Advisory Council on Employee Welfare and Pension Benefit Plans

Report to the Honorable Julie A. Su, United States Acting Secretary of Labor

Qualified Default Investment Alternatives – Start to Finish, Default to Payout

December 2024

NOTICE

This report was produced by the Advisory Council on Employee Welfare and Pension Benefit Plans, usually referred to as the ERISA Advisory Council (the "Council"). The Council was established under Section 512 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") to advise the Secretary of Labor (the "Secretary") on matters related to welfare and pension benefit plans. This report examines Qualified Default Investment Alternatives (QDIAs) – Start to Finish, Default to Payout.

The contents of this report do not represent the position of the Secretary or of the Department of Labor (the "Department").

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ABSTRACT

The 2024 Advisory Council examined the effectiveness of Qualified Default Investment Alternatives ("QDIAs") in both accumulation and decumulation phases of retirement. The Council's examination included a review of the Department's final rules on QDIAs issued in 2007, through changes prompted by SECURE[1] (lifetime income fiduciary relief) and SECURE 2.0[2] (automatic enrollment mandate for new plans).

Plan sponsors adopt a QDIA for participant-directed, individual account retirement savings plans (401(k), 403(b), etc.) to provide a default investment for participants who do not affirmatively select investments. Adoption of a QDIA is often paired with automatic enrollment. Department regulations seek to provide relief for plan fiduciaries with respect to assets invested in QDIAs, including target date investments, managed accounts, and balanced funds. However, these regulations are primarily focused on the initial investment decision and on the accumulation phase, not on the longer-term benefits a QDIA might provide participants.

The Council examined the following issues related to QDIAs:

- How QDIAs are being used, deployed, and selected by plan fiduciaries
- QDIAs and decumulation
  - Impact of new laws, identification of any residual issues when incorporating insured/pooled lifetime income components
  - Update on current market QDIA offerings, including those that incorporate insured/pooled lifetime income components, and QDIA offerings in development
  - Participant behavioral finance concepts and automatic defined contribution plan features as they pertain to QDIAs with insured/pooled lifetime income features
- Evaluating QDIA performance
  - Potential metrics for evaluating results (e.g., performance, transparency, risk)
  - How transparency is assessed at the securities level within asset classes of Target Date Funds ("TDFs") in collective investment trusts ("CITs") for exposures including

[1] Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. 116–94, December 20, 2019.
[2] SECURE 2.0 Act of 2022, Pub. L. 117–328, December 29 2022.

private equity and annuities, state banking regulator registration shopping, and fees
- Differences between participant disclosures for mutual funds and CITs

The Council previously examined income replacement from defined contribution ("DC") retirement plans six times since the Department issued guidance on QDIAs in 2007. In 2020, the Council discussed cognitive decline among participants, including those in payout status. In 2018, the topic was QDIAs that incorporate lifetime income solutions. In 2012, the Council studied income replacement from DC plans. In 2016, 2015 and 2014, the Council analyzed various facets of lifetime plan participation. The Council reviewed the recommendations from each report to identify those applicable to our current issue.

ACKNOWLEDGEMENTS

The Council recognizes the following individuals and organizations who provided testimony or information that assisted the Council in its deliberations and the preparation of its report. Notwithstanding their contributions, any errors in the report rest with the Council alone. The witnesses are shown in alphabetical order on the date of their testimony. Their submitted written testimony can be found at https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council.

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I. EXECUTIVE SUMMARY

The use of Qualified Default Investment Alternatives has dramatically increased over the past 20 years after the Department added QDIA regulations pursuant to the Pension Protection Act of 2006 and its embrace of automatic features in retirement savings plans. Given the explosive growth in QDIA usage, coupled with changes under SECURE and SECURE 2.0, the 2024 Council's objective was to examine the effectiveness of QDIAs in both the accumulation and decumulation phases of retirement.

The Council heard testimony from a variety of witnesses and offers recommendations designed to extend the past success in the accumulation phase of retirement to participants in retirement plans during the transition and decumulation phases of retirement:

1. The Department should issue guidance, in the form of a comprehensive "Tips" document or other form of guidance, to serve as a road map for plan fiduciaries when selecting and monitoring both non-guaranteed and guaranteed retirement income options, inside or outside of a QDIA. The guidance should include necessary elements and key substantive considerations that will ensure prudent selection and periodic monitoring processes. The Council believes the Department's guidance should be informed by relevant statutes, regulations, stakeholder input, and case law to build an effective road map.
2. The Department should provide and update guidance to plan sponsors and other fiduciaries to improve participant education, notices, transparency, and disclosures regarding the actual investments held within the QDIA in all phases of participation (accumulation, transition, decumulation), as well as non-guaranteed and guaranteed retirement income solutions offered within or outside the QDIA.
3. The Department should amend the safe harbor for automatic rollovers to individual retirement plans (29 C.F.R. § 2550.404a-2) to allow use of QDIAs (29 C.F.R. § 2550.404c-5) as the investment safe harbor for involuntary, automatic rollovers. The new investment default options would be in addition to, not in lieu of, the existing capital preservation default.

II. PRIOR COUNCIL REPORTS

The Council previously examined income replacement from DC retirement plans six times since the Department issued QDIA guidance in 2007. The recommendations from the prior Council reports are as follows:

2018: Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA) – Focus on Decumulation and Rollovers[3]

The 2018 Council recommendations included:

- Amending the QDIA regulations to address using Lifetime Income in a QDIA … we recommend the Department clarify that sponsors may default participants into different options based on participant demographics because plan populations may not be sufficiently similar for a single default to be universally appropriate, clarify whether living benefits satisfy these requirements.
- Encourage plan sponsors to adopt plan design features that facilitate LTI, including, but not limited to allowing participants to take ad hoc distributions, enabling installment payments, providing social security bridge options, and allowing for payment of required minimum distributions.

2016: Participant Plan Transfers and Account Consolidation for the Advancement of Lifetime Plan Participation[4]

The 2016 Council recommendations included:

- A Request for Information on how to encourage and support the adoption of secure electronic data standards to expedite the processing of eligible rollovers.
- Plan sponsor education to support participant-initiated plan to plan transfers.
- Sample participant communications for consolidating accounts. Collaborate with the U.S. Department of the Treasury ("Treasury") to identify options for relief from disqualification

[3] Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA) – Focus on Decumulation and Rollovers, Accessed November 6, 2024 at: https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2018-lifetime-income-solutions-as-a-qdia.pdf

[4] Participant Plan Transfers and Account Consolidation for the Advancement of Lifetime Plan Participation, Accessed November 6, 2024 at: https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2016-participant-plan-transfers-and-account-consolidation-for-the-advancement-of-lifetime-plan-participation.pdf

for eligible retirement plans accepting rollovers and revisit the §402(f) notice with an eye to promote lifetime plan participation.

2015: Model Notices and Plan Sponsor Education on Lifetime Plan Participation[5]

The 2015 Council recommendations included:

- The Department published a range of sample communications that encourage lifetime plan participation.
- Tips and FAQs to educate plan sponsors about plan design features that encourage lifetime plan participation.
- The creation of plain language communications promoting lifetime plan participation, while encouraging innovation and customization by sponsors and providers.

2014: Issues and Considerations Surrounding Facilitating Lifetime Plan Participation[6]

The 2014 Council recommendations included:

- The provision of education to participants and plan sponsors regarding asset retention.
- Model plain language communications to participants on decumulation of retirement assets.
- Materials to plan sponsors on plan designs that encourage lifetime participation.
  - An updated, defined contribution plan annuity selection safe harbor.
  - New options to make the Department's Lifetime Income Calculator[7] available while integrating existing tools such as those in My Social Security account.[8]
  - Information on allowing continuation of loan repayments after separation from employment and the advantages of loan initiation post-separation to prevent leakage.
  - Fostering technology standards while creating uniform sample forms to facilitate plan to plan transfers.

[5] Model Notices and Plan Sponsor Education on Lifetime Plan Participation, Accessed November 6, 2024 at: https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2015-model-notices-and-plan-sponsor-education-on-lifetime-plan-participation.pdf

[6] Issues and Considerations Surrounding Facilitating Lifetime Plan Participation, Accessed November 6, 2024 at: https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2014-facilitating-lifetime-plan-participation.pdf

[7] Department of Labor, Employee Benefits Security Administration, Lifetime Income Calculator, Accessed November 6, 2024 at: https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/advanced-notices-of-proposed-rulemaking/lifetime-income-calculator

[8] Social Security Administration, My Social Security Account, Accessed November 6, 2024 at: https://www.ssa.gov/myaccount/

2012: Examining Income Replacement During Retirement Years In a Defined Contribution Plan System[9]

The 2012 Council recommendations included:

- The Department review, modify, and/or develop regulatory guidance/clarification with respect to decumulation of retirement assets, including a defined contribution plan annuity safe harbor, participant education, and investment advice.
- Develop more immediate clarification in the same areas in the form of FAQs or other sub-regulatory guidance.
- Develop educational materials to assist employers and plan sponsors in evaluating and selecting income replacement options.
- Develop educational materials to assist individuals in understanding and choosing income replacement options to best suit their retirement needs.
- The report also highlighted other issues:
    - Auto enrollment or other default features for income replacement options which could include a safe harbor.
    - Barriers to a plan sponsor acting as a facilitator of income replacement options outside of an employer-sponsored plan.
    - Income illustrations of the participants' account balances on their benefit statements.

2008: Advisory Council Report on Spend Down of Defined Contribution Assets at Retirement[10]

The 2008 Council recommendations included:

- The Department simplify the proposed annuity provider selection rules and eliminate the requirement for an independent expert (noting that on October 6, 2008, the Department of Labor published final regulations regarding the safe harbor for individual account plan when selecting annuity providers).
- Update, expand, and amend Interpretive Bulletin 96-1 by adapting it to the spend-down phase to address information, education, and advice related to the spend-down of retirement plan

[9] Examining Income Replacement During Retirement Years In a Defined Contribution Plan System, Accessed November 6, 2024 at: https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2012-examining-income-replacement-during-retirement-years-in-a-defined-contribution-plan-system.pdf

[10] Advisory Council Report on Spend Down of Defined Contribution Assets at Retirement, Accessed November 6. 2024 at: https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council/2008-spend-down-of-defined-contribution-assets-at-retirement#1

assets (distribution options, in-plan vs. out of plan payments.

- Clarify the QDIA with respect to default options incorporating guarantees that extend into the distribution phase so that fiduciaries receive the same fiduciary protection under the QDIA regulation for amounts that remain invested in guaranteed lifetime income products.
- Encourage and allow additional participant disclosures and communications that would estimate the annual retirement income from converting the account balance and enhance plan sponsor and participant education regarding the inherent flexibility of distribution options.

III. BACKGROUND

Qualified Default Investment Alternatives

The QDIA regulations were issued by the Department in 2007 and established the criteria for a fund or allocation to be considered a "qualified default investment alternative."[11] The final regulation was intended to ensure that an investment qualifying as a QDIA is appropriate as a single investment capable of meeting a worker's long-term retirement savings needs. The final regulation does not identify specific investment products – rather, it describes mechanisms for investing participant contributions. The final regulation identifies two individual-based mechanisms and one group-based mechanism to address retirement savings. It also provides for a short-term investment for administrative convenience.

The Department specifically stated in the Federal Register Notice for the QDIA regulations that "[c]onsistent with providing flexibility and encouraging innovation in the development and offering of retirement products, model portfolio or services, the Department intends that the definition of 'qualified default investment alternatives' be construed to include products and portfolios offered through variable annuity and similar contracts, as well as through common and collective trust funds or other pooled investment funds, where the qualified default investment alternative satisfied all of the condition of the regulation."[12] The final regulation provides for four types of QDIAs:

- A product with a mix of investments that takes into account the individual's age or retirement date (an example of such a product could be a life cycle or target date fund.
- An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date (an example of such a service could be a professionally managed account).
- A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (an example of such a product could be a balanced fund); and
- A capital preservation product for only the first 120 days of participation (an option for plan sponsors wishing to simplify administration for workers who opt-out).

[11] 29 C.F.R. § 2550.404c–5
[12] 72 FR 60452 (Oct. 24, 2007), Default Investment Alternatives Under Participant Directed Individual Account Plans.

A QDIA generally may not invest participant contributions in employer securities. A QDIA must either be managed by an investment manager, plan trustee, plan sponsor or a committee comprised primarily of employees of the plan sponsor that is a named fiduciary or be an investment company registered under the Investment Company Act of 1940.

The Department has provided a wide array of guidance to facilitate selection of retirement income solutions (e.g., QDIA regs, TDF selection tips, participant disclosure requirements, lifetime income in QDIA and annuity selection safe harbors from SECURE 1.0, and SECURE 2.0). Field Assistance Bulletin 2008-03 was issued the following year to respond to the industry's questions regarding the QDIA regulations. As a result, target date funds experienced significant growth in assets following the issuance of the QDIA regulations.

Following the 2008 global financial crisis, the Securities and Exchange Commission and the Department jointly published an Investor Bulletin on Target Date Retirement Funds in 2010, providing guidance on assessing the benefits and risks associated with these funds. The Department also issued additional guidance in 2013, this time directed at plan sponsors, titled "Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries," ("TIPS") which offers general advice for selecting and monitoring target date funds. This TIPS guidance is still the primary source of guidance used by plan fiduciaries in selecting and reviewing target date funds today, including those with insurance components. The SECURE 2.0 Act of 2022 included a mandate, with some exceptions, that newly established 401(k) and 403(b) plans must include auto-enrollment and escalation features and investment in a QDIA unless participant elects otherwise, which will further increase utilization of QDIAs in the future.

Participant Disclosure Requirements

The primary regulations governing participant disclosure requirements for lifetime income solutions are the Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans of 2010.[13] These regulations contain specific provisions related to "fixed return" investments

[13] Department of Labor, Employee Benefits Security Administration, Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, October 20, 2010, Accessed November 6, 2024 at: https://www.federalregister.gov/documents/2010/10/20/2010-25725/fiduciary-requirements-for-disclosure-in-participant-directed-individual-account-plans

such as guaranteed insurance contracts, variable annuity fixed accounts, and other similar interest baring contracts from bank or insurance companies which require disclosure of the current rate of return, the minimum rate guaranteed under the contract or agreement, if any, and a statement advising participants that the issuer may adjust the rate of return prospectively and how to obtain the most recent rate of return information available.

These regulations also include specific disclosures regarding annuities provided as designated investment alternatives (a contract, fund or product that permits participants or beneficiaries to allocate contributions toward the current purchase of a stream of retirement income payments guaranteed by an insurance company). Required disclosures include:

- The name of the contract, fund, or product.
- The option's objectives or goals (e.g., to provide a stream of fixed retirement income payments for life).
- The benefits and factors that determine the price (e.g., age, interest rates, form of distribution) of the guaranteed income payments.
- Any limitations on the ability of a participant or beneficiary to withdraw/transfer amounts allocated to the option (e.g., lockups) and fees applicable to such withdrawals or transfers.
- Any fees that will reduce the amounts allocated by participants or beneficiaries to the option, such as surrender charges, market value adjustments, and administrative fees.
- A statement that guarantees of an insurance company are subject to its long-term financial strength and claims- paying ability; and
- An internet web site address that is sufficiently specific to provide participants and beneficiaries access to the following information:
    - The name of the option's issuer and of the contract, fund, or product;
    - Description of the option's objectives or goals;
    - Description of the option's distribution alternatives/guaranteed income payments (e.g., payments for life or a specified term, joint and survivor, optional rider payments), including any limitations on the right of a participant or beneficiary to receive such payments;
    - Description of costs and/or factors taken into account in determining the price of benefits under an option's distribution alternatives/guaranteed income payments (e.g., age, interest rates, other annuitization assumptions);

  - Description of any limitations on the right of a participant or beneficiary to withdraw or transfer amounts allocated to the option and any fees or charges applicable to a withdrawal or transfer; and
  - Description of any fees that will reduce the amount allocated by participants or beneficiaries to the option (e.g., surrender charges, market value adjustments, administrative fees).

In order for an investment option to qualify as a QDIA, the regulations mandate the provision of certain participant notices. These notices include both initial and annual QDIA notices, which serve to remind participants about their default into the QDIA and their right to direct the investment of their accounts. Notices must:

- Be written in a manner calculated to be understood by the average plan participant, and include:
  - When the QDIA will be used regarding account assets, and contributions,
  - Confirm that participants retain the right to direct investments,
  - A description of the QDIA,
  - Confirm the participant's right to redirect assets from the QDIA to other investments, with notice of any applicable restrictions, fees, or expenses in connection with such transfer; and
  - An explanation of where the participants and beneficiaries can obtain investment information concerning the other investment alternatives available under the plan.
- Deliver the initial notice at least 30 days prior to the later of the date of eligibility to participate or the date of any first investment into the QDIA; and
- Deliver annual notices within a reasonable period at least 30 days in advance of each subsequent plan year.

Required notices need not include any information regarding the actual allocation of assets within the target date fund, managed account, or balanced fund.

