies rather than plan sponsors.

The American Academy of Actuaries offers the following recommendations for consideration as the ERISA Advisory Council considers what useful information participants need in order to reasonably make an informed decision regarding their choice between taking a lump sum distribution or opting for a monthly annuity payment:

- Develop consumer information material to be made available on the DOL website, or another appropriate government or government-sponsored web portal, to provide objective information to plan participants being offered a lump sum distribution, either through a pension risk transfer transaction (i.e., lump sum window) or in the course of regular plan administration. Specific suggestions are detailed in the *Recommendations* section of our remarks.
- Consider additional mandatory disclosures to be made by plan providers to assist plan participants in evaluating a lump sum offer. Such disclosures should strike a balance between sufficiency and completeness with efficiency and brevity.
- Review the current relative value disclosure requirements to ensure they are adequately addressing the needs of today's plan participants.

Regulatory agencies such as the DOL, Pension Benefit Guaranty Corporation (PBGC) and the Internal Revenue Service (IRS) can support improved outcomes for plan participants by providing easily accessible consumer information combined with safe harbor notices and disclosure language that provide protection for plan fiduciaries and objective guidance to plan participants.

Background

The transferring of risk from defined benefit pension plans (often called “de-risking”) has become a matter of much scrutiny over the last few years. Currently, the Pension Committee is developing an Issue Brief that examines these transactions and looks at the perspectives of the various constituents affected by them—plan participants (and other employees of the plan sponsor), plan sponsors and company owners/shareholders, regulators, and plan fiduciaries. Portions of this forthcoming paper form the basis of my testimony today, along with observations based on my own experience as a consulting pension actuary who assists plan sponsors with the design and implementation of these risk transfer transactions.

The decision of whether to accept the offer of a lump sum distribution in lieu of lifetime monthly pension checks is extremely complex. Many factors influence the analysis of which option might ultimately be in the best interest of a given participant. There is no one-size-fits-all answer to the question of whether a participant should elect a lump sum distribution or retain the right to future monthly income payments. What is the right decision for one participant might be an ill-suited decision for another.

As noted in the Government Accountability Office's (GAO) January 2015 report *Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits* ("2015 GAO report"), participants need to have sufficient information to make an informed decision, and those interviewed by GAO reported that having "more information would have helped them assess whether or not to accept the lump sum." This raises two important questions:

- How much information is enough?
- Is there such a thing as too much information?

In making recommendations for additional required notices and disclosures, or modifications to existing notices and disclosures, it would be prudent for DOL to strive for a balance between the amount of information that is provided and the amount of information that can be reasonably processed by participants.³ Finding ways to communicate the information in a clear, concise, and efficient manner to suit participants' needs will be critically important to ensuring that the information can remain useful and facilitate the goal of improving participant understanding in their decision making regarding lump sum or annuity income. Certainly, some information provided within the participant election package should be detailed and personalized to the participant and plan. However, other information could appropriately be covered in less detail and in broader terms. One approach would be to provide high-level information within the direct participant communication, supported by easy-to-access, detailed supplemental information that participants can refer to as needed to support their individual decision making.

Perspectives of Plan Fiduciaries

Many of the issues involved for a plan participant in evaluating a pension risk transfer lump sum offer are complex and create challenges for the plan administrator to craft language that the participant can readily grasp while conveying a sufficient level of detail so that key issues are given the attention necessary to convey their importance. This is magnified further when a lump sum offering is made to a retiree who is already receiving a monthly pension payment, and may (due to declining cognitive abilities) be unable to understand the ramifications or may be relying on the advice of caregivers who may not have the participant's best interest at heart. Plan fiduciaries are responsible for ensuring all participant disclosures are complete, adequate, and fairly represent the plan provisions and other key factors. Many fiduciaries use professional financial advisors to craft these disclosures to reduce the risk of miscommunication.

As noted in the 2013 paper *Risky Business: Living Longer without Income for Life*⁴ produced by the Academy's Lifetime Income Risk Joint Task Force (representing the perspective of both pension and life insurance actuaries):

Although employers are often optimally situated to make retirement planning information and advice available to their employees, not all are willing or able to do so. One possible reason for this is a concern that it could lead to the employer's liability should advice

³ Many studies have been done on the subject of "information overload," which occurs when decision-makers are provided with more information than they have the cognitive ability to process. Information overload can lead to a reduction in the quality of decision-making. [For example, see Keller, Kevin Lane, and Richard Staelin. "Effects of Quality and Quantity of Information on Decision Effectiveness." *Journal of Consumer Research* (1987): 200.]

⁴ http://www.actuary.org/files/Risky-Business_Discussion-Paper_June_2013.pdf.

received by an employee through such an effort later be claimed to have harmed an individual's financial position. Thus, employer-based education will require some action to appropriately protect employers from liability under ERISA fiduciary requirements. Small employers in particular would probably benefit from cost-saving, standardized approaches, perhaps supported and coordinated by the DOL.