<u>Lifetime Income in QDIAs and the Annuity Safe Harbor</u>

As noted above, the QDIA regulations explicitly state that an investment option that is an insurance product, or contains features of an insured product, can qualify as a QDIA. The preamble to the QDIA regulations states that "it is the view of Department that the availability of annuity purchase rights, death benefit guarantees, investment guarantees or other features common to variable annuity contracts will not themselves affect the status of a fund, product or portfolio as a QDIA when the conditions of the regulation are satisfied."[14]

The regulations establishing a safe harbor for annuities in defined contribution plans have evolved over time to provide greater clarity and protection for plan fiduciaries. Here is a summary of the key guidance regarding the selection of QDIAs:

- 2008 Annuity Selection Safe Harbor[15]: In 2008, the Department issued a fiduciary safe harbor regulation for the selection of annuity providers or contracts for benefit distributions in DC plans. This safe harbor provides guidance on the selection of unallocated deferred annuity contracts as investments of TDFs. The Department confirmed that the use of deferred annuity contracts does not cause a TDF to fail to meet the QDIA requirements, as long as the conditions of the safe harbor are met.
- Department Information Letter to J. Mark Iwry at the Treasury Department: In 2014, an information letter outlined to what extent the 2008 annuity selection safe harbor is available in connection with the selection of the unallocated deferred annuity contracts as investments of TDFs. The information letter states that the selection of the unallocated deferred annuity contracts satisfies the requirements of section 404(a)(1)(B) of ERISA if the designated investment manager satisfies each of the conditions of the annuity selection safe harbor.[16]
- Field Assistance Bulletin No. 2015-02[17]: In 2015, the Department issued this bulletin to provide additional clarity on the 2008 safe harbor regulation. It addressed employers' uncertainties regarding their fiduciary obligations related to annuity selection in DC plans. The bulletin also explained the applicable statute of limitations on fiduciary liability for the selection of annuity providers and contracts.
- SECURE Act[18]: The SECURE Act, passed in 2019, introduced a new safe harbor in the form of the 404(e) annuity safe harbor to protect fiduciaries from liability for losses to participants or beneficiaries if an insurer fails to meet its contractual obligations. The SECURE Act also

[14] 72 FR 60452 (Oct. 24, 2007), Default Investment Alternatives Under Participant Directed Individual Account Plans.
[15] 29 C.F.R. § 2550.404a-4, 72 FR 58447 (Oct. 7, 2008), Selection of Annuity Providers-Safe Harbor for Individual Account Plans.
[16] https://www.dol.gov/sites/dolgov/files/ebsa/pdf_files/10-23-2014.pdf
[17] https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2015-02.
[18] Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. 116–94, December 20, 2019.

enhanced the portability of lifetime income investment options by providing for either qualified distributions of a lifetime income investment, or distributions of a lifetime income investment in the form of a qualified plan distribution annuity contract in the event a lifetime income investment is no longer held as an investment under a DC plan.

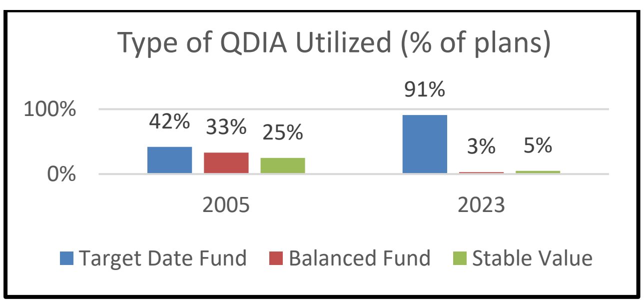
- SECURE 2.0[19]: SECURE 2.0 further facilitated the inclusion of annuities in DC plans. It confirms that annuities with certain features can be offered without violating required minimum distribution rules and eliminates the penalty on partial annuities. It also increased the dollar limits on premiums for qualifying longevity annuity contracts ("QLACs") and allows for a "free look" rescission period of up to 90 days for QLACs.

These developments reflect ongoing legislative and regulatory efforts to provide fiduciaries with clear guidelines and protections when considering the inclusion of annuities in DC plans.

Changes in Qualified Default Investment Alternatives Following the Pension Protection Act

Department guidance facilitated the transition of QDIAs from investments focused on capital preservation to investments focused on long term appreciation.[20]

- TDFs are the most prevalent QDIA (Government Accountability Office Reports[21])
- Vanguard survey results show the evolution of TDFs as QDIAs. In the years between 2005 and 2023, TDF utilization as a QDIA more than doubled.[22]



[19] SECURE 2.0 Act of 2022, Pub. L. 117–328, December 29 2022.
[20] 29 C.F.R. § 2550.404c–5; 72 FR 60452 (Oct. 24, 2007), Default Investment Alternatives Under Participant Directed Individual Account Plans; 73 FR 23349, 23350 (Apr. 30, 2008) Field Assistance Bulletin No. 2008-03. Target Date Retirement Funds - Tips for ERISA Plan Fiduciaries U.S. Department of Labor Employee Benefits Security Administration, February 2013, https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/target-date-retirement-funds.pdf
[21] Government Accountability Office, 401(k) Retirement Plans, Department of Labor Should Update Guidance on Target Date Funds, GAO-24-105364, March 2024, Accessed November 6, 2024 at: https://www.gao.gov/assets/gao-24-105364.pdf
[22] Vanguard, How America Saves, 2024, Accessed December 24, 2024 at https://institutional.vanguard.com/content/dam/inst/iig-transformation/insights/pdf/2024/has/how_america_saves_report_2024.pdf

In 2024, the same survey showed that 98% of plans that designate a QDIA select a TDF.[23]

		QDIA plans	Non-QDIA plans	All plans
Among all plans	**Target-date fund**	86%	5%	91%
	Balanced fund	2%	1%	3%
	Money market or stable value	–	5%	5%
	Total plans designating default	**88%**	**11%**	**99%**
Among plans designating a QDIA	**Target-date fund**	98%	–	–
	Balanced fund	2%	–	–
	Total plans designating a QDIA	**100%**	–	–

<u>Benchmarking</u>

In their selection of target date funds, fiduciaries generally utilize the 2013 Tips for ERISA Plan Fiduciaries. The first two items on Department's tip sheet address the process for selecting and monitoring these investments. However, the discussion is general in nature and does not focus on the types of peer group benchmarking issues common in recent DC plan litigation.

Regulatory guidance does not mandate a benchmark for target date funds as part of quarterly or annual fee disclosures. As a possible solution, Section 318 of SECURE 2.0 identifies an opportunity for voluntary benchmarks for asset allocation funds.[24] Section 318 requires the Department to modify existing regulations for QDIAs that use a mix of asset classes to enable (not require) a plan administrator to use a benchmark that is a weighted blend of different broad-based securities market indices. A benchmark blend of different broad-based securities market indices must:

- Be reasonably representative of the asset class holdings of the designated investment alternative;
- Be modified at least once per year if needed to reflect changes in the asset class holdings when determining the blend's returns for 1-, 5-, and 10-calendar-year periods (or for the life of the alternative, if shorter);

[23] Id.
[24] SECURE 2.0 Act of 2022, Pub. L. 117–328, December 29 2022

- Be furnished and communicated to participants and beneficiaries in a manner that is reasonably calculated to be understood by the average plan participant; and
- Limit the securities market indices to those that would separately satisfy the regulatory requirements for that associated asset class.

The Council studied what multi-asset class benchmarks were available today in the marketplace which included receiving testimony from Standard & Poor's (S&P) and Morningstar.

The Council received testimony from S&P regarding the S&P Indices:

- Target date index vintages (e.g., 2025, 2030, 2035, etc.) are dynamic. New vintages are added for younger participants as the in-retirement vintages merge into a terminal landing point (e.g., income). New indices are introduced once 30% of TDF providers offer the new vintage; indices are retired once less than 20% of sponsors offer that vintage.
- A consensus glidepath is created for benchmarking by identifying the Consensus Asset Class Exposure (to measure the impact of the manager's asset class allocation decisions) with Passive Asset Class Representation (to measure the impact of manager's security selection decisions) which yields the S&P Target Date Index – A Representative Target Date Benchmark.

The Council also received testimony from S&P regarding Dow Jones Indices:

- Measures performance of subindices of stocks, bonds, and cash, each considered a Composite Major Asset Class ("CMAC") on a glidepath.
- Each sub-series is comprised of 14 indices representing a target date. New vintages are launched every 5 years.
- CMAC's are determined based on a risk-weighted glide path:
    - The risk of each vintage lies between that of a diversified stock portfolio and T-bills (cash).
    - The most near-dated vintage begins with 90% of the risk of an all-stock portfolio 35 years from the respective target date.
    - The glide path decreases to 20% of the historic market risk of an all-stock portfolio on December 31 of the tenth year past the target date year then maintains the risk level for 10 years.
    - Indices within each CMAC are equally weighted.

- CMAC allocations are rebalanced to an increasingly conservative asset mix.

Morningstar also provided testimony regarding its TDF evaluation process:

- Quarterly evaluation based on the ratings for five components – Top, Above Average, Average, Below Average, Bottom.
- Focus on TDFs as a comprehensive, long-term investment option while working and throughout retirement.
- Morningstar evaluates two qualitative and three quantitative components for each target-date fund series. The five components are:
  - People (Management team, manager incentives),
  - Parent organization (culture, board oversight/independence, transparency, and regulatory issues history),
  - Performance (Compares each target-date fund series' overall Morningstar Risk-Adjusted Returns ("MRAR") with the average MRAR of the target-date universe - MRAR adjusts a fund's total return by deducting a "risk penalty" based on its month-to-month variation in return),
  - Portfolio (quality of underlying mutual funds in each fund series, comparing each underlying fund's risk-adjusted performance with its peer group), and
  - Price (Experience confirms low costs are important predictors of future outperformance - especially for TDFs which are intended to be held for the long term and where the advantage of lower costs can compound greatly over time; selecting the lowest-cost share class that has at least 10% of the overall assets in the target date fund series).

<u>Notices, Education and Disclosure</u>

In their 2021 analysis,[25] the Government Accountability Office ("GAO") estimated the following regarding the level of a 401(k) plan participant's knowledge regarding fees:

39% of participants	*37% of participants*	*24% of participants*
Less than half correct	**Half to 79% correct**	**80%+ correct**

[25] GAO, 401(k) Retirement Plans: Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them, GAO 21-357, July 27, 2021. Accessed November 6, 2024 at: https://www.gao.gov/products/gao-21-357; see also GAO, 401(k) Plans: Reported Impacts of Fee Disclosure Regulations, and DOL Efforts to Support Implementation of Regulations, GAO-24-107125, October 28, 2024, Accessed November 6, 2024 at: https://www.gao.gov/products/gao-24-107125

The GAO recommended that "[t]he Assistant Secretary of the Employee Benefits Security Administration should take steps to provide participants important information concerning the cumulative effect of fees on savings over time. For example, steps could include ensuring disclosures cite a working, specific Department web address for where such information is shown and requiring that fee disclosures include the agency's graphic illustration on the cumulative effect of fees."

On its website, the GAO noted that: "As of September 2023, DOL told us that all recommendations in [the 2021] report will be considered in connection with implementing SECURE 2.0. On August 11, 2023, EBSA published a Request for Information to solicit public feedback on a number of provisions of the SECURE 2.0 Act that relate the reporting and disclosure framework of the ERISA, including new disclosure requirements for defined contribution retirement plans."[26]

In their 2015 report,[27] the GAO noted that employers who sponsor 401(k) plans report using a range of default investment types to automatically enroll employees in their plans based on each type's design and other attributes. "From 2009 through 2013, the majority of employers who sponsored 401(k) plans reported using a target-date fund as their default … Plan sponsors cited regulatory uncertainty, liability protection, and the adoption of innovative products as significant challenges when adopting one of the three default investments. Stakeholders generally said that the regulations were unclear as to: (1) how sponsors could fulfill the regulatory requirement to factor the ages of participants into their default investment selection; (2) whether each default investment provided the same level of protection; or (3) whether they were allowed to incorporate other retirement features, such as products offering guaranteed retirement income, into a plan's default investment. Such uncertainty could lead some plan sponsors to make suboptimal choices when selecting a plan's default investment that could have long-lasting negative effects on participants' retirement savings…." The GAO recommendations included: "To encourage plan sponsors to continue efforts to improve plan participation and overall retirement savings through the use of Qualified Default Investment Alternatives, the [Department should] assess the challenges that plan sponsors and stakeholders reported, including the extent to which these challenges can be addressed,

[26] GAO, 401(k) Retirement Plans: Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them, GAO 21-357, July 27, 2021. Accessed November 6, 2024 at: https://www.gao.gov/products/gao-21-357.
[27] GAO, 401(k) Plans: Clearer Regulations Could Help Plan Sponsors Choose Investments for Participants, GAO-15-578, August 25, 2015, Accessed November 6, 2024 at: https://www.gao.gov/products/gao-15-578

and implement corrective actions through clarifying guidance or regulations, as appropriate."

On their website, the GAO noted that: "In 2018, DOL reported that it had convened the 2018 ERISA Advisory Council (EAC) to study lifetime income solutions in the context of QDIAs with a focus on decumulation issues and rollovers. Among other recommendations, the EAC recommended to DOL that it clarify that sponsors may default participants into different options based on participant demographics because plan populations may not be sufficiently similar for a single default to be universally appropriate. However, DOL noted that it has not added a public comment process on QDIA issues to EBSA's regulatory agenda and had no specific timeline for any next action. As of September 2023, the agency reported no changes to the status of this recommendation."[28]

In a March 2024 report, the Government Accountability Office ("GAO") recommended that the Department update its TIPS guidance on TDFs to reflect recent developments and highlight the variance among TDF glide paths using the same destination ("to" and "through").[29] The Council heard witness testimony that plan sponsors often relied on the 2013 TIPS guidance.

In their September 2024 report,[30] the GAO obtained information from 13 stakeholders and noted that the fee disclosure regulations have not meaningfully contributed to lower participant-paid fees ("10 out of the 13 stakeholders we spoke with said they did not believe the fee disclosure regulations played a measurable role in decreasing fees"). Instead, (a) litigation, (b) competition and technology and (c) innovation "had a greater impact on decreasing fees." The report provides an example of the limited impact disclosures can have.

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[28] Id.
[29] GAO, Department of Labor Should Update Guidance on Target Date Funds, GAO 24-105364, March 28, 2024. Accessed November 6, 2024 at: https://www.gao.gov/products/gao-24-105364
[30] GAO, 401(k) Plans: Reported Impacts of Fee Disclosure Regulations, and DOL Efforts to Support Implementation of Regulations, GAO-24-107125, September 27, 2024, Accessed November 6, 2024 at: https://www.gao.gov/products/gao-24-107125

IV. WITNESS TESTIMONY

A. Plan Sponsors

Kevin Hanney and Kenneth Levine

Kevin Hanney is the former Senior Director of Pension Investments for RTX Corp., and Kenneth Levine is the Executive Director of Global Retirement Strategy for RTX Corp.

Mr. Hanney and Mr. Levine addressed the RTX Corp. savings plan's integration of retirement income into its QDIA, which was first implemented in 2012 by United Technologies Corp. ("UTC") before the merger of its aerospace subsidiaries with RTX Corp. (formerly known as Raytheon Company). They also shared their broader perspectives on issues related to offering retirement income options in defined contribution plans.

The RTX Corp. plan uses a bespoke QDIA that resembles a target date fund in that it adjusts its asset allocation over time to lower investment risk as participants age. Key differences of the RTX Corp. QDIA, known as lifetime income strategy, compared to a typical target date fund include the personalization of the glidepath to the participant's actual age, with a terminal age of 65; a higher allocation to equities, with a terminal allocation of 60% equities and 40% fixed income; and the inclusion of a default insured retirement income feature.

The default income feature is a group variable annuity with guaranteed lifetime withdrawal benefits ("GLWB"), which is allocated at the individual participant level. Starting at age 50, the lifetime income strategy fund begins allocating an individual's account to a separate portfolio, known as the secure income portfolio, and completes the allocation to this portfolio at age 62. The secure income portfolio provides the terminal 60/40 equities-fixed income allocation. Further, the GLWB is provided through the secure income portfolio. In addition to the regular investment expenses, an insurance premium of 100 basis points and an administrative fee of about 12 basis points are charged to investments in the secure income portfolio.

The insurance premium pays for GLWB contracts from multiple insurers at rates that are set quarterly. Participants activate the GLWB when they choose to start distributions at retirement. The GLWB guarantees participants can withdraw a certain percentage of their secure income portfolio each year (i.e., the benefit rate) with a promise that the insurers will step in to make payments if a participant's secure income portfolio is depleted. Every dollar that goes into the secure income portfolio goes in at a specific benefit rate (typically, 4-7%). At retirement, a participant has a single benefit rate (e.g., 5.5%) that is a composite of those specific benefit rates. There are no liquidity constraints on investments in this portfolio, with participants retaining the right to withdraw their balances at all times.

Mr. Levine stated, "[The RTX Corp.] QDIA isn't necessarily going to fit everybody's needs…but we believe it's the right place to default people…."[31] Mr. Levine and Mr. Hanney noted that according to their calculations, the GLWB default has low net cost to the participant when the higher average investment returns resulting from the higher allocation to equities are taken into account. Mr. Levine explained, further, that the plan now allows participants to make personal choices within the lifetime income strategy fund, setting their own target retirement dates and specifying how much of their balance they want allocated to the secure income portfolio.

Mr. Hanney and Mr. Levine reflected on the decision to incorporate insured lifetime income into the plan and some of the considerations behind it. Mr. Hanney noted the design of the lifetime income strategy fund as the default investment and the inclusion of the secure income portfolio were driven by the employer's commitment to providing access to guaranteed income in retirement after it closed its defined benefit plan. Mr. Levine expanded on this, explaining that while providing meaningful retirement income was important, they were not "arrogant enough to think that's what every single person needs and we're locking them into it."[32] Mr. Hanney suggested that plan sponsors similarly develop their own retirement policy statement that articulates the plan's goals and guides plan design.

Mr. Levine noted that he and others at UTC had expected others to follow their lead in integrating lifetime income into 401(k) plans. He suggested that the reason few plans have done so has less to do with regulatory uncertainty, litigation risk and lack of a safe harbor and more to do with misperception, misunderstanding and a lack of knowledge of lifetime income products, including by plan sponsors and the investment, consulting, and actuarial communities.

[31] Council Hearing of Sept. 11, 2024, Transcript of Testimony of Kenneth Levine, RTX Corp., at 211.
[32] Id. at 224.

Mr. Hanney testified that they found the 2007 proposed regulations to be helpful guidance (29 C.F.R. § 2550.404a-4 - Selection of annuity providers—safe harbor for individual account plans). He testified that the Department should consider some of those criteria for fiduciaries to use as a "road map" – but noted that any road map should not be structured to be minimum criteria or as the exclusive standard.