When disclosures are required, it is helpful to plan fiduciaries to have access to model notices and sample language that can be used to fulfill the disclosure requirements. To the extent DOL deems it appropriate, offering safe harbor protection to fiduciaries who use model notices and language would encourage them to include this information in their communications to participants regarding these offerings. Participants should also value the objective perspective that comes from using language developed by regulatory agencies rather than the plan sponsor (should they fear they might not act in the best interest of plan participants in developing their own disclosure language).

Commentary on the 2015 GAO Report Findings

The 2015 GAO report identified eight questions or key factors that participants need to know in order to make an informed decision. Generally, we concur with the list of items identified in the 2015 GAO report. The GAO's list of course raises questions regarding the best means by which to communicate this information and the most appropriate and efficient source of the information. We consider each of the eight key questions (including sub-questions) from the GAO report below in this context.

1. What benefit options are available?

The 2015 GAO report found that generally the benefit election packages they reviewed disclosed the amount of the normal retirement annuity in addition to the lump sum and the currently available immediate annuity options. We believe that providing the amount of the accrued benefit payable at the normal retirement date is important to the decision-making process, and should be included in all benefit election packages in a manner that allows the participant to easily identify and compare to the currently available annuity options. This could be an additional mandated disclosure item that shouldn't create any undue burden on plan administrators to provide.

Additionally we support requiring a description of the key benefit provisions that could apply in the future and would affect the participant's evaluation of the lump sum offer, including the availability of any subsidized early retirement benefits or optional payment forms and when they would become available. It has been my personal observation that many plan administrators choose to provide this information in descriptive terms, rather than through numeric illustrations. Where numeric illustrations are utilized, they are often not customized to the individual participant but rather illustrate a representative sample participant. Often, the main consideration is the cost and complexity involved in developing an individualized illustration for each participant, particularly in plans with multiple early retirement provisions that apply to various groups of legacy participants.

These disclosures are necessarily provided by the plan administrator. Guidance on minimum standards that DOL identifies as prudent to ensure participants' understanding could be helpful to plan fiduciaries in developing the disclosures.

2. How was the lump sum calculated?

Currently, some plan fiduciaries choose to describe the rates used (e.g., required three-segment interest rates for Month, Year, as published by the Internal Revenue Service) rather than stating the actual rates. Requiring a statement of the actual interest rates and mortality table used would improve participant understanding with little additional cost to the plan. To the extent not already disclosed, indicating the annuity amount and assumed form of payment and commencement date upon which the lump sum was calculated could also improve understanding without adding significant administrative cost or complexity.

Providing an illustration of how the interest and mortality rates combine to compute the actual lump sum amount might be instructional to some participants, but we believe the complexity could outweigh the incremental value by unnecessarily creating participant confusion. Rather than requiring this illustration be provided by the plan fiduciaries, it might be helpful for DOL to develop consumer information material that explains how the Pension Protection Act (PPA) three-segment interest rates and applicable mortality rates work in determining the lump sum. Plan fiduciaries could incorporate this material into their benefit election communications, or could direct participants to the relevant DOL website (or other "dol.gov" website) for further information.

We agree with the GAO finding that plan participants would gain from an understanding of whether additional plan benefits were included in their lump sum calculation, and believe this information would be best provided through a descriptive disclosure within the benefit election package provided to participants. Providing a list of the types of plan-specific features DOL believes are important to facilitate participants' understanding would support fiduciaries in improving the quality of the disclosures provided.

3. What is the relative value of the lump sum versus the monthly annuity?

Periodic monitoring of laws and regulations is prudent to ensure they remain current and reflect current market trends. We agree that this applies with respect to relative value disclosures, which were initially implemented to ensure that participants are given the means to evaluate the economic value of optional forms of benefit payments—especially a lump sum distribution—at the time of the election. If examples of how these disclosures are working in practice do not appear to provide participants with the information they are intended to provide, revisions might be necessary to achieve the desired objective.

GAO's second sub-question, regarding the cost to replicate a plan's annuity income through an individual retail annuity contract, raises concern about how plan administrators could obtain this information to include in participant disclosures. Pricing of individual annuity contracts takes into consideration factors that are beyond the means of pension plan fiduciaries to evaluate. Therefore, information to estimate the income that could be purchased with the offered lump sum distribution must be assessed outside the

plan's communication material. This is another example of consumer information that DOL could develop and make available through a public website. Alternatively, if DOL identifies other appropriate sources where this information is available, a link could be provided from a lump sum consumer information website hosted by DOL.⁵

4. What are the potential positive and negative ramifications of accepting the lump sum?

Explanation of what happens with beneficiary protections and any inflation-adjustment taken into account in either the lump sum or the available annuity options would be appropriate disclosures to include in the description of key plan provisions provided by plan fiduciaries. To the extent this information is and has been available in a Summary Plan Description (SPD) that has been provided to participants in a timely manner, fiduciaries may have historically relied on the SPD for providing these disclosures (whether or not they explicitly state so or refer the participant to the SPD for additional information). We encourage DOL to evaluate whether language already crafted and provided through a plan's SPD must be repeated or summarized separately in a benefit election notice, or whether it is acceptable to refer participants to the SPD for additional information on those topics. We believe allowing such a cross-reference to other plan communications is helpful in reducing the volume of information provided to participants while still offering easy access to those participants to whom it could be helpful in making an informed decision.

The effect of inflation, investment risk and longevity risk falls into a category of "known unknowns" that participants face in managing their retirement assets. These types of disclosures are better suited to a standardized notice that could be provided to plan participants. Plan administrators will value the fiduciary protection from unintentional omission, misstatement or misrepresentation that could be offered by requiring inclusion of a generic notice. Other issues discussed in the GAO report that could be appropriate for inclusion in a standardized notice (in addition to those addressed previously) include:

- Impact of changes in interest rates over time (not only between the look-back month and date of distribution, but after the distribution date);
- Impact of plan funding levels and how benefit restrictions can change participant options in the future (e.g., if benefit restrictions apply at a future election date);
- Personal factors to consider, such as health, marital status, other retirement savings and access to guaranteed monthly retirement income, comfort level with investing a (potentially) large sum of money, and managing the drawdown of retirement assets; and
- Options for managing the drawdown period after retirement.

⁵ For the purposes of an example only, such a website that is currently available is www.immediateannuities.com, which allows an individual to enter basic pricing variables (gender, current age, deferral period) and the desired investment (e.g., lump sum amount) and obtain estimates of various annuity options available through retail products.

GAO's conclusion that adequate disclosures combined with financial literacy could improve participants' outcomes is consistent with those contained in the *Risky Business: Living Longer without Income for Life* paper:

Increased education at the time of distribution about the value of lifetime income could lead to a better-informed decision and a general change in behavior by employees at the time of retirement in favor of securing lifetime income. Creation of safe harbors for ERISA fiduciaries could facilitate actions that are advantageous to plan participants...

Standardized communication requirements, model disclosures and educational materials would provide uniform information, simplify administration, reduce fiduciary risk for plan sponsors, and enhance participant understanding...

In designing standardized communications and model documents, input from retirement security practitioners is critical to making these tools effective and understandable.

5. What are the tax implications of accepting a lump sum?

The IRS issued a standardized notice for plan administrators to use to comply with the disclosure requirements of Internal Revenue Code (IRC) Section 402(f). As a result, the GAO study found that all of the election packages they reviewed met their standards for providing adequate information on the tax implications of a lump sum distribution. This would support the notion that standardized notices can be an extremely effective means of ensuring participants can make informed decisions and support for our recommendations that additional disclosures come in the form of fiduciary safe-harbor notices to be included with benefit election packages when a lump sum is offered.

6. What is the role of the PBGC and what level of protection does PBGC provide on each benefit option?

The DOL has developed standardized language for plan administrators to include in a plan's SPD that discusses the role of the PBGC and its pension insurance program. DOL might consider requiring these disclosures be repeated in benefit election notices where a lump sum distribution option is provided, or alternatively require that the notice refer the participant to the SPD for this information. A link to the PBGC website could also be required. We believe that such disclosures would add little additional cost and complexity and could improve participants' understanding about the role of the PBGC.

In order to have a complete understanding of the benefit guarantees and security of their benefits, participants might also be informed that PBGC coverage would be eliminated in the future as the result of an annuity purchase, and that different coverage through state guaranty associations would replace the PBGC insurance at that time.⁶ State guaranty association coverage acts as a "backstop" in the event of insurer insolvency in much the

⁶ DOL has issued guidelines for plan fiduciaries to assist in evaluating annuity providers to ensure that the selected insurer is financially secure and offers a high level of benefit security to plan participants (DOL Interpretive Bulletin 95-1).

same way that the PBGC provides insurance against plan sponsor insolvency, however the coverage works differently than the PBGC benefit guarantees. Generally a notice of PBGC cessation of coverage is currently provided only at the time a plan sponsor decides to purchase a group annuity buy-out contract. However, participants might wish to consider the potential substitution in coverage when determining whether to accept or reject a lump sum offer. DOL has previously issued guidelines for plan fiduciaries to assist in evaluating annuity providers to help ensure that the selected insurer is financially secure and offers a high level of benefit security to plan participants through DOL Interpretive Bulletin 95-1. Participants could also benefit from knowing that plan fiduciaries are bound to follow these guidelines and select the “safest available annuity provider,” to alleviate concerns that their benefit will not remain secure should the plan sponsor decide to subsequently settle their monthly pension benefit through an annuity contract.