B. Consultants

Dr. Olivia S. Mitchell

Dr. Olivia S. Mitchell holds the chair professorship of the International Foundation of Employee Benefit Plans at the Wharton School of the University of Pennsylvania, where she is a Professor of Insurance/Risk Management and Business Economics/Policy, Executive Director of the Pension Research Council, and Director of the Boettner Center for Pensions and Retirement Research. She is also a Research Associate at the National Bureau of Economic Research. Her research focuses on public and private pensions, risk management, financial literacy, household finance, and public finance.

Dr. Mitchell has devoted most of her research and career to retirement payouts. Her testimony focused on longevity risk as it relates to pension design. She began her testimony by noting the aging population in the United States and that longevity is rising at all ages, making it increasingly important to be able to finance retirement at older ages. However, she noted that it is in the later years where financial literacy declines. Thus, Dr. Mitchell concluded that more must be done to help retirees from outliving their assets.

Dr. Mitchell then directed Council to three key points.

- First, due to increasing longevity, financing retirement at older ages is crucially important.
- Second, financial literacy is generally low in the United States and falls about 1% per year beginning at age 65.
- Finally, people lack understanding and awareness of their longevity. While they have some general idea how long they might live, they are typically focused on the average lifespan and not the probability that they might live a very long time. This misunderstanding can undermine their retirement security.

Dr. Mitchell stated that, despite the risk of a long life, people do not plan appropriately, save enough, or protect themselves through the purchase of long-age protection, such as long-term care insurance or annuities. She testified that 60% of older survey respondents regretted not protecting themselves by saving more or otherwise better preparing once provided with information about a possible long life.

Dr. Mitchell's emphasized the crucial role of lifetime income. She noted the need for lifetime income streams to be provided through DC plans, such as with a payout option for an annuity. Research revealed that, for those with account balances of at least $65,000, setting aside around 10% of savings at age 65 to fund an annuity that begins payments at age 80 increases well-being by 6% to 14% for ages 66 forward. It is important to note that longevity varies, but allowing for that, the welfare gains are still positive even for the lowest educated with lowest life expectancies. Dr. Mitchell explained the recommendation to set aside 10% of savings was developed by looking at people of various education levels and the simulation of hundreds of thousands of cases, and it was determined that 10% would be sufficient for most cases. An employer could have that as a default and people could decide later in life if they wanted more to supplement it.

Dr. Mitchell concluded her prepared remarks with some additional thoughts and recommendations. First, consider including default income annuities as a QDIA for 10% of a DC balance where the balance is greater than $65,000, perhaps funded from employer contributions. Second, during the accumulation of savings, offer participants a pooled annuity that might be converted to a QDIA at retirement. This would be particularly valuable if provided through participating annuities or variable annuities subject to examination of insurer capacity.

In discussions following her prepared remarks, Dr. Mitchell described how cognitive decline interacts with QDIA products, noting that products should not be structured so that people are asked to opt in during a later age range. She favored a default with an opt-out feature, and noted that ages 55 to 65 are the latest people should be asked to consider an opt-in.

Dr. Mitchel also expanded on her concerns regarding insurer capacity. She pointed to recent discussions around insurers that offshore their business, thus managing assets outside the US regulatory environment. This has been a particular concern with defined benefit plans that transfer annuities to insurers through pension risk transfers.

Dr. Mitchell stated that there are benefits in requiring a plan to offer an annuity option, even though there are so many unknown aspects, since people understand life expectancy, but not longevity and the need for insurance. In other cases, we do require insurance, such as for a house or a car, and defined benefit plans naturally have longevity insurance. Dr. Mitchell encouraged putting the "pension" back in the defined contribution plan through some form of guarantee.

Dr. Mitchell stated that long-term care could also be integrated into her recommendations. She described a need to have a payout that is linked to limitations of daily living, such that the payout would increase when limitations begin applying because that is also when lifespan is shortened. This could be provided through a rider for a long-term care policy, although she was not aware of anyone currently selling such a policy.

Dr. Mitchell concluded that there should be an effort to educate people that life expectancy should not be their focus for planning; they should instead consider how long they could live. This education should be provided for individuals of all ages. She stated that explaining the need for insurance and how it relates to the need for annuities (which are often seen as a "bad investment") would help, including an explanation that insurance can provide peace of mind that one will not run out of money late in life. In addition, it is helpful for employers to provide financial literacy information at life events. In the end, maximizing one's payout requires understanding the tradeoff of more now as compared to nothing later.

Gregory Fox and Preet Prashar

Gregory Fox is a Partner and Head of Retirement Income Solutions at Aon Investments USA Inc. Preet Prashar is a Principal and Director of Defined Contribution Strategic Research Teams at Mercer.

Mr. Fox and Mr. Prashar addressed the lifetime income marketplace landscape, the impact of new laws on plan offerings and fiduciary decision making, what they are hearing from plan sponsors including barriers to adoption, and related issues.

Mr. Prashar and Mr. Fox defined "retirement income" as a worker converting their DC account into some form of income at retirement. Mr. Prashar noted that "given the variation in retiree needs, circumstances and preferences, we believe no single solution would be optimal for all retirees."[33] Similarly, Mr. Fox stated, "We don't think that one retirement income solution per plan menu is going to be the magic wand that every participant in that particular plan needs."[34]

Mr. Prashar presented a framework for understanding the range of available retirement income offerings. These include tools (e.g., Social Security optimization and retirement planning and projection tools); resources (e.g., targeted communications and plan design, such as partial withdrawal features); advice (e.g., managed accounts and income advice services); guaranteed income (e.g., investment solutions such as a target date fund with an annuity and standalone in-plan and out-of-plan annuities); and non-guaranteed income (e.g., managed payout funds, target date funds with spend-down guidance and managed accounts with decumulation features). He noted that there has been "a lot of action" recently with guaranteed income solutions coming to market or in development, which he attributed partly to enactment of the SECURE Act. He remarked, further, that guaranteed income products mostly have been "options in feature," i.e., "a participant's decision to annuitize a portion of their balance or savings is optional and it's totally at their discretion."[35]

Mr. Fox elaborated on the kinds of guaranteed products that are available in target date funds. These include in-plan and out-of-plan annuities provided by a single insurance company or through a shopping service with multiple companies; stand-alone annuity options in which a participant decides whether, how much and when to purchase; annuity sleeves in which a share of a target date fund is allocated beginning at a certain age, e.g., 50, with an individual option to convert that into an income annuity; and immediate, e.g., at age 65, and deferred annuities, e.g., at age 85. Mr. Prashar also noted that there are products in the market and in development that provide for guaranteed annual withdrawal amounts from a defined contribution account, with the guarantee kicking if the account is depleted.

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[33] Council Hearing of July 9, 2024, Transcript of Testimony of Preet Prashar, Mercer, at 90.
[34] Council Hearing of July 9, 2024, Transcript of Testimony of Gregory Fox, Aon Investments USA, Inc., at 132.
[35] Council Hearing of July 9, 2024, Transcript of Testimony of Preet Prashar, Mercer, at 91.

Mr. Fox reviewed recent statutory changes he believes are most impactful on and relevant to retirement income in plans, which were all part of the SECURE Act:

- Sec. 204 of that law created a fiduciary safe harbor for the selection of an annuity provider in a defined contribution plan.
- Sec. 109 provides for the portability of lifetime income options in defined contribution plans.
- Sec. 203 requires annual disclosures translating participants' account balances into an illustrative income statement.

Mr. Fox described his sense of how plan sponsors are thinking about retirement income for their plan participants. He noted the beginnings of some traction for retirement income among plan sponsors, with some now recognizing this as an important issue and others implementing solutions for participants drawing retirement income from their accounts. Nevertheless, he stated that an overwhelming majority of plan sponsors have not adopted retirement income solutions or options.

Mr. Prashar noted that, while sponsors are interested in learning more about available retirement income solutions, the typical sponsor is taking a wait-and-see attitude and is willing to wait until existing products have been tested in the real world. He described many in-market products as being in their early stages, leading some plan sponsors to wait to see what the refined, or version 2.0, product looks like.

Mr. Fox attributed plan sponsors not adopting retirement income solutions to five main reasons: fiduciary concerns, administrative complexity, costs, limited adoption by participants, and the complexity and variation in available solutions.

He described fiduciary concerns as the main barrier. He noted that fiduciaries have concerns regarding litigation risk (particularly that being an early adopter of a retirement income solution will make the fiduciary a litigation target) and expanded oversight responsibilities that come with adding retirement income solutions. He noted further that the permanence of the annuity selection decision is "one of the main reasons that there is a fiduciary concern about selecting lifetime income providers."[36]

[36] Council Hearing of July 9, 2024, Transcript of Testimony of Gregory Fox, Aon Investments USA, Inc., at 132.

With respect to the other barriers, he noted that administrative complexity includes the need to build out the technology and infrastructure to handle retirement income solutions. Concerns regarding cost include both the cost of selecting, implementing, and monitoring retirement income solutions and product fee levels, which may not be transparent (e.g., spread-based fee structures) and therefore may be difficult to assess for reasonableness. The concern regarding limited adoption is based on the observation that not many participants in plans that have implemented retirement income options have chosen to use them so far. Additionally, the complexity of offerings, the number of retirement income products available, and how different they are in nuanced ways make it difficult to determine which product is right for a plan.

Mr. Prashar suggested some sponsors have a fear of the unknown, i.e., a fear that they do not yet know everything that could go wrong, leading them to wait several years or longer to see how products perform for others. He also noted sponsor concerns about both portability and whether participants will use these solutions, especially annuities. With respect to portability, plan sponsors do not want to be locked into using a certain recordkeeper.

Mr. Prashar and Mr. Fox both recommended in general terms that Department act to encourage and facilitate the adoption of retirement income solutions as opposed to doing nothing at this time. Specific recommendations included the following:

- Mr. Fox suggested that the Department provide guidance on the selection and monitoring process fiduciaries should use with respect to annuity providers. He described the SECURE Act Sec. 204 fiduciary safe harbor as being “a pretty low bar” that “to many employers, doesn’t feel like…an adequate process to avoid some of the legal risks that they’re worried about.” He elaborated, “The attestation and the things that are required as part of the attestation just doesn’t [sic] feel like a robust sort of protection against some of those threats.”[37]
  - Mr. Fox recommended finding more creative ways to get the kinds of information required in the SECURE Act Sec. 203 disclosures in front of participants given that many do not read those disclosures.

[37] Id. at 97.

- Mr. Prashar recommended more broadly that the Department promote participant education on retirement income issues, such as by issuing an information letter or retirement income tips for participants.
- Mr. Prashar recommended that the Department issue fiduciary tips for selecting TDFs with decumulation features, similar to its February 2013 "Target Date Retirement Funds - Tips for ERISA Plan Fiduciaries" guidance.
- Mr. Fox and Mr. Prashar both endorsed a Council member's suggestion that the Department explore safe harbor guidance for automatic payout funds.

Michael Finke

Michael Finke, PhD, CFP® is a professor of wealth management and the Frank M. Engle Distinguished Chair in Economic Security at The American College of Financial Services.

Mr. Finke testified that retirees holding a portion of their defined contribution plan balance in annuities makes sense for the following reasons:

- First, retirees have a better understanding of what their retirement lifestyle will look like with annuities, because the retiree knows how much they can safely spend.
- Second, participants with annuities spend more in retirement than those without annuities.
- Third, participants with annuities have a less volatile spending path than those without who generally follow the highly volatile spending path of withdrawing according to required minimum distribution rules.
- Finally, annuities provide a form of "dementia-insurance" in that turning savings into lifetime income in old age ensures lifestyle preservation protected from financial mistakes and abuse.

Mr. Finke went on to say that annuities are well-suited for default investments because the mortality pool of defaulted participants is more favorable than the pool of retail annuity buyers, so both men and women would receive an income boost with in-plan annuities as compared to retail annuities. The cost of distribution is also likely lower for annuities in default investments than among retail annuities.

Mr. Finke's research indicates that compared to withdrawing income from a stock and bond portfolio, a risk averse woman who annuitizes 25% of her $500,000 of retirement savings would experience a welfare improvement of 19% and if she were to annuitizes 50% her savings the welfare improvement increases to 35%.

Mr. Finke then addressed the three main barriers to adoption of annuities in DC plans: Insolvency risk of insurance companies, product design, and liquidity and elaborated on each.

- Insolvency risk of insurance companies: Mr. Finke explained that if we put annuities in QDIAs, then a lot more people are going to have annuities, which could potentially stress state guarantee association programs. Also, from his perspective, once an annuity is purchased by an individual there is a general loss of control in how the assets are invested or whether the annuity block is sold to another insurance company. One solution would be to require that annuity holders be notified and allowed to trade their annuity for a comparable fair market value of their lump sum payment (commutation) before their insurance liability is transferred to another insurance company or should their insurer be downgraded. Mr. Finke explained that tontines could provide a stable income stream as an alternative to insurance contracts but that the legality of the structure in the US is unclear and needs further guidance.
- Product design: Numerous flexible annuity designs exist today in the retail market, but few exist within DC plans outside of the CREF annuity offered by TIAA. Mr. Finke suggested a product design that would provide much of the welfare benefit of a traditional annuity with greater expense, transparency, and reduced insolvency risk. Such a design may invest a portion in a traditional ladder of bonds whose maturity matches income payments from retirement through a specified age, for example, age 80. Income after age 80 would be derived from either a longevity annuity or some other pooled asset design, such as a closed end fund, that can transfer longevity risk to the group of retirees.
- Liquidity: A common retail annuity product design that provides longevity, risk protection, and access to liquidity is a fixed or variable annuity with a guaranteed lifetime withdrawal benefit,. A guaranteed lifetime withdrawal benefit offers numerous advantages over an irrevocable annuity in that the value of investments within the annuity can be accessed and, unlike participating annuities or tontines, the guaranteed lifetime withdrawal benefit provides a guaranteed stable lifetime income. A guaranteed lifetime withdrawal benefit can also be blended more easily with an investment portfolio than full annuitization.

Mr. Finke noted that annuity products designed for a defined contribution plan will look different than products offered in the retail market. Retail products are tailored to solve specific individual financial planning needs and appeal to different segments of consumers. By contrast, an in-plan annuity is selected by ERISA fiduciaries to meet the income needs of an average participant and are most likely to be adopted in the defaults.

Mr. Finke concluded his remarks by providing the Council with two considerations to facilitate greater annuity adoption in DC plans:

- Clarity is desperately needed around the legality of tontine-like pooled investment structures that offer longevity risk protection in to facilitate product innovation.
- Creation of a "PBGC-like entity" to manage insurers – like the PBGC for defined benefit pension plans – to provide oversight to ensure that the insurance market functions well.

C. Recordkeepers and Asset Managers

Jessica Sclafani

Ms. Sclafani is a Chartered Alternative Investment Analyst, and Global Retirement Strategist for T. Rowe Price.

Ms. Sclafani testified that in response to a survey of plan sponsors conducted by T. Rowe Price, a majority of respondents (71%) agreed with the statement that plan participants are older today compared to a decade ago.[38] A decade ago, it was far more common for plan sponsors to prefer (and nudge or encourage) all terminated vested and retired participants to leave the plan. Today, while smaller plans have not changed their preference, an increasing number of plan sponsors of large and jumbo plans now encourage asset retention. She stated that a majority of respondents (69%) want participants to remain in the plan after retirement.[39]

Ms. Sclafani stated that one rationale for the shift is the potential impact on active employee participants. Plan sponsor survey respondents confirm that potentially 20% of plan assets could leave the plan due to recent and pending retirements, negatively impacting economies of scale that benefit

[38] Council Hearing of September 11, 2024, Transcript of Testimony of Jessica Sclafani, T. Rowe Price, at 162.
[39] Id.

all participants.[40]

Ms. Sclafani testified that most plan sponsors are considering or deploying decumulation solutions without any guaranteed income component.

Ms. Sclafani explained that T. Rowe Price approached the decumulation challenge by reviewing the existing universe of retirement income solutions and analyzing the trade-offs in each product design. She stated that T. Rowe Price developed a process for evaluation of decumulation solutions, using a Five-Dimensional Framework ("5DF") consisting of:

- Longevity risk hedge – The portfolio duration or planning horizon, confirming how many years will retirement savings last with this solution.
- Level of payments – The income, confirming the amount of annual income with this solution.
- Volatility of payments – Will income vary from year to year, and if so, how much?
- Liquidity – Should circumstances change and a need arises, how much of my savins can I access, and at what cost.
- Depletion – Asset preservation, confirming the level of risk that my assets will be exhausted before planned horizon.

Ms. Sclafani stated that the 5DF process clearly illustrates and articulates the tradeoffs when evaluating any specific product. They assert that the 5DF evaluation process helps to demonstrate procedural due diligence for investment fiduciaries.

Ms. Sclafani recommended that any proposed changes to QDIAs not inhibit innovation – citing as examples two T. Rowe Price products among the emerging/developing marketplace:

- Adjustments to the terminal vintage of their target date solution, to offer income equal to 5% of the year-end balance, paid monthly, with smoothing based on the trailing 5-year Net Asset Value of the fund, and
- A "managed lifetime income" 15-year payout period at 7.5% of the year-end balance, plus a Qualified Longevity Annuity Contract (QLAC) commencing at the end of the 15 year payout period.

[40] Id. at 181.

D. Middleware Technology Providers

Elizabeth Heffernan and Jacqueline Rynn

Elizabeth Heffernan is the head of partnerships and consulting strategy at Micruity. She is part of Micruity's leadership team and a driver of the business strategy around retirement income solutions. Prior to her current role at Micruity, Ms. Heffernan spent 24 years at Fidelity Investments, working in a variety of roles, including marketing, sales, and product, most recently working in investment strategies. Jacqueline Rynn is head of Product Development: Rollover, Retirement Income & Intelligence Solutions at SS&C Technologies. She has held executive positions with industry leading organizations, including wealth management systems, Cigna, and Fidelity Investments.

The testimony of Ms. Heffernan and Ms. Rynn addressed financial technology that focuses on retirement income. The organizations they represent are leading providers of the technology solution sometimes referred to as middleware, which makes it easier for recordkeepers to connect participants with lifetime income solutions. Middleware's primary objective is to do the work that recordkeepers are not able to facilitate with target date funds or other solutions with income features.

Ms. Heffernan began by noting that a target date fund is comprised of a series of underlying investments that make up a glide path. All of that necessary trading happens outside the recordkeeping platform, and it is very efficient. There is equality, and it does not matter if someone is 58 or 48; they own the same share class and there is no difference.

Ms. Heffernan next noted that, as you begin looking at products that are focused on decumulation, or even accumulating guarantees on behalf of a participant, there is a need to have more unique information to determine those values. As a middleware provider, Micruity connects with the recordkeeper on behalf of the asset managers that have these methodologies and gathers data about the participant who wants an income stream. Data will include current investments, current balances, and perhaps date of birth. Micruity takes that information and uses it to apply desired methodologies, and it then manages the methodology and connections to various different asset managers. Once the methodology is applied, results are sent back to the recordkeeper to act upon along with transactions for them to operate.

With the above approach, target date fund managers can start delivering income, which is typically left up to the participant to determine. Ms. Heffernan stated that QDIA target date funds have been doing a spectacular job in helping people accumulate assets, but so far have been inconsistent in how they decumulate assets. Micruity's middleware provides participants with average size balances the opportunity to leave their investments in the plan while creating a paycheck from their savings.

Ms. Rynn next discussed how middleware works for recordkeepers that are looking to introduce lower cost retirement income products with better growth potential for participants, that also helps participants secure principal and investment earnings relative to market downturns. Recordkeepers know how to allow a participant to invest in a target date fund. But, when a particular product has a corresponding market value in a specific security (such as a stock, bond, and other financial instrument), and also has an insurance wrapper or guarantee from an insurance provider, recordkeepers struggle to present that income benefit base to participants, which is key in servicing and offering retirement income products within a plan. A middleware platform can help recordkeepers streamline services, reduce their administrative burden, and enable them to bring these products to market.

Middleware is helping to address four main concerns from a recordkeeper perspective:

- It is cost prohibitive for recordkeepers to integrate with product providers on an individual basis because it is administratively burdensome and highly inefficient. Middleware platforms allow recordkeepers to plug in once and then exchange data with the middleware platform in order to distribute multiple retirement products to participants. Most of the larger recordkeepers are looking to do this because participants have different needs, and no single retirement income product will fit the needs of all. A middleware platform creates efficiencies with the recordkeeper as they can connect with the middleware platform and can then offer multiple different products across their participant constituency.
- Middleware platforms can present a holistic experience for the participant since the platform sits between the recordkeeper and the insurance providers that are part of a product offering. Middleware platforms are able to inform participants not just about their market value in a

particular security (such as a stock, bond, and other financial instrument), but the corresponding income benefit they are building in the long run.

- Middleware platforms can provide software that allows financial institutions to communicate with third-party services, so that when participants are making investment decisions within the plan, they understand the impact of choices on the guaranteed benefit, if they are invested in a retirement income product.
- Middleware platforms provide program oversight and management by sitting between recordkeepers and product providers and insurers, and ensuring the exchange of information runs smoothly.

These are the key services that most recordkeepers are looking for middleware providers to deliver.

Ms. Rynn then provided details on how the process works:

- A recordkeeper will add a retirement income product and the underlying fund option to their fund universe, just as they would with a mutual fund or index fund. The retirement income product is made available to participants at the plan level.
- The participants are educated about the product offering, including how the income benefit basis and future guarantees will work.
- Participants elect to invest in a particular product offering.
- The participants make contributions and potentially withdrawals on an ongoing basis, as they would with any other fund. The middleware provider may apply particular rules for some of the products, mapping participants to an age-appropriate target date fund that might be within a collective investment trust.
- Participants are given a composite view of their market value, their income benefit base, and their projected benefits when they attain retirement.

Ms. Rynn noted that middleware platforms can also help participants understand when they are eligible to make an income benefit election, provide notifications, and help participants manage installments of payout elections.

Ms. Rynn concluded her testimony by explaining how middleware can address the significant concern of portability. First, it helps when there is a change in recordkeeper. If a plan is on recordkeeper A and they are offering a particular retirement income product with a guarantee, and the plan moves to recordkeeper B, the plan can continue to support the same retirement income product. Middleware providers can also support participant transfers to a plan with a new employer if the old and new plan both offer the same retirement income product, by mapping and preserving the participant's income benefit base. Finally, when participants initiate rollover transactions to a companion IRA, middleware providers have the ability to map and preserve that participant's income benefit base in the IRA.

E. Associations

Lew Minsky

Lew Minsky is the President and Chief Executive Officer of the Defined Contribution Institutional Investment Association (“DCIIA”), a non-profit organization dedicated to enhancing retirement security of America's workers.

DCIIA’s goal is to bring retirement benefit providers, investment managers, consultants, advisors, law firms, recordkeepers, insurance companies and plan sponsors all together to develop thought leadership that supports the defined contribution market and solutions. They have formed a research team that is focused on key defined contribution topics, QDIA and retirement income being two of those topics.

Mr. Minsky testified that DCIIA has created a robust body of thought leadership to support plan sponsors:

- 2024 released study of 18 recordkeepers and their approaches to retirement income
- 2023 published a piece on choice and elective defaults, kit for plan sponsors
- 2022 conducted and issued the results of a custom target date fund survey (published every 2 years)
- 2021 published a series of papers on the steps for adding a retirement tier to a defined contribution plan
- 2019 a published article on managed accounts

Mr. Minsky stated that the 2024 Retirement Income Solutions: Recordkeeper Study included 18 recordkeepers and their approaches to retirement income. The providers ranged in size and capabilities. Mr. Minsky summarized the survey results:

- Lack of plan sponsor demand is the primary driver of adoption.
- Technology integration is critical to enable new solutions.
- Participant experience plays a big role in willingness to prioritize building out solutions

Mr. Minsky highlighted how the survey focused on non-guaranteed solutions and considerations, such as managed payout solutions and Social Security bridging solutions. He noted that our ability to lean in as an industry to facilitate withdrawals in a non-guaranteed solutions has the greatest ability to move forward.

Mr. Minsky described the various options available in the QDIA universe. There are dynamic QDIAs (or hybrid QDIAs) supported by recordkeepers, personalized QDIAs or managed accounts, recordkeepers that offer proprietary solutions and target date funds with guaranteed income built in. Mr. Minsky described a hybrid QDIA as when participants below a certain age go into a target date fund initially, then upon reaching a certain age, when the need for personalization is greater, they move into a managed account solution.

Mr. Minsky was asked if there was an option to create a low-cost managed account solution (single digit fee) with the plans DIAs, where it would become more of an active choice, causing participants leaving the target date fund to go into the managed account, if he believed that "active choice" supported the increased fee that would most likely come with that customized solution. Mr. Minsky felt that the sponsor may struggle with the additional cost and the challenges of where the fiduciary role begins and ends in making those decisions and also what are considered reasonable fees.

Mr. Minsky stated that it is a challenging business model for the recordkeepers; plan sponsors are looking to them to develop new solutions, developments and services. The incentive to build proprietary solutions is strong because recordkeepers need to price them in to recapture their investment or to generate additional revenue/fees for those services.

When asked if there is anything in the current QDIA legislation is an obstacle to implementing lifetime income either in a guaranteed or non-guaranteed form, Mr. Minsky responded that he believes there is an opportunity to implement more guidance to help "good actors" implement the right things (less so to block bad actor activity). However, hard guidance with a framework can stifle innovation by limiting or trapping sponsors into a safe harbor box, and then anything outside the guidance is considered "unsafe." Mr. Minsky suggested that instead of putting the onus on plan sponsors, recordkeepers should develop a reasonable framework and universally make it available to clients.

Mr. Minsky characterized the current landscape as a "Tale of Two Markets," where the plan sponsors in the large plan market are interested in retaining assets in the plan after separation, wanting to offer a suite of services, while making themselves a small target for litigation. By contrast, in the small plan market, plans sponsors are less interested in keeping participants in the plan as it could have a negative impact on recordkeeping fees.

Mr. Minsky was asked if the DCIIA Study on Retirement Income saw different perspectives for small plan market as compared to the large plan market. He responded that the survey did not focus on segmentation but rather on how the recordkeepers have different business models or partnerships with the advisors that they work with. Typically, large plan sponsors are more likely to innovate as they have resources and bandwidth to support new solutions. However, the small plan market seems to be leading with retirement income innovation, not because they can support it, but because the advisors that they work with are assisting them with the decisions to implement retirement solutions. He thinks that the pooled solutions (PEPs or OCIOs) will begin to take on responsibilities for launching lifetime income solutions and that may also drive market adoption. Mr. Minsky believes that the pooled arrangements will become more focused on financial wellbeing and as a result will incorporate lifetime income into their solutions.

David Certner

David Certner is legislative council and director of legislative policy for government affairs at AARP, a member of the American College of Employee Benefits Council, and a former chair of the ERISA Advisory Council.

Mr. Certner testified that while retirees generally living longer, longevity is uneven across demographics. Retirees face challenges paying for the rising cost of healthcare and long-term care, costs which are two great unknowns in retirement. With the shift from defined benefit to defined contribution plans, workers and retirees are left with hard decisions about how to invest their money and how to develop a spend-down plan. Roughly half of workers are fortunate enough to even have a plan. For the approximately 55 million workers without a plan, they are truly on their own. Mr. Certner then noted that there are great disparities in financial literacy; average scores are quite low.

Mr. Certner stated AARP agrees with the need for better lifetime income options in DC plans to help address the fear of running out of money in retirement. The traditional defined benefit provided an annuitized benefit for the lifetime of the participant and spouse, while the DC model is based on a lump sum. Some studies have found that almost one third of DC participants are likely to spend the entire lump sum within five years of receiving it, leaving them decades without a steady source of income aside from Social Security. It is important to point out the role that Social Security plays. Social Security is not only the largest source of income for most Americans, but also generally the only guaranteed lifetime income source for most Americans.

Mr. Certner added that the combination of Social Security and pensions as income sources must be considered when determining income needs and distribution options in retirement. He recommended both improving coverage as well as ensuring workers have access to prudent lifetime income options in their DC plans upon retirement. He confirmed that any lifetime income option should be offered with appropriate guard rails, including strong fiduciary protections, cost effectiveness, and understandability, as well as meeting basic standards for liquidity and needs of all plan participants.

Mr. Certner then addressed whether it is prudent for retirement plan participants to be defaulted into investment products that include insurance products like annuities. He stated that, while AARP believes that annuity products can and should be options available to participants, particularly upon separation of service at retirement, having automatic enrollment or a default into an insurance product faces a high bar.

There are many reasons for this, including what he called the three C's: cost, commissions, and complexity. Annuities can be expensive. There are a variety of fees that can be imposed on an annuity from administrative fees to underwriting fees to surrender fees. There are fees for additional provisions like inflation protection or survivor benefits. Some fixed annuities have been marketed as charging no fees, but the “fee” is a reduction in the returns. Mere disclosure alone will not result in sufficient understanding of the fees, costs, risks, and benefits associated with annuities.

Mr. Certner went on to explain that, in relation to costs, there are also commissions associated with insurance products which can be quite high, sometimes ranging from 1% to 8%, depending on the type and complexity of the annuity. Conflicted advice often drives many annuity purchase decisions. Consumers focused on longevity risk may be unaware of potential investment risk. Insurance products can be complicated, glossed over in marketing as a guaranteed income solution. There is often a lack of transparency. Ideally, consumers would receive a comprehensive breakdown of fees, expenses, commissions, and other cost related provisions in the annuity contract. In practice, these products are opaque, and fees are hidden. Disclosure alone of fees does not always mean the consumer fully comprehends the fees and true costs being paid.

Mr. Certner questioned the prudence of defaulting participants into or even offering employees a long-term annuity vehicle when most employees will not be employed long term. Consideration should be given to the penalties or costs to disentangle from an annuity product. While these products may be appropriate for certain individuals, more liquidity may be far preferable for some, if not most. Others may need greater access to their assets in retirement for unexpected emergencies or health situations. It is difficult today to see under what circumstances it would be prudent to default or automatically enroll participants in a product that is costly, complex, and illiquid. Fixed annuities make more sense as an option upon separation from service, either for all or part of one's asset balance. Mr. Certner stressed that AARP urges, similar to defined benefit pension plans, that all DC plans have a group annuity option (including a spousal option) as part of distribution options at retirement.

Mr. Certner next noted that other retirement income options might attempt to provide a lifetime income stream, a post-retirement target date-type fund. Such a fund would be managed more conservatively but would look similar to a target date fund pre-retirement. This fund could have a monthly pay-out stream based on a percentage (e.g., 4% of the account balance) determined on the first day of the year (with potentially the ability to access additional amounts as needed). The monthly payout would change annually, based on plan returns and plan balance amounts on the first day of each year. Thus, payment streams would not be steady or guaranteed from year to year but may fluctuate with market returns. However, plan assets would be liquid, and fees could be lower. Mr. Certner stated that the AARP urges members of the Council to consider emphasizing the necessary fiduciary guardrails for any of the potential options.

Mr. Certner concluded his testimony by stating that the AARP strongly urges that guidance with respect to lifetime income products should not be based on age. The quality of a lifetime income product should be determined wholly on its own merits.

F. Target Date Fund Benchmark Provider

Lucian Marinescu and Sara Pollock

Mr. Lucian Marinescu is a senior portfolio manager and head of investments for the Morningstar Group. Ms. Sara Pollock is a Director of Multi-asset Indices at S&P.

Mr. Marinescu testimony focused on how Morningstar approaches benchmarking, evaluating, and analyzing target date funds. Mr. Marinescu testified that the target date fund market has assets exceeding $3.5 trillion as of the end of 2023, new funds are coming to market, and there has been tremendous growth in new collective investment trust target date funds representing 49% of market share versus mutual funds.

Mr. Marinescu then described the proprietary allocation indices that Morningstar created to help plan sponsors benchmark their target date funds and determine appropriate glidepaths. Morningstar evaluates and places target date funds into categories that are designed to group similar types of target date funds based on investment objectives and expected retirement year. This allows Morningstar to compare funds with similar goals and asset allocation approaches. However, he noted that there continues to be wide dispersion of returns within the same category.

Mr. Marinescu stated that the largest target date funds were launched before uniform benchmarks were being offered resulting in each investment manager developing their own methodology to set benchmarks. Currently, there is no uniform industry wide approach for setting benchmarks for target date funds. Mr. Marinescu did note, however, that the S&P Target Date Indices are the most popular - 51% all mutual funds and collective investment trusts in their database use the S&P indices and that the other 49% of funds use a very wide mix of indices.

He testified that Morningstar has published a white paper “Selecting a Target-Date Benchmark” in which it proposes key qualitative and quantitative to consider when selecting a target date fund benchmark. Mr. Marinescu described the qualitative aspects as: the benchmark should align glide path philosophy with asset allocation, provide a robust opportunity set in individual asset classes, and specific equity and fixed income allocations that make the composition of the benchmarks. He described the quantitative measures as: calculating the average absolute glide path equity differential, average annual tracking error and looking at the forward-looking estimate of the tracking error.

Mr. Marinescu stated that Morningstar’s approach for building a target date index solution begins with a participant in mind, starting with an in-depth analysis of United States participant base using the Morningstar Managed Account database with greater than 2 million participants as a basis to study participant characteristics. Morningstar also uses this data to determine a plan’s optimal equity glide path.

Mr. Marinescu described how Morningstar analyze performance from multiple perspectives such as performance attribution, peer comparisons, risk-adjusted results for example. He noted that peer comparisons may not provide much insight into the underlying manager’s results if the asset allocation differs significantly from peers.

Mr. Marinescu further described some tools that Morningstar has developed to help participants decide how much to save and how to spend their savings. These tools measure outcomes using standard assumptions around retirement and can run simulations to measure success on an after-fee basis, estimate probability of success at various ages, defined as a positive remaining balance at the respective age.

Ms. Pollock introduced two benchmarking methodologies that her firm uses to build target date fund benchmarks. The S&P asset allocation methodology is based on weighting to sub-indices across different asset classes and sub asset classes. The Dow Jones risk sensitive market benchmarking benchmarks the performance of sub-indices of stocks, bonds, and cash on a glidepath. Ms. Pollock explained that the main difference between the two methodologies is that the S&P

version is a market consensus benchmark and is heavily utilized in the industry. The Dow Jones methodology has a mathematical index that derisks over time based on the market risk of each asset class.

Ms. Pollock further explained that the S&P index is constructed using fund sponsor data for plans with greater than $100 million in assets, aggregating the data by fund and security level and then mapping it to an asset class. To include an asset class, at least 25% of fund sponsors need to include it in at least one vintage and to introduce a new asset class, at least 30% of fund sponsors must include it in one or more of their respective funds in order to be considered for inclusion. From there S&P normalizes the data to exclude outliers to avoid skewing the data. They will launch the new far-dated vintages when at least 30% of fund sponsors offer them and will retire the near-dated vintages when less than 20% of fund sponsors are offering them. S&P conducts an annual reconstitution on the last trading day in May and rebalancing back to annual reconstitution weights occur after close of business on the last trading day of each month.

Ms. Pollock also discussed the two types of glidepath approaches – "to" index manages the asset allocation up to the date of retirement and the "through" index manages to asset allocation through retirement resulting in a higher equity exposure.

Ms. Pollock described the Dow Jones methodology as a "risk sensitive market benchmark" based on a mathematical glide path that is rebalanced monthly. The benchmark is broken into three composite major asset classes – stock, bonds, and cash – and does not include real assets. The first index is launched 35 years before retirement with a 90% allocation to stock. Then, on a monthly basis, that allocation will gradually de-risk until it gets to 20% stock ten years past retirement. The indices are rebalanced each month and will always have exposure to all three of the major asset classes. The is a tolerance band around equity, if it is within 25% – 35% it will not be rebalanced, to reduce turnover. Additionally, there is a cap on the amount of combined equity and bond reallocation that can be done in any month.

Ms. Pollock stated that the expected returns for each asset class are six percent for stocks, three percent for bonds and one percent for cash. New vintages are launched every five years.