7. What are the instructions for either accepting or rejecting the lump sum?

The 2015 GAO report noted that all of the information packages reviewed provided clear instruction on how to make an election to accept or reject a lump sum. We see no need for any further regulatory requirements on model notices in this area.

8. Who can be contacted for more information or assistance?

The 2015 GAO report similarly noted that all of the information packages reviewed provided instructions on who to contact for additional information regarding the lump sum offering, and we conclude that this is also an area where no further regulatory requirements are specifically needed. However, as discussed previously, if DOL or other agencies develop consumer information materials that can be used by plan fiduciaries to support the communication process, those materials could either be provided in the information package, or fiduciaries could direct plan participants to a website or other means of accessing the information. DOL should consider whether this additional information should be included on a voluntary or mandatory basis within participant communications.

Recommendations

In exploring the overarching question as to what useful information participants need to make an informed decision, the ERISA Advisory Council has asked how those testifying suggest getting this information to participants. The American Academy of Actuaries offers the following recommendations for consideration, as noted previously in this testimony:

- Develop consumer information materials to be made available on the DOL website to provide objective information to participants being offered a lump sum distribution, either through a pension risk transfer transaction (i.e., lump sum window) or in the course of regular plan administration. Suggested materials include:
 - How lump sum calculations work under PPA, including the effect of interest rates and mortality assumptions, and how the individual lump sum calculation (indirectly) takes into account the concept of “life expectancy”;

- Key factors in determining the cost of an individual retail annuity and how that compares to the assumption used to calculate lump sum options under a pension plan, as well as how to obtain an estimate of the individual annuity amounts that could be purchased from the plan's lump sum proceeds;
- A discussion of how individual circumstances can influence a participant's decision of whether to elect a lump sum distribution or retain access to an in-plan annuity (even if ultimately provided through a group annuity contract rather than directly from the plan);
- Where to go to find trusted advice on managing assets and drawdown distributions from an advisor that is free from personal conflict⁷; and
- Comparison of PBGC insurance coverage to that of the state guaranty association coverage that takes over upon the purchase of a group annuity buy-out contract by the plan, and the factors that fiduciaries must consider in selecting an insurer.
- Consider additional mandatory disclosures that might be prudent to assist plan participants in evaluating a lump sum offer. Potential additional disclosures include:
 - A statement of the amount and annuity form of the accrued benefit payable at the plan's normal retirement date;
 - A description of any additional plan benefits or subsidies that might be available presently or in the future that are not taken into account in determining the amount of the lump sum; and
 - A summary of the "known unknowns" and individual circumstances that could influence a participant's decision of whether to accept or reject the lump sum offer, but only if it is supported by a fiduciary-protected safe harbor notice (similar to the IRC Section 402(f) "standard tax notice") issued by DOL or another appropriate regulatory agency (e.g., IRS or PBGC).
- Review the current relative value disclosure requirements to ensure they are adequately addressing the needs of today's plan participants, as recommended in the 2015 GAO report.

Closing

The Pension Committee of the American Academy of Actuaries acknowledges that today's workers face a more pronounced emphasis than in several generations on individual responsibility and risk for managing their lifetime income needs as the result of both a general decline in defined benefit plan sponsorship and the more the prevalence of more recent risk-transfer methods. When faced with a significant financial decision such as choosing between an up-front lump sum distribution or a guaranteed monthly pension check for a lifetime, plan participants should have access to sufficient information to ensure an informed decision is made and improve the likelihood that the participant makes a prudent decision given their individual circumstances. Plan fiduciaries assume a tremendous amount of responsibility for ensuring that participant communications appropriately convey information regarding the terms of the plan, the participant's benefit distribution options and other key factors such as taxation of benefits and benefit guarantees.

While requiring plain language explanations to be written in a manner intended to be understood by the average participant is an appropriate standard to apply to fiduciary communications, much

⁷ See the discussion on page 33 of the 2015 GAO Report on "Finding Trusted Professional Advice."

of the information that relates to evaluating individual circumstances and their influence on the decision to accept or reject a lump sum offer is beyond the expertise required of an ERISA plan⁸ fiduciary. Therefore, it could be ill-advised to require consideration and disclosure of such circumstances on a plan-by-plan basis. Regulatory agencies such as DOL, PBGC and the IRS can support improved outcomes for plan participants by providing easily accessible consumer information combined with safe-harbor notices and disclosure language that provide protection for plan fiduciaries and objective guidance to plan participants.

⁸ Plans covered under the 1974 Employee Retirement Income Security Act (ERISA).