A council member asked Ms. Pollock which method she thought was more appropriate for smaller, less sophisticated plan sponsors. Ms. Pollock responded that, in her personal view, the Dow Jones version is easier to understand as it provides a straight mathematical calculation.

Mr. Marinescu was asked if the Morningstar data was compiled by individuals who had engaged Morningstar apart from their plan and if they might be slightly more sophisticated or have higher incomes. He responded that the data used in their database is gathered from plans that offer managed account solutions – so it is individual investment information that is gathered from a plan level download of data. Mr. Marinescu described the database as a diverse group of participants and did not think it skewed to more highly compensated individuals.

A council member asked how the witnesses would guide a plan sponsor on the appropriate index to use if they were to allocate a portion of the TDF to an annuity solution. Mr. Marinescu suggested that Morningstar would build a customized benchmark for that solution. For the annuity portion of the solution, they would likely review the characteristics of the annuity, such as how much could be modeled with fixed income backdrop, and incorporate that into the benchmark calculation.

Mr. Marinescu described Morningstar's methodology for how to assist plan sponsors with the selection of an appropriate target date fund suite. He noted that each consultant has their own methodology, some are more qualitative, and Morningstar's is a bit more quantitative, relying on data and risk capacity.

A council member asked if either organization had explored measuring how much income can be generated off a TDF or a QDIA. Ms. Pollock stated that S&P has not as they are an index provider and it is not within their business scope. Mr. Marinescu indicated that they do this analysis on a case-by-case basis where they look at the income that a participant could derive from their retirement account. Their managed account solution could model how a participant could withdraw their assets to create an income stream.

Both witnesses were asked if they created risk-based peer groups to determine which target date funds are the highest risk in their peer group. Mr. Marinescu responded that Morningstar focuses rankings on returns, but groups funds mainly based on their strategy and goals. Ms. Pollock said

SP& addresses that by offering the two styles of benchmarks.

G. Investment Fiduciaries

James Watkins and Chris Tobe

James Watkins is an attorney with Invest Sense LLC. His current practice provides forensic fiduciary audits for plans and other trustees. Chris Tobe is the Chief Investment Officer for the Hackett Robertson Tobe Group. He works as a consultant to retirement plans and serves as a litigation consultant.

Mr. Watkins stated there are three cases that he refers to as the "responsibility trinity," that defines the area of fiduciary responsibility right now:

1. *Tibble v. Edison* – recognized the Restatement of Trusts (Restatement) as a legitimate resource in resolving fiduciary issues and ruled that a plan sponsor has an ongoing fiduciary duty to monitor plan investment options for prudence
2. *Hughes v. Northwestern* – ruled that a plan sponsor has a fiduciary duty to ensure that each investment option within a plan is prudent and to remove any that are not
3. *Brotherston v. Putnam* – ruled that comparable index funds can be used for benchmarking purposes, citing Section 100 b(1) of the Restatement, that index funds are proper comparators

Mr. Watkins stressed that he is a big proponent of cost benefit analysis and believes the math is not that hard to do, especially as it is being used to determine whether an investment is in the best interest of a participant. Mr. Watkins stated that the industry does not support his focus on cost benefit analysis given studies that show the majority of actively managed funds are not cost efficient.

Regarding annuities within a QDIA, Mr. Watkins noted that he most often is asked by the plan sponsor considering an in-plan annuity solution whether a participant can get out of it, and if so, how. Mr. Watkins's understanding is the only way a participant can get out of an annuity without harsh tax penalties is to do a 1035 exchange (a tax-free exchange of an existing annuity contract, life insurance policy, or endowment for another of like kind).

Mr. Watkins stated that he is aware of a lot of annuity providers trying to embed annuities into target date funds within qualified plans. He suggested that this raises the question about the feasibility of a 1035 exchange in a qualified plan, and whether it is the only way you can make this move or can a participant make an exchange from a like product to another like product.

Mr. Watkins thinks that enhanced disclosures should be provided to participants with the appropriate information to ensure that they understand the annuity product, which should include the conditions for them to "break even" and how that would work if they were to surrender the annuity contract. Mr. Watkins stated that, if annuities are embedded in QDIAs, there needs to be much more meaningful, clear, and simple disclosures provided to enable the participant to make an informed decision and comply with IRC section 404(c).

Mr. Watkins concluded by stating he does not believe annuities should be offered in a plan nor specifically in a QDIA. If ERISA does not require that a plan offer guaranteed income products or annuities, he does not see a reason to do so. His biggest concern is that once a participant is in an annuity, they lose control and are locked in.

Mr. Watkins was asked if he has seen any ERISA 3(38) fiduciaries (those who have the authority to buy and sell assets, make strategic decisions, and otherwise handle all aspects of account investing) implementing annuity solutions in collective investment trusts or in unregistered products. He indicated that many plan sponsors are encountering products embedded in collective investment trusts and a lot of proprietary products. He believes that collective investment trusts are not transparent enough and participants do not understand or have access to information, as they would in a mutual fund that posts information in a newspaper or Morningstar. He stated that collective investment trusts typically do not publicly publish their performance results or their fees.

Mr. Tobe began his testimony by stating that target date funds hold 50% of all 401(k) assets and thinks they deserve more fiduciary oversight by regulatory agencies. Historically, TDFs have been primarily offered in mutual funds registered with the Securities and Exchange Commission ("SEC"), but the trend is that more target date assets are flowing into weakly regulated state collective investment trusts. The SEC does not allow investments in annuities, crypto currency, and private equity, for example, in mutual funds. By contrast, state-governed collective investment trusts do permit these types of investments, and do not offer the same level of disclosures and transparency as mutual funds. They also have lower capital requirements as well.

Mr. Tobe suggested the Council should examine federally-regulated investment vehicles being used as they are more transparent. He believes that collective investment trusts should become federally-regulated rather than being regulated at a state level. He noted that there are some collective investment trusts that are superior to mutual funds because they are "clones of a mutual fund" but have lower fees.

In his opinion, the collective investment trusts being offered by insurance companies are deploying illiquid investments (annuities, private equity). He stated that this is just a way to get high-priced annuities into the mainstream target date fund solutions. He raised concerns that there are no requirements for the insurance companies to disclose interest spreads, and that there is no transparency into the revenue that the insurance companies are earning.

Mr. Tobe believes that QDIAs should be held to the highest standard, that all investments should be held to the highest federal standards, such as compliance with Global Investment Performance Standards, and that the Department should be pushing for more transparency for collective investment trusts.

Mr. Tobe testified that he would not recommend annuities, private equity or crypto currency in any DC plan or embedded in a QDIA as those investments are too expensive and risky right now. When asked how participants should protect themselves from market volatility, Mr. Tobe suggested that a participant should move into the lowest risk target date fund; annuities bear embedded risks that are not readily transparent to the holder. He believes that annuities could be downgraded and that insurance companies have high default risk that translates to high risk for that component of a participants' investment. He stated that the risks for partial annuitization are the same until there is more transparency and information on annuities.

Mr. Watkins stated that a lot of the concerns could be addressed if the insurance companies could guarantee that annuities could provide a commensurate return, but historically that has been very expensive.

Some Council members noted this was inconsistent with their professional experience and suggested it should be researched further. Members of Council also questioned the witnesses' opinions regarding the insurance companies default risks, noting that historical failure of insurance companies has been very low and less than 0.03%.

When asked where they would want to see changes that would provide them with comfort with the annuity products, Mr. Tobe suggested federal regulations that oversee the insurance agencies, coordinated in partnership with the Department for ERISA-based assets.

When asked what level of fees and risk would satisfy the witnesses that a product is worthwhile, Mr. Watkins responded that the issuer would need to provide a cost benefit analysis that shows the return and guarantee. Mr. Tobe also offered a detailed example of how to diversify over 4 to 5 insurance companies to minimize the default risk and use synthetic stable value-like solutions for annuities to keep the fees low.

When asked if defined contribution plans should only use mutual funds due to their greater transparency, Mr. Tobe replied no and that he would rather see greater transparency requirements for collective investment trusts.

G. Attorneys

Brad Campbell

Brad Campbell is the former Assistant Secretary of Labor for Employee Benefits and head of the Employee Benefits Security Administration. Mr. Campbell led EBSA when the Pension Protection Act ("PPA") was negotiated, and the Department of Labor issued the QDIA regulations. Currently, he is a partner at the law firm of Faegre Drinker Biddle & Reath LLP, where he advises financial service providers and plan sponsors on ERISA Title I issues. Also, as a nationally recognized ERISA expert on issues relating to employer sponsored retirement plans, he regularly serves as an expert witness in cases involving ERISA litigation.

Mr. Campbell began his testimony by commending the Council for selecting the topic of QDIAs. He explained that this topic was both timely and appropriate because the QDIA regulations have been in effect long enough to both evaluate them and identify ways of improving them. Also, he stated that because Congress effectively codified the use of QDIAs in SECURE 2.0, he believes that this topic is a very important one for the Council to consider.

Mr. Campbell noted that the QDIA regulations were controversial when they were promulgated. However, he believes that there now is general agreement that the QDIA regulations have been successful as a matter of public policy. He attributed this shift in perception to there being a deliberate and open process in crafting the QDIA rule. This process engaged the entire community, and it also had the goal of developing a rule that would achieve the objectives of the statute and stand the test of time. In other words, he explained, the rule was designed to not only increase current retirement savings in the existing landscape but also to be flexible enough to accommodate greater utilization and greater innovation in the future. He stated that he believes for the most part this goal was achieved, with data, from adoption of automatic enrollment in general and QDIAs in particular, that shows millions of workers are now saving for retirement who otherwise would not have done so. Notwithstanding this success, however, Mr. Campbell noted that the rules could be improved in several respects.

For example, Mr. Campbell believes it necessary to mandate automatic enrollment and escalation features in new 401(k) plans because allowing employers to offer such features on a voluntary basis has not been successful in small plans. In taking this position, he stated that he recognizes it places renewed pressure on policymakers to study whether the QDIA rules are working as intended and to determine if there are areas that need to be changed.

Also, Mr. Campbell believes that in view of the new and more sophisticated products and strategies that can be employed by professional asset managers, there is a need for clarification regarding the fiduciary responsibility of individualized assets allocation services.

In his closing remarks, Mr. Campbell noted the tension between providing greater protection to plan participants and facilitating the adoption of voluntary retirement savings plans. As a result, he explained, the Department always has had to balance how it approaches its regulations. Thus, in keeping with this concern, he urged the Council not to recommend regulatory solutions that reduce or diminish the fiduciary safe harbor rules. He feared that this would discourage employers with existing plans, which are grandfathered regarding the SECURE 2.0 Act requirements, from adopting automatic enrollment features, thereby potentially impacting QDIA efforts.

Marla Kreindler and Michael Kreps

Marla Kreindler is a partner at Morgan Lewis, and Michael Kreps is the Chair of the Retirement Services Group at the Groom Law Group.

Ms. Kreindler's testimony focused on the current regulatory guidance that supports QDIAs and lifetime income structures, and how it could be improved. She confirmed that the 2007 QDIA regulations make little reference to how QDIAs might someday be designed to offer lifetime income and/or guaranteed income. She believes that the Department should work with key stakeholders to continue to issue regulatory or sub-regulatory guidance to support creation of new and innovative investments with a goal of providing better retirement outcomes and financial wellness, including supporting plan fiduciaries when adopting QDIAs to address retirement income and decumulation strategies and other new innovations and developments.

Ms. Kreindler provided two specific examples of how Department guidance was done effectively to create policy and support innovation for plan fiduciaries: custom target date funds and the annuity safe harbor for the selection of an annuity provider or contract for benefit distributions in a DC/individual account plan.

Ms. Kreindler concluded by suggesting numerous actions the Department could take to support the current annuity safe harbor. These suggestions included the Department issuing sub-regulatory guidance to further support the adoption of annuities to offer lifetime income – for example, "Selection of Annuities: Tips for ERISA Plan Fiduciaries," providing additional sub-regulatory guidance to support the further use of multiple QDIAs and creating Department Investor Bulletins or Tips on Decumulation and Lifetime Income options. Ms. Kreindler stated that she purposely stopped short of recommending changes to the QDIA regulation because she noted that other forms of sub-regulatory guidance could be used more readily to accomplish similar objectives.

Mr. Kreps first noted that a large part of his practice is devoted towards the development of QDIAs and attempts to incorporate lifetime income features, whether guaranteed or not guaranteed, into default investments and other plan investment options. He then discussed how fiduciaries, large and small, have more options to deliver retirement income than ever before, including QDIAs that purchase group annuity contracts and incorporate them into collective investment trusts. He observed that what he is seeing in the marketplace right now is a considerable amount of product development, but slow adoption of lifetime income solutions by plan sponsors. Mr. Kreps testified that the risk of litigation is what is holding plan sponsors back.

Litigation risk creates very significant impediments to innovation because litigation as an asymmetric risk that deters plan sponsors from offering things in DC plans that aren't required. He went on to say that currently lifetime income is a difficult proposition for employers because lawsuits can cost people their jobs and defense costs can be in the millions. In response to a question about why the current annuity safe harbor is not leveraged more by plan fiduciaries, Mr. Kreps responded that it's a narrow safe harbor that addresses selection and evaluation of the insurer, but it doesn't provide a safe harbor for fees, and litigation has primarily been around fees.

Mr. Kreps concluded by agreeing with Ms. Kreindler's testimony that, as a policy matter, if the Department wants to encourage default investments with lifetime income, they need to favor this approach in their guidance to a larger degree than what has been done to date.

Mr. Thomas E. Clark, Jr. JD, LLM

Mr. Thomas E. Clark, Jr., is Chief Operating Officer and partner at Wagner Law Group, specializing in ERISA and employee benefits. His experience as an ERISA attorney includes work for plaintiffs as well as defendants. Mr. Clark is an adjunct professor at the Washington University in St. Louis School of Law and at Boston University School of Law.

Mr. Clark first stated that the QDIA safe harbor appears to be a success. Within the last year, multiple matters have gone through the courts, including prudence claims related to offering target date funds, in which plan fiduciaries ultimately prevailed. The common theme: plan fiduciaries had engaged in a comprehensive and robust procedurally prudent process, and selected substantively prudent investments in the best interests of plan participants. These steps helped support a procedurally prudent process: fiduciaries meet regularly and have special meetings when necessary; quarterly monitoring reports are reviewed examining performance and fees; outside experts such as advisors, investment managers, consultants, and attorneys are retained to support the fiduciaries, and they were not blindly followed; plan fiduciaries independently evaluated investments; an investment policy statement and watch list were used; alternative funds were considered through requests for proposals; participant data, demographics, and preferences were examined; software or tools were used to compare fund performance and fees.

Mr. Clark noted that no court has rejected the Department's 2013 guidance regarding selection of target date funds. He added courts have instead found Department's guidance to be instructive and, in one matter, found specifically that developing a custom TDF that sought to address the unique demographics and needs of the plan's participants appeared to be a fiduciary directive of the Department (and consistent with ERISA's fiduciary duties). Mr. Clark found no reported cases where the annuity safe harbors for defined contribution plans were at issue. He noted that he was surprised he did not find any litigation involving the regulatory safe harbor that Department published first in 2008. Mr. Clark also stated very few plan fiduciaries include annuities in their defined contribution plans.

Mr. Clark had three key points and recommendations for the Council, noting that fear of potential litigation should not negatively affect future regulations or guidance:

- A prudent plan fiduciary, acting in the best interests of the plan participants, will be the key driver of which products and solutions will prevail, and which will not.
- Future regulations or guidance should emphasize robust disclosure to plan participants of the plan fiduciaries' fiduciary process.
- There should be a disclosure regime akin to suggestions from the Supreme Court around circumstantial evidence to prove actual knowledge as noted in *Intel Corp. Inv. Policy Comm. v. Sulyma.*

Mr. Clark summarized additional court cases in his testimony.

Ms. Bonnie Treichel, JD

Bonnie Treichel is the founder and chief solutions officer of Endeavor Retirement, a consulting firm to retirement plan sponsors, advisors, and service providers, and an attorney and partner at Endeavor Law. Ms. Treichel also works with the American Retirement Association as a subject matter expert, and Broadridge's retirement income consortium.

Ms. Treichel questioned who retirement income solutions are really meant for. She stated that, when paired with Social Security, an in-plan retirement income solution for $65,000, can start to make a meaningful impact for an individual retirement saver. She added that these solutions are really intended for the masses of retirement plan savers, not necessarily individuals with large balances.

Ms. Treichel stated that, since about 2018 and the passage of the SECURE Act, 1 in 10 defined contribution plans that offer an in-plan retirement income option have started to make more in-plan retirement income solutions available. Ms. Treichel's specific observations were focused on three types of retirement plan payout solutions: (1) securities-based solutions, managed payout options, (2) insurance-only solutions, and (3) hybrid solutions – a mix of securities-based and insurance-based payouts. There are 25-30 solutions among those three buckets; many have come to market and evolved substantially in the past 5 years. There are also multi-insurance company-based solutions. Portability is a problem at both the participant and plan level. Retirement income solution's integration of middleware helps make portability a reality. It is like the plumbing that connects one recordkeeper to another. Two examples are SS&C and Micruity. Retirement income is becoming part of target date funds and/or is becoming available as the QDIA. For example, Income America's 5ForLife, a Guaranteed Lifetime Withdrawal Benefit option, has two underlying insurers and is available as a QDIA.

Ms. Treichel stated that, to enhance the target date fund experience with a component of income, a target date fund can be added, such as BlackRock's LifePath Paycheck option, to the target date fund already in place. Modern solutions are embracing the current target date fund structure, or the QDIA components. She noted that one complaint about retirement income solutions is that you cannot put insurance or an insurance option into a plan because it is too personal. Technology may be useful there. iJoin uses technology to add personalization. She also noted the concept of partial annuitization, rather than annuitization of the entire retirement account.

She further testified that resources for conducting due diligence are evolving. There are third-party frameworks, such as the Retirement Income Consortium. The American Retirement Association has a training program for advisors. She stated that both of these resources are free. Other resources can help plan fiduciaries prudently select and monitor income solutions, such as a

10-step process for vetting retirement income solutions in-plan. Fee-for-service tools are available through Broadridge, Nestiment, and 401 Annuity Hub.

Ms. Treichel added that the safe harbor from 2019 still does not feel safe enough; the reasonableness of fees component analysis for the safe harbor is where she sees people struggling. Other challenges include implicit versus explicit fees and lack of consistent vocabulary. There is also a lack of adoption – if it is not the QDIA, there is a lack of uptake from participants. The information letter from 2014 and the fear of litigation does not give plan sponsors enough comfort. She stated that there needs to be consistent language and transparency in fees, to inform plan fiduciaries and assist with the prudent selection and monitoring of retirement income solutions.

V. COUNCIL OBSERVATIONS

A. The Evolution of the QDIA Landscape

Background

The QDIA landscape when the PPA was enacted in 2006:

- Vanguard's How America Saves report shows, as of year-end 2007, that 32% of eligible workers were not participating in their employer-sponsored plan. By year-end 2024, as plan sponsors increasingly adopted automatic features and QDIAs, participation has increased to 82% of eligible employees, 94% in plans that deployed automatic features.
- In 2007, studies suggested automatic enrollment plans (where workers "opt-out" of participation rather than "opt-in") could significantly increase participation (to more than 90%) and retirement savings.
- The PPA removed impediments to employers adopting automatic enrollment, including employer fears about legal liability for market fluctuations and the applicability of state wage withholding laws.
- These impediments had prevented many employers from adopting automatic enrollment or had led them to invest workers' contributions in low-risk, low-return "default" investments.
- PPA directed the Department to issue regulations to guide fiduciaries in selecting default investments for those participants who do not direct their own investments.
- The Department issued its proposed regulation on September 27, 2006, and received more than 120 public comments. The regulation was finalized October 24, 2007.

The final regulations were designed to ensure a *single* investment would effectively address the long-term savings needs of workers, included shifting defaults away from a stable value and reducing the use of company stock for both employer and employee contributions. QDIAs now represent a considerable asset accumulation, serving as a singular investment for many individuals and constituting a significant portion of defined contribution plan assets.

QDIA utilization demonstrates the effectiveness of automatic features and allows plan fiduciaries the option to bypass like-to-like mapping processes when changing investments.

A written witness statement[41] confirmed the substantial growth in TDF usage and assets stems primarily from their use in individual account retirement savings plans as QDIAs. As of June 2024, defined contribution retirement plans held 84% of all target date fund assets. Nearly nine in 10 401(k) plans include TDF investments and more than two-thirds of 401(k) plan participants invest in a TDF.

Experience shows that the TDF, as a QDIA, is very "sticky." Overall, 94% of 401(k) TDF investors held one TDF, varying little from 97% among those in their 20s to 93% among those in their 50s and 60s. About 9 in 10 401(k) TDF investors held one TDF – an age-appropriate TDF for a retirement age of 65.

A review of the Vanguard How America Saves series confirms that the 2007 QDIA regulations triggered a dramatic evolution in the use of TDFs. In 2004, no Vanguard-administered plan offered a target date fund and 50% of plans incorporated a target risk fund. By 2008, 68% of Vanguard-administered plans offered target date funds.

As plan sponsors increasingly adopted automatic features, even though most only applied them to new hires, there was a steady increase in TDF use among participants of all ages:

Year-End	Under Age 25	35 - 44	40 – 45	65+
2015	74%	35%	25%	17%
2020	81%	50%	35%	24%
2023	79%	59%	41%	25%

This reflects the maturation process during a less than 20-year period of TDF expansion.

QDIA Utilization

Following the adoption of QDIA regulations, QDIA usage steadily increased. Vanguard's 2024 How America Saves report (year-end 2023 data) confirms improvements in both accumulation and decumulation.[42]

[41] Sara Holden, Shannon Salinas, Jason Seligman, Steven Bass, Investment Company Institute

[42] Vanguard, How America Saves, 2024, Accessed December 24, 2024 at

Statistics to support the success of the accumulation side of the equation[43]:

- 88% of plans designate a QDIA
- 98% of QDIAs are target date funds
- 83% of participants use a target date fund (as noted above)
- 58% use a single target date fund for all their assets
- 41% of plan assets are in target date funds
- 64% of all contributions are allocated to target date funds
- 12.3% is the average savings rate for plans offering auto-enrollment compared to 7.4% for plans offering voluntary enrollment.

Figure 20 of the Vanguard 2024 How America Saves report confirms that the default percentage of pay has steadily increased from 3% of pay in 2014 to 4% of pay in 2023, that the default automatic increase rate of 1% per year has remained unchanged at 67% - 68% of surveyed plans throughout the 10 year period, the cap on default automatic increases has remained mostly unchanged at 10% of pay throughout the 10 year period and that the TDF has been the default fund 95% of the time throughout the 10 year period.[44]

Default fund	Target-date fund	95%	97%	97%	97%	98%	98%	98%	98%	98%	98%
	Other balanced fund	3%	2%	2%	2%	1%	1%	1%	1%	1%	1%
	Subtotal	98%	99%	99%	99%	99%	99%	99%	99%	99%	99%
	Money market or stable value fund	2%	1%	1%	1%	1%	1%	1%	1%	1%	1%

Importantly, Figure 49 of the Vanguard 2024 How America Saves report also confirms that even though most plans with automatic features only added them after PPA 2006 legislation, and only applied them prospectively to new hires, the use of automatic features has matured and generated significant improvements in participation.[45] The average aggregate employee and employer contribution rates are 12.3% in plans with automatic enrollment versus 7.4% in plans with

https://institutional.vanguard.com/content/dam/inst/iig-transformation/insights/pdf/2024/has/how_america_saves_report_2024.pdf

[43] Id.

[44] Id.

[45] Id.

voluntary enrollment. And, just as important, active participation is more than 50% higher in plans with automatic enrollment for workers whose income is less than $50,000, who are under age 35 and who have less than 4 years of service.

No Plan Design Barrier to Decumulation

There does not appear to be a plan design barrier preventing participants who retained assets in their DC plans to start withdrawing their assets to generate a retirement income stream. Vanguard 2024 How America Saves report data shows that about 67% of plans, which represents about 83% of the participants, afforded the opportunity to take installment payments other than required minimum distributions (RMD) from their DC plans.[46]

Figure 114. Distribution options, 2023

Vanguard defined contribution plans

		Number of participants				
		All	<500	500–999	1,000–4,999	5,000+
Percentage of plans	Deferral	100%	100%	100%	100%	100%
	Deferral only to age 65	2%	3%	4%	2%	1%
	Deferral only to age 70	<0.5%	0%	1%	0%	1%
	Installments other than RMDs	67%	61%	67%	70%	87%
	Ad hoc partial distributions	40%	23%	41%	55%	74%
Percentage of participants offered	Deferral	100%	100%	100%	100%	100%
	Deferral only to age 65	1%	3%	4%	2%	1%
	Deferral only to age 70	4%	0%	1%	0%	4%
	Installments other than RMDs	83%	63%	68%	71%	88%
	Ad hoc partial distributions	75%	29%	42%	59%	83%

There do not appear to be significant barriers that prevent participants from taking partial or systematic distributions in retirement. However, while 65-87% of plans allow installments, only 10% of participants over age 70 are taking them (and mostly for RMDs). Surveys show that only a small percentage of eligible participants who remain in the plan are taking partial or systematic distributions. So, while, testimony confirmed that distributions based on RMD compliance may be a sub-optimal decumulation strategy, the data does support that participants have the ability and are converting DC assets into a stream of retirement income.

[46] Id.

The Vanguard 2024 How America Saves report survey results also show that most participants over age 60 preserve the vast majority of their assets in the retirement system.[47] It appears the crossover asset level is over $25,000. Once that asset level is achieved, the chances assets will be preserved in the retirement system are estimated at 80% - 95%.

Participants with termination dates in 2023

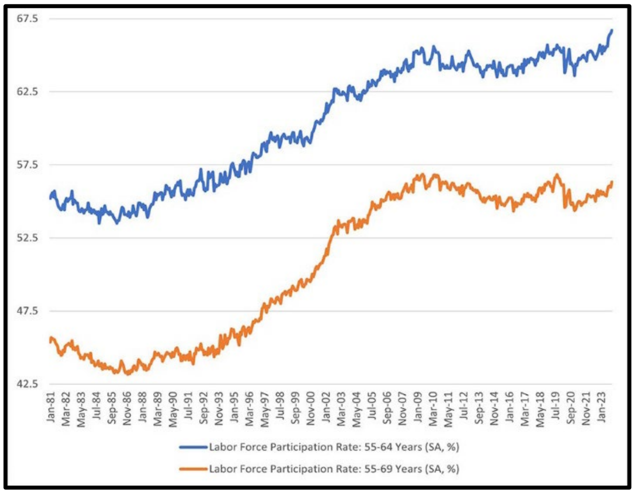
		20s	30s	40s	50s	60s	70s	Total
Percentage of participants choosing	Remain in plan	50%	50%	48%	49%	44%	31%	48%
	Rollover	14%	15%	16%	20%	30%	29%	18%
	Installment payments	0%	0%	0%	<0.5%	1%	11%	<0.5%
	Participants preserving assets	64%	65%	64%	69%	75%	71%	66%
	Cash lump sum	36%	35%	35%	30%	24%	28%	33%
	Rollover and cash	<0.5%	<0.5%	1%	1%	1%	1%	<0.5%
Percentage of assets available for distribution	Remain in plan	70%	69%	67%	63%	53%	43%	61%
	Rollover	18%	22%	26%	32%	43%	51%	33%
	Installment payments	0%	0%	0%	<0.5%	<0.5%	1%	<0.5%
	Assets preserved for retirement	88%	91%	93%	95%	96%	95%	94%
	Cash lump sum	12%	9%	7%	4%	3%	4%	5%
	Rollover and cash	<0.5%	<0.5%	1%	1%	1%	1%	1%

Source: Vanguard 2024.

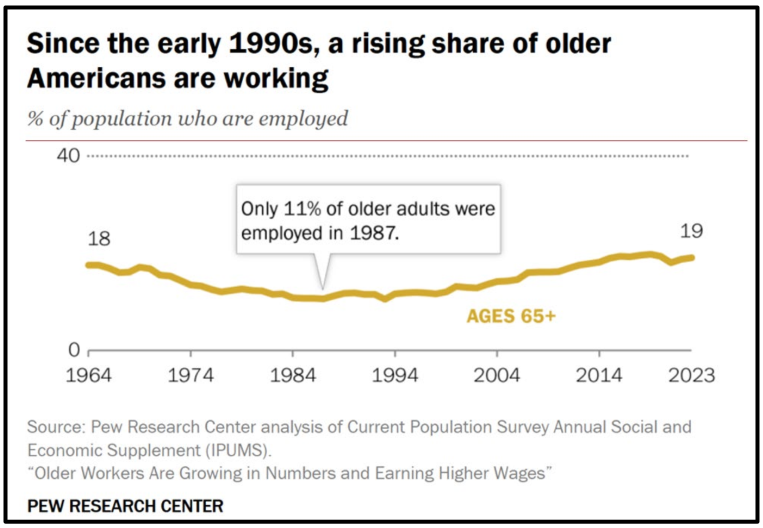
Many more Americans now continue employment beyond traditional normal retirement ages. Since the turn of the century, Bureau of Labor Statistics (BLS) data shows that more than 50% of workers aged 55 to 69 (mostly, the Baby Boom generation) remain in the labor force. Similarly, BLS data shows that more than 60% of workers aged 55 to 64 remain in the labor force.[48]

[47] Id.

[48] J. O'Trakoun, How Older Workers Got Their Groove Back, Richmond Federal Reserve Bank, January 9, 2024, Accessed November 6, 2024 at: https://www.richmondfed.org/research/national_economy/macro_minute/2024/older_workers_20240109



Similarly, 19% of Americans age 65 and over remain in the workforce.[49]



The SECURE Act repealed the age restriction for Traditional IRA contribution eligibility. Effective for 2020 and later taxable years, individuals with earned income can make Traditional IRA contributions at any age, not just for years before reaching age 70½. Similarly, SECURE also changed the Required Beginning Date (RBD) from age 70 ½ to age 72. SECURE 2.0 changed the RBD to age 73 beginning in 2023, and to age 75 beginning in 2033.

The combination of the change in RBD with continued employment, whether full time

[49] Pew Research Center, The growth of the older workforce. Since the early 1990s, a rising share of older Americans are working. December 13, 2023, Accessed November 6, 2024 at: https://www.pewresearch.org/social-trends/2023/12/14/the-growth-of-the-older-workforce/st_2023-12-14_older-workers_1-01-png/

employment in a career role, as part of a phased retirement transition, or as flexible employment, will allow many participants to accumulate additional assets and retain them in the system longer, which may naturally increase the amount of assets available to be used as income in retirement. Vanguard 2024 How America Saves survey data suggests that only 15% of participants over age 60, who remain in the plan, activate an installment payment which represents about 1% of the assets.[50] In addition, about 11% of participants over the age of 70, which represents only about 1% of the assets, take an installment payment.

Alternatively, the Vanguard 2024 survey data also confirm that about 30% of the participants over the age of 60 roll their assets out of the plan which represents about 40-50% of the plan assets. Unfortunately, we do not currently have visibility to confirm whether those rolled over assets are being used to facilitate income in retirement.

Where participants retain assets in their plan, the modest activity in generating periodic income in retirement suggests that better education is needed on how they can activate installment payments.

B. Retirement Income Landscape

A Changing Marketplace

The retirement landscape is in a state of change with the continued decline of defined benefit pension plans being offered and the greater dependency for future retirees on defined contribution plans as their sole source of retirement income to supplement social security. Plan sponsors and participants are starting to view the defined contribution plan as more than just an "accumulation plan" and are seeking to evolve it into a retirement income plan that offers decumulation features, such as:

- Installment and ad-hoc payments,
- "Non-guaranteed" investment solutions (in-retirement strategic asset allocations within a target date fund or managed account), and/or
- "Guaranteed" insurance-based solutions.

Increasingly, participants are keeping their assets in the plan longer and are looking for guidance

[50] Vanguard, How America Saves, 2024, Accessed December 24, 2024 at https://institutional.vanguard.com/content/dam/inst/iig-transformation/insights/pdf/2024/has/how_america_saves_report_2024.pdf

from plan sponsors on spending down those assets in retirement.

Surveys tell us that:

- 59% of employees feel employers have a responsibility to help them adequately save for retirement[51]
- 69% of plan sponsors say they prefer that retirees stay in the plan[52]
- 86% of plans offer a target date fund and installment payments[53]
- >70% of participants over the age of 60 keep their assets in the retirement system instead of cashing out and more than 95% of the assets for participants over the age of 60 remain within the retirement system[54]
- 72% of employers believe that DC plans should include lifetime income options[55]
- Yet only 46% of employees are confident they can turn retirement savings into consistent stream of lifetime income[56]
- 30% of workers expect to use savings from their workplace retirement savings plan to purchase a product that guarantees monthly income for life once they retire, 84% of workers expect retirement savings to be a source of retirement income, and 83% of workers who are participating in a workplace retirement plan would be interested in using some or all of their retirement savings to purchase a product that guarantees monthly income[57]

The increased reliance on defined contribution plans as the main source of retirement income paired with increased asset retention may influence plan sponsors to add non-guaranteed and/or guaranteed decumulation features so participants can satisfy their retirement income needs.

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[51] MetLife Employee Benefits Trends Survey 2023

[52] J. Scalfani, Implementing an in-plan retirement income solution, T. Rowe Price, May 2024, Accessed 11/6/24 at: https://www.troweprice.com/content/dam/ide/articles/pdfs/2024/q2/implementing-an-in-plan-retirement-income-solution.pdf

[53] NEPC, 2023 NEPC DC Plan Trends & Fees survey, March 2024, Accessed November 6, 2024 at: https://www.nepc.com/wp-content/uploads/2024/03/2023-NEPC-DC-Plan-Trends-Fees-Report-Press-Release_Final.pdf

[54] Vanguard, How America Saves, 2024, Accessed December 24, 2024 at https://institutional.vanguard.com/content/dam/inst/iig-transformation/insights/pdf/2024/has/how_america_saves_report_2024.pdf

[55] Aon, Driving DC Plan Success, How Employee Retirement Readiness Will Shape the Road Ahead, 2020. Note, more than 90% of surveyed plans had more than 1,000 participants. Accessed November 6, 2024 at: https://insights-north-america.aon.com/research/aon-u-s-2020-defined-contribution-dc-employer-survey-report

[56] Mercer, Rethinking what we need from work, 2022 Inside Employees' Minds study, Accessed November 6, 2024 at: https://www.mercer.com/assets/us/en_us/shared-assets/local/attachments/pdf-2022-inside-employees-minds-report.pdf

[57] Employee Benefits Research Institute (EBRI), 2024 Retirement Confidence Survey, Accessed November 6, 2024 at: https://www.ebri.org/docs/default-source/rcs/2024-rcs/2024-rcs-release-report.pdf?sfvrsn=2447072f_2

The good news is there are many non-guaranteed and guaranteed retirement income solutions available today. These solutions can be offered within a defined contribution plan (in-plan) or out-of-plan and can either be liquid publicly traded investments (such as a target date fund) or guarantee lifetime income (such as an annuity) as well as portable. Retirement income solutions and products can be offered as stand-alone options within a core lineup, as a plan provision, or as part of an asset allocation solution such as the in-retirement strategic asset allocations of a target date fund, managed account, or model portfolio.

Non-Guaranteed Solutions

Non-guaranteed solutions are an investment solution that a participant can use to set up a "scheduled payout" stream from their plan balance to be paid out to their personal checking as a synthetic paycheck. These payments are offered as a plan distribution feature and are facilitated by the recordkeeper. Scheduled payouts can be paid from the existing investments funds (e.g., target date funds, managed accounts, stocks, bonds, stable value, etc.) in the plan that were used during the accumulation years or in-retirement a participant could exchange their balance into a unique fund that is set up to accommodate a managed retirement income stream during the decumulation phase.

Some plans allow participants the option to select specific investments or sources for payout, allowing the participants to manage taxation and/or to reallocate investments using distributions

These non-guaranteed payments are commonly offered in the following methods and are paid at specific intervals (e.g., monthly, quarterly, annually) to replicate a paycheck:

- **Fixed Dollar:** Participant specifies a specific dollar amount for each transaction.
- **Fixed Percentage:** Participant specifies a percentage of assets for each transaction.
- **Life Expectancy:** Distributions amounts are paid based on their life expectancy.
- **Interest or Dividend Income Only:** Periodic payments of interest or dividend income.

Guaranteed Solutions

Guaranteed solutions, most commonly insurance-based solutions available through annuities or some form of guaranteed living benefit that participants will purchase with all or a portion of their retirement plan account balance. Types of guaranteed solutions are as follows:

- **In-Plan Annuity:** An annuity that is available to plan participants through an employer plan. Commonly, the annuity contract is issued to plans on a group basis.
- **Out-of-Plan Annuity:** An annuity purchased through IRAs or on a non-qualified basis – that may be offered via access to an "annuity platform."
- **Fixed Annuity**: For a single sum, offers a guaranteed fixed interest rate on the money paid into it (over a fixed-period of time) – sometimes referred to as a MYGA – Multi-year Guaranteed Annuity.
- **Income Annuities**: For a single sum, it offers a contract that exchanges an irrevocable payment for guaranteed income for the rest of one's life.
    - **Single Premium Immediate Annuity (SPIA)**: income may start immediately
    - **Deferred Income Annuity (DIA)**: deferred payout annuity, e.g., commence at normal retirement
    - **Qualified Longevity Annuity Contract (QLAC)**: deferred payout annuity, e.g., commence at age 85
- **Guaranteed Living Benefits:** An accumulation annuity contract that provides protection, during the life of the participant, against longevity and market risk by providing a guaranteed level of annuity payments and/or withdrawal amounts
- **Guaranteed Lifetime Withdrawal Benefit (GLWB):** Provides guaranteed systematic withdrawals from a participants account (preserving some liquidity) without having to annuitize the contract (prior to the annuity commencement date). The amount that can be withdrawn under a GLWB is based on a percentage of the "benefit" calculated in accordance with the terms of the contract.
- **Guaranteed Minimum Income Benefit (GMIB):** Provides a guarantee that under certain conditions the participant may annuitize (at the annuity commencement date) the contract based on the greater of 1) the actual account value at standard annuity payout rates or 2) a "benefit base" at conservative GMIB payout rates guaranteed under a rider to the contract.

Market Solutions and Availability

The chart below illustrates the types of options available in the market today and how they are offered:

	Type of Option	In-Plan	Out-of-Plan	Guarantee	Liquid	Stand-Alone	Part of Asset Allocation
Scheduled Payout	Managed Payout - Unique Fund	✓			✓	✓	✓
	Multi-Asset Solution (E.b. TDF, MA, model portfolio)	✓			✓		
	Asset Class (e.g. stock, bond, cash)	✓			✓		✓
	Deferred Guaranteed Withdrawal Benefit (GLWB)	✓		✓	✓	✓	✓
Ongoing Guaranteed Income	Deferred Guaranteed Income Benefit (GIMB)	✓		✓	✓	✓	✓
	Deferred Fixed Annuity	✓		✓	✓	✓	✓
Lump Sum Annuity Purchase	Immediate Income Annuity (SPIA)	✓	✓	✓		✓	
	Deferred Income Annuity (DIA)	✓	✓	✓		✓	
	Annuity Platform		✓	✓		✓	
Longevity Insurance	Longevity Insurance (QLAC)	✓	✓	✓		✓	✓

DCIIA's Retirement Research Center published the results of two online surveys targeting 18 recordkeepers of various sizes.[58] The survey provided insights into the availability and types of solutions under development to deliver retirement income solutions to participants. The survey showed, for recordkeepers of large plans, that about half allow participants to direct payouts by investment and taxation, where:

- 94% have non-guaranteed fixed dollar payouts,
- 76% have fixed percentage payouts,
- 65% have life expectancy payouts, and
- 18% offer interest/dividend only payouts.

That same survey showed that over half of the recordkeepers surveyed offered in-plan guaranteed solutions: 61% of recordkeepers offer at least one annuity, of which 33% offer only one type of annuity and 28% offer two or more types of annuities. A GLWB is the solution most frequently offered, especially among recordkeepers offering only one annuity option.

Recordkeepers continue to explore new solutions, whether developing proprietary products, leveraging third-party providers or engaging in strategic partnerships. Retirement income solutions are considered very important by 56% of all recordkeepers. For those considering implementing new solutions, three key influences were cited as considerations in their strategic planning:

1. Demand: 86% were waiting for increased plan sponsor demand.

[58] Defined Contribution Institutional Investment Association (DCIIA) Retirement Research Center (RRC), Retirement Income Solutions: Recordkeeper Study, June 20, 2024, Accessed November 6, 2024 at: https://dciia.org/news/675628/DCIIA-RRC-Publishes-Recordkeeper-Study.htm

2. Evolution: 57% were waiting to see how the various retirement income solutions offerings evolve.
3. Technology: 57% were assessing new technology requirements need to support solutions.

Assets are Remaining in DC Plans Longer

There is an increasing plan sponsor focus on retaining assets post separation. One witness noted one rationale for the shift is the potential impact on active employee participants – that potentially 20% of plan assets could leave the plan due to recent and pending retirements, negatively impacting economies of scale that benefit all participants.[59]

A DCIIA study revealed that in 2021, 74% of plan sponsors preferred to retain assets in the plan, compared to 46% of plan sponsors in 2015.[60] That study also highlighted many pros and cons for plan sponsors. Plan sponsor pros included:

- Achieve scale resulting in access to lower fund fees
- Maintain corporate brand by offering a "through retirement" program,
- Scale may allow sponsors to maintain financial wellbeing programs, and
- Uphold fiduciary standard extending those benefits to former employees.

Plan sponsor cons included:

- Additional efforts to tailor and update DC plans to meet the different needs of former employees,
- Increased potential and expense for missing participants, and
- Higher headcount could result in increased administrative fees if the plan sponsor pays.

For comparison, small plans have fewer economies of scale and less negotiating leverage, however, they can generally achieve similar outcomes by using an institutional purchasing platform.

The use of a guaranteed retirement income solutions may not be limited to provision within a QDIA but may instead be offered as a standalone option.

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[59] Council Hearing of September 11, 2024, Transcript of Testimony of Jessica Sclafani, T. Rowe Price, at 181.
[60] DCIIA, The Pros and Cons of Keeping Assets in DC Plans, May 2022, https://cdn.ymaws.com/dciia.org/resource/resmgr/resource_library/StayingInPlan_042922.pdf

Retirement Income Product Evolution and New Solutions

Multiple witnesses, including Olivia Mitchell, Michael Finke, Greg Fox and Preet Prashar, confirmed the potential improvement in retiree welfare from partial annuitization using products that have been available for many decades.

For example, Michael Finke confirmed that "… retirees spend more than economic theory would predict … retirees often perform worse than younger investors managing their investments. … (an) annuity … could be incredibly valuable…"[61] He suggested development of a process where: "The potential welfare improvement from a suggestion of putting a certain percentage of your retirement savings into annuity that is customized for the individual, but also based on the recommendation of an expert, (would) be an incredibly valuable service that managed accounts could provide. … where you could consolidate different assets and get a recommendation for the percentage that you would want in an annuity and use some sort of an instrument like they use risk tolerance test to be able to evaluate your preference for guaranteed lifetime income."[62]

In addition to traditional annuity products described earlier (MYGA, SPIA, DIA, QLAC), new solutions and products have recently seen great expansion in the market as more investment management firms are launching target date funds with embedded annuity features, personalized target date funds, enhancements to managed accounts and target date funds draw down capabilities, and recordkeepers are offering new annuity platform solutions. Specifically, within asset allocation solutions, we are seeing different approaches from increasing investment risk levels in retirement to the embedding of annuity features.[63] Some examples are:

- Target date fund providers providing fiduciaries the option to increase equity in retirement from 35% to 50% equity to generate higher returns.
- Managed accounts have evolved their approach to managing participant assets in retirement by expanding their asset allocations beyond a single risk level; instead, they now offer participants the flexibility to choose among five different risk levels.
- Target date funds and managed accounts providers, with the support of Middleware providers, are offering to take on fiduciary responsibility on behalf of a participant when

[61] Council Hearing of July 8, 2024, Transcript of Testimony of Michael Finke, at 46.
[62] Id. at 78.
[63] Meta-analysis of currently available guaranteed income products.

facilitating scheduled payouts from their investment solutions into a participant's checking or savings accounts.

- Participants may purchase an immediate annuity at a certain age (SPIA) with all or a portion of the balance in their TDF.
- Participants may purchase a QLAC with a portion of their TDF balance, with retirement income beginning at age 78. The remaining assets in the TDF are distributed as a managed payout solution.
- No required election/decision from the participant where the asset manager gradually replaces the fixed income allocation within the TDF with a GLWB, where assets continue to be liquid, whether specifically selected by the participant or defaulted as the QDIA. Lifetime income payments may begin as provided under the terms of the plan.
- Model portfolio solution with an embedded deferred fixed annuity that a participant can elect to purchase at time of retirement.

Additionally, some managed account solutions now provide flexibility for participants to select either a non-guaranteed income planning feature or a scheduled payout approach that includes an insured guaranteed income component. For example, GLWB solutions are evolving as well and can be used alongside existing TDFs, managed accounts or as standalone options.

Non-guaranteed investment products can be designed to provide most of the pooling benefits and income certainty of an annuity. Such a design, similar to an insurance company's general account, may allow participants to invest a portion in a traditional ladder of bonds whose maturity matches income payments from retirement through a specified age, for example age 80. Income after age 80 would be derived from either a longevity annuity or some other pooled asset design such as a closed-end fund that can transfer longevity risk to the group of retirees. Since the increased spending provided through mortality risk pooling, also known as mortality credits, occurs primarily after age 80, this type of design can provide much of the welfare benefit of a traditional annuity with greater expense transparency and reduced insolvency risk.

To maintain perspective, more than 90% of plans today offer a target date fund which is a non-guaranteed retirement income solution. At the same time, the marketplace often highlights the lack of in-plan guaranteed retirement income solutions. These trends may reflect the free market in full effect. With such continuous and rapid product development, with the ever-increasing adoption of automatic features including QDIAs, plan sponsors may prefer to continue to wait and see what new retirement income products emerge in the marketplace. Some plan sponsors may perceive a potential benefit to waiting until the product landscape is more mature while observing the implementation and adoption experience of other plan sponsors.

Middleware Technology

Technology integration is a critical component for seamlessly implementing new and current retirement income solutions. Middleware technology was developed to serve as an adjunct to traditional recordkeeping service and middleware's primary objective is to do the work that recordkeepers are not able to do to facilitate income withdrawals from target date funds. Recordkeeping of traditional target date funds is generally standardized, but most recordkeepers can only facilitate a systematic pro-rata distribution based on all the assets in participant accounts.

When a target date fund provider adds a non-guaranteed or guaranteed income feature to their strategic asset allocation then a middleware provider becomes a necessity to operationalize the target date fund provider's methodology. Further, each retirement income solution may be subject to different rules and regulations requiring significant technology development by the recordkeeper. Middleware providers can help with the integration between the recordkeeper and potentially multiple retirement income solutions –improving participant experience and making solutions scalable for the recordkeeper. This enables recordkeepers to focus more on participant communications and retirement income activation decision making.

Selection and Prevalence

The current QDIA regulations do not prohibit TDFs nor Managed Accounts as QDIAs if they include insurance products, or otherwise include insurance features. In fact, the 2014 information letter explicitly confirmed the application of the 2008 safe harbor to a series of TDFs including unallocated deferred annuity contracts.

Kenneth Levine stated that while the RTX Corp.'s "QDIA isn't necessarily going to fit everybody's needs…but we believe it's the right place to default people."[64] He noted that the RTX Corp. plan now offers additional options for participants to "customize their lifetime income strategy portfolio."[65]

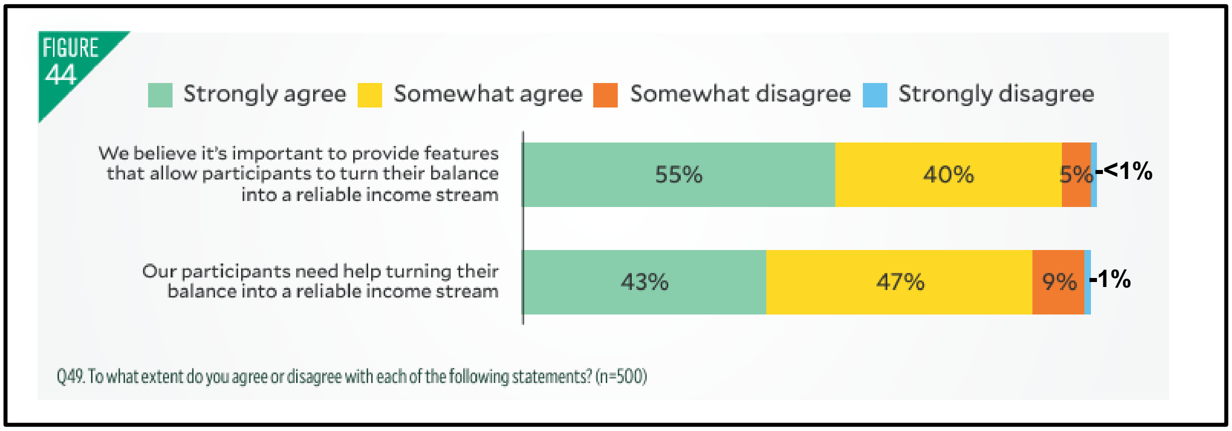
Dr. Mitchell proposed including default deferred income annuities that pay out at age 80 or 85, using 10% of a participant's account balance so as long as the account balance is over $65,000.[66] Ten percent of $65,000 is $6,500, which would be roughly equivalent to a benefit of $325 per year. While this was recognized as a modest amount, it was also understood to be a starting point to manufacture mass adoption. Dr. Mitchell also suggested the default would be more acceptable if the annuity purchase were funded with employer contributions.

In addition, the selection of non-guaranteed options (target date funds, managed accounts, managed payouts, etc.) is clear and working. Moreover, the QDIA rules as currently written address retirement income in QDIAs in a broad and flexible fashion that allows for future innovation without being too prescriptive.

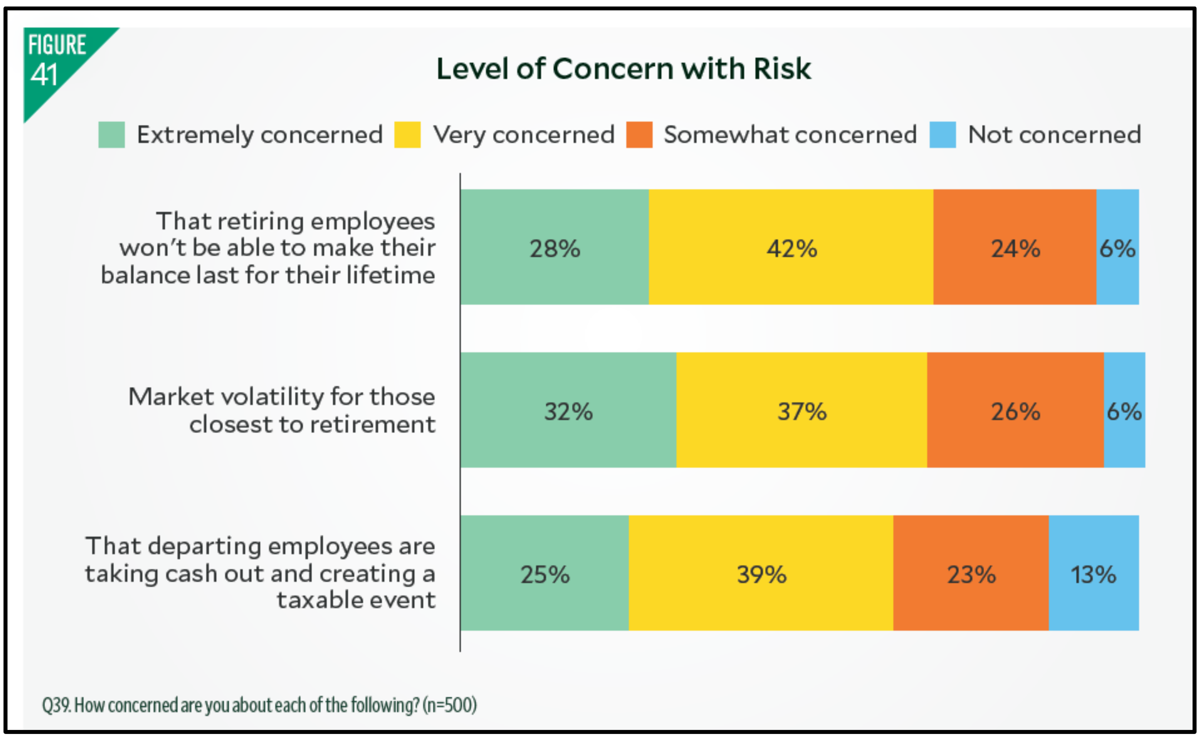
The decision to select a retirement income solution is a complicated and often technical process. In response, the consultant community has started creating decision frameworks as well as rating processes to assist plan sponsors with their decision making to select and monitor various retirement income solutions. In a recent survey, 48% of consultants said that they have some form of formal rating process in place today and another 28% are planning to implement a ratings process in the next 12-months.[67]

Surveys[68] confirm that there has been an increase in the number of plan sponsors that believe it is important to add features that will provide participants with a reliable income stream, for example:

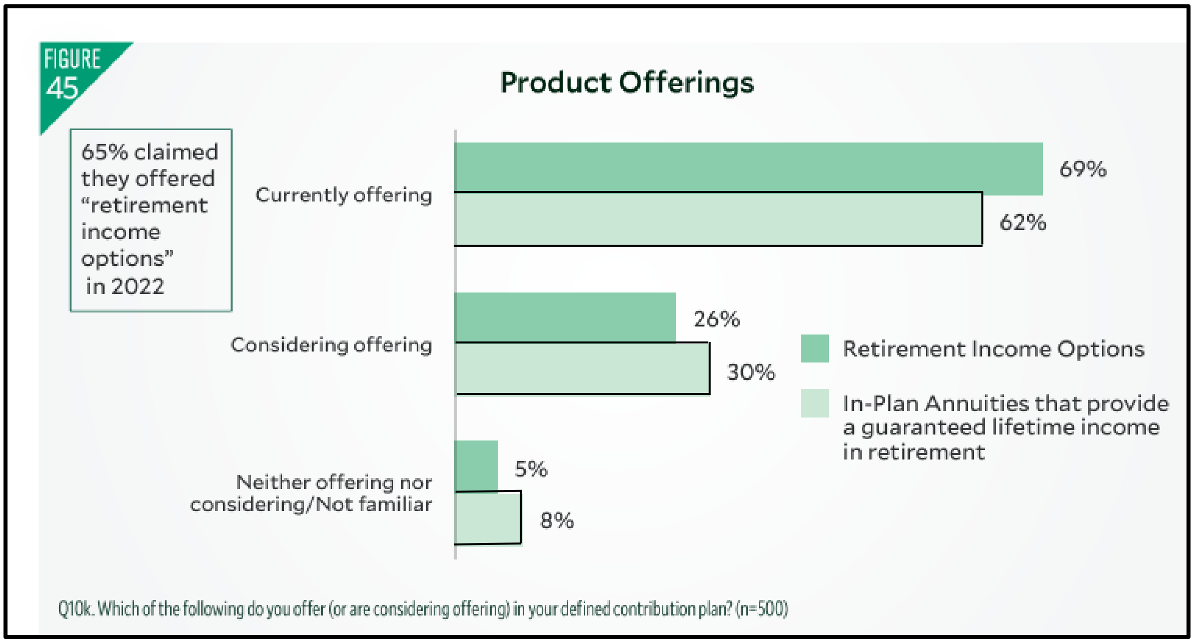
[64] Council Hearing of September 11, 2024, Transcript of Testimony of Kenneth Levine, RTX Corp., at 211.
[65] Id.
[66] Council Hearing of July 8 2024, Transcript of Testimony of Olivia Mitchell, at 22.
[67] T. Rowe Price 2024 Defined Contribution Consultant Research Study, September 2024, Accessed November 6, 2024 at: https://www.troweprice.com/content/dam/ide/pdfs/consultant-research-study/2024-dc-consultant-study.pdf
[68] American Century Investments, Plan Sponsor Survey, July 2024, Accessed November 6, 2024 at: https://res.americancentury.com/docs/2024-Annual-Retirement-Survey-Plan-Sponsor-Report.pdf



Similarly, surveys also show plan sponsor concerns about investment risk near retirement and their impact on retirement income:



And, most plan sponsors already offer various decumulation solutions:



However, the Council noted that ***participant*** adoption rates continue to be modest.

C. Participant Heterogeneity

Council member experience confirms that participant needs, requirements, circumstances, demographics (households, age, incomes, debt, other assets, other income, etc.) all vary significantly among that population, and among participants within any one plan.

Testimony confirmed that accumulation and decumulation are asymmetrical and that a single solution is inconsistent with financial needs and life expectancy – which vary significantly by income, race, ethnicity, sex, and other factors. Testimony confirmed past Bureau of Labor Statistics surveys indicating that the median tenure of American workers ages 25 and over has been less than 5 years with a specific employer for the past 7 decades – even lower if we include all in the labor force (ages 16 and over). [69] The same surveys show that median tenure is less than 10 years for workers ages 50 and over, suggesting that most full-time workers reaching their Social Security Full Retirement Age have a different employer than the one they had at age 50.

Investment Company Institute testimony, both in prior Council hearings and in written

[69] Department of Labor, Bureau of Labor Statistics, Employee Tenure in 2024, September 26, 2024, Accessed October 8, 2024 at: https://www.bls.gov/news.release/pdf/tenure.pdf

testimony this year confirmed that most low- and moderate-income Americans reaching retirement age are already highly annuitized.

Witnesses testified that annuities were too complex to be offered as a default feature in a QDIA. Testimony highlighted the cost of a guaranteed retirement income feature, and a lack of financial sophistication among many, perhaps most participants. Testimony also suggested that the current required disclosures, while robust, are insufficient when it comes to understanding the fees, risks, benefits, foregone opportunity, and permanence of guaranteed lifetime income features.

Witnesses suggested that while they would support the offer of in-plan annuities as a payout option where they meet ERISA's fiduciary requirements, both would apply a "high bar" when adding a guaranteed lifetime income feature to a QDIA, suggesting that an annuity default is only appropriate for a pension plan, not a savings plan.

In lieu of an insurance or annuity policy that incorporates guaranteed lifetime income features, Mr. Certner suggested the better option for most participants who need additional guaranteed, inflation-indexed retirement income would be to defer commencement of Social Security benefits (noting the modest assets suggested by one survey where only 54% of households report retirement savings with a median of $87,000, and only 26% report savings in excess of $100,000).[70]

With such a large number of plans and even larger number of participants, it seems unlikely that a QDIA that only incorporates a single guaranteed, insurance-based retirement income solution will be a good fit for a large share of the participant population. While solutions are being developed that incorporate greater choice and flexibility across retirement income solutions, plans may need to offer a menu of retirement income options and tools so that solutions can be personalized to the participant.

Some witnesses suggested that unlike in the accumulation phase, single solutions, including defaults, generally do not work well for decumulation because of the heterogeneity of participant

[70] Board of Governors of the Federal Reserve System, 2022 Survey of Consumer Finances (SCF), Accessed November 6, 2024 at: https://www.federalreserve.gov/econres/scfindex.html

circumstances, financial needs and desires for retirement income.

In a written statement, Vanguard noted, "[p]lan sponsors also recognize that retirement income is complicated, and one solution would not be able to solve for varied income needs of participants."[71] In addition, Vanguard noted, "[M]uch more value for participants could potentially be unlocked if hybrid annuity TDFs were integrated with other solutions that already exist in the DC ecosystem (or are being added to the ecosystem), rather than offering a hybrid annuity TDF solely as a one-size-fits-all standalone product. A standalone product would have to meet evolving guaranteed income needs of certain participants, which poses a suitability challenge when implemented at scale."[72]

In her testimony, Ms. Sclafani noted that "[T. Rowe Price] believe[s] that retirement income will ultimately be implemented in an array of solutions, probably a non-guaranteed and a guaranteed solution supported by access to tools and advice."[73]

D. Barriers to Adoption

While the Pension Protection Act of 2006 and subsequent regulatory guidance have removed almost all barriers to plan sponsor adoption of automatic features and plan investment fiduciary selection of non-guaranteed retirement income solutions within a QDIA, witness testimony and written statements highlighted a number of risks which may form barriers to adoption of guaranteed lifetime income solutions within a QDIA, as an option in the core lineup, or as a payout option, including:

- Insurer insolvency,
- Product design,
- Liquidity,
- Participant diversity,
- Litigation, and
- Participant behavior.

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[71] Roger Aliaza-Diaz, Ankul Dago, and Vibor Dave, Vanguard, Written Statement to Department of Labor ERISA Advisory Council, August 30, 2024.
[72] Id.
[73] Council Hearing of September 11, 2024, Transcript of Testimony of Jessica Sclafani, T. Rowe Price, at 177.

In his testimony, Gregory Fox, Aon, noted the "overwhelming majority" of plan sponsors have not adopted "guaranteed" retirement income solutions. He attributed the causes of plan sponsors not adopting "guaranteed" retirement income solutions to: (1) fiduciary concerns; (2) administrative complexity; (3) costs; (4) limited adoption by participants; and (5) the complexity and variation in available solutions.

While sponsors are interested in learning more about available "guaranteed" retirement income solutions, the typical sponsor is taking a wait-and-see attitude, according to Preet Prashar, Mercer. Plan sponsors are willing to wait until existing products have been tested in the real world. He described many in-market products as being early stage, leading some sponsors to wait to see what the refined, or version 2.0, product looks like.

Insurer Insolvency Risk

Historically, credit ratings of insurance companies have been a good predictor of subsequent liquidation, and cumulative 10-year liquidation rates are below 2% for A-rated insurers. Even when an insurer is liquidated, this may or may not impact the regular income received by annuity owners if liabilities are absorbed by another insurer.

Although insurance failures have been rare under the insurance regulatory framework, adding annuities to DC plans, particularly to QDIAs, would substantially increase income liabilities within the industry and potentially stress state guarantee funds, because of the pure velocity of money currently flowing into QDIA being so much greater than any other option within a DC plan.

More importantly, a highly rated insurer can be acquired by a lower-rated company, the insurer may itself experience a credit downgrade, or the insurer may sell a block of annuity liabilities to a lower-rated insurer to profit off the risk-arbitrage yield spread.

Product Design

The diversity of non-guaranteed and guaranteed retirement income options paired with differences in individual participants' financial needs presents several challenges for plan sponsors. Key barriers include the complexity and sheer number of these options and various features, which complicates the process of comparing different products and determining the best fit for a specific plan. Additionally, there are concerns related to administrative complexity and the potential for increased fees and costs.

The massive growth in DC has sparked evolution by the creation of many new retirement income solutions, often those solutions are more complex. Middleware platforms are becoming more prevalent to address those complexities and help bridge the gap between participants and recordkeepers in the delivery of both non-guaranteed and guaranteed retirement income solutions. Another challenge results from variations in vocabulary across retirement income solution manufacturers, creating intentional and unintentional confusion and complexity.

According to the GAO, asset allocations may significantly vary among TDFs with the same Target Date even among those who purport to have the same glide path destination (e.g., "to," "through").[74]

Both participant level and plan level portability to transfer guaranteed, insurance-based solutions and retain the income benefit has been a historical challenge because the insured component of retirement income solutions is tailored to each individual participant. The SECURE Act improved participant level portability by permitting employees to make special distributions from their "lifetime income investments" if the plan sponsor changes recordkeepers or removes the investment option from the plan.

Liquidity

Most annuities are liquid to some degree (free withdrawal, free look and surrender provisions) especially the institutional annuities generally made available to retirement plan

[74] GAO, 401(k) Retirement Plans, Department of Labor Should Update Guidance on Target Date Funds, GAO-24-105364, March 2024, Accessed November 6, 2024 at: https://www.gao.gov/assets/gao-24-105364.pdf. "The target investment mix can vary considerably for both "through" and "to" TDFs with the same target date … the percentage of equities varies more widely for "to" TDFs than for "through" TDFs, with some "to" TDFs reducing investment risk by having a relatively low allocation to equities. These differences in equity percentages reflect asset managers' preferences for managing risks and returns and have a direct impact on participants. Because of these differences, exposure to investment risk will vary among participants, even those that invest in TDFs with the same target date and glide path type."

participants. However, once an annuity contract is purchased there is limited liquidity. Partial annuitization is common in QDIAs with income components. With partial annuitization, the majority of a participant's balance remains unannuitized and fully liquid.

Participant Diversity

Not everyone will be drawn to a guaranteed insurance-based income option, nor a non-guaranteed solution with a scheduled payment. Therefore, a single solution may be a challenge. Multiple decumulation, retirement income solutions, either in the DC investment menu or as payout options, or both, are likely necessary to meet diverse participant needs. For various reasons, incorporating a single guaranteed income solution as part of the QDIA default or even as a stand-alone option within a plan may be inconsistent with the significant variation in individual needs.

Prior Investment Company Institute testimony to the Council confirmed that many Americans should avoid annuitizing because they already have a significant portion of wealth annuitized: "… When including all retirement resources, it is clear that US households are highly annuitized outside their DC plans. Individuals entering retirement who need more annuity income should first consider delaying claiming Social Security before purchasing an annuity in the market. … Required minimum distributions (RMDs) are a responsible way to produce a lifetime income stream while still maintaining access to the account balance. …"[75]

An in-plan solution may be most effective for longer tenured older workers who have been continuous savers for decades and have accumulated above average account balances. However, as noted earlier, median tenure has been less than 5 years for the past 7 decades, and the median tenure of American workers over age 55 is 9.7 years. Since America's workforce is fluid and our current DC ecosystem is fragmented, it is fair to assume that more than half of active workers reaching age 65 would have changed jobs between ages 50 and 65. For that reason, workers reaching traditional retirement ages may have more than one plan with different QDIAs, and different access (or lack thereof) to in-plan guaranteed lifetime income options.

[75] S. Holden, S. Salinas, Investment Company Institute, Written Statement to the ERISA Advisory Council, August 2018 testimony, Accessed December 26, 2024 at: https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2018-lifetime-income-solutions-as-a-qdia-holden-written-statement-08-15.pdf

In addition, life expectancies vary significantly among groups, by income, race, and ethnicity. A fiduciary can choose from many different TDFs and balanced funds. Oftentimes, an existing TDF is later selected to be the QDIA. Those TDFs and balanced funds often consider many variables when building a specific glidepath. But once adopted, whether participation in the QDIA was the result of automatic enrollment, an affirmative election, or a change in plan investments, a TDF does not incorporate any variation that would account for individual participant diversity, or how the diversity of all plan participants might have changed over subsequent periods.

In the 2013 TIPS document, the Department confirmed that fiduciaries should consider how well the TDF's characteristics align with the demographics of the entire population of eligible employees and their likely retirement dates: "… It also may be helpful for plan fiduciaries to discuss with their prospective TDF providers the possible significance of other characteristics of the participant population, such as participation in a traditional defined benefit pension plan offered by the employer, salary levels, turnover rates, contribution rates and withdrawal patterns. …"[76]

A written statement advised that the QDIA is "for people who do not want to engage (or do not want to be known) … As account balances increase and as individuals approach retirement, their needs, goals, marital and familial status, health, longevity, and accumulated assets vary substantially …"[77]

Another difference across participants is financial literacy. Dr. Mitchell's testimony confirmed the need for increased participant education, noting that a significant portion of participants are not literate when it comes to financial or investment decision-making. In terms of participant education regarding QDIAs, a GAO study showed the Department's most recent participant education on TDFs was issued in 2010. That guidance focused solely on TDFs, without incorporating other QDIAs, nor focusing on other risks (longevity risk, sequence of returns risk, inflation, etc.).

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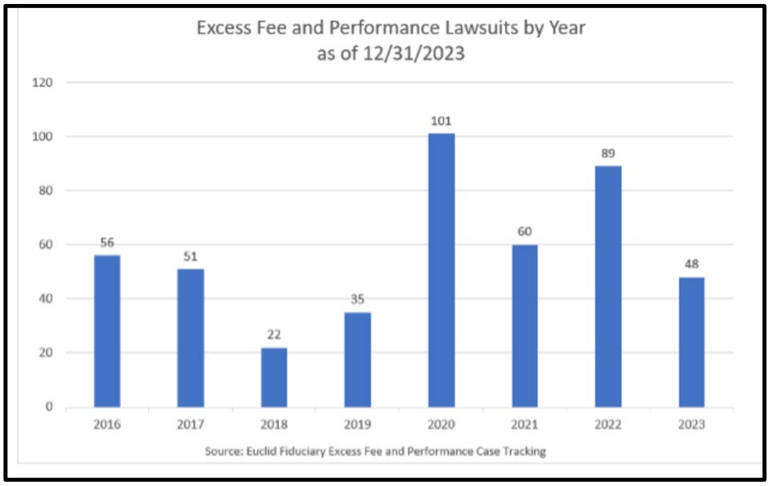
[76] Target Date Retirement Funds - Tips for ERISA Plan Fiduciaries U.S. Department of Labor Employee Benefits Security Administration, February 2013, https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/target-date-retirement-funds.pdf
[77] Ron Surz, Target Date Solutions, Written Statement to Department of Labor ERISA Advisory Council, September 12, 2024.

Dr. Mitchell also noted that participants do not readily distinguish between life expectancy and longevity. She suggested education might confirm that published life expectancy is an average (e.g., Social Security Actuarial Life Table)[78] while participants (and spouse) longevity may be considerably greater than the average (e.g. American Academy of Actuaries Longevity Illustrator).[79] She also noted that education should not be limited to those who have attained a specific age (e.g., over age 50) but should occur throughout participation in a retirement savings plan.

[78] Social Security Administration, Accessed November 6, 2024 at: https://www.ssa.gov/oact/STATS/table4c6_2019_TR2021.html
[79] American Academy of Actuaries, Longevity Illustrator, Accessed November 6, 2024 at: https://www.longevityillustrator.org/

Litigation Risk

Through the first half of 2024, litigation shows no sign of slowing down compared to prior years.[80]



To many plan sponsors, because insurance products generally have fees that are higher and are structured differently than traditional investment funds, the safe harbor to select an insurer is not adequate because it does not address fees. Some retirement income solutions are perceived to be too expensive, while others lack transparency in fees and reporting structure. The SECURE Act of 2019's safe harbor requires that the relative cost of the selected guaranteed retirement income contract is "reasonable."

As a result, while additional guidance may not technically be required, there is a perception by some that the current guidance is not enough for fiduciaries who want to use guaranteed, insurance-based retirement income solutions as QDIAs. According to witness testimony,[81] some plan sponsors believe the existing statutory and regulatory safe harbors offer insufficient guidance and protection to meet their fiduciary duties of prudence and loyalty[82] when selecting insurance providers.

The Council heard witness testimony regarding litigation exposure – confirming that the

[80] Aronowitz, Summary of 2023 Excess Fee and Performance Litigation, January 8, 2024, Accessed October 8, 2024 at: https://encorefiduciary.com/summary-of-2023-excess-fee-and-performance-litigation/
[81] Council Hearing of July 9, 2024, Transcript of Testimony of Gregory Fox, Aon Investments USA, Inc.
[82] 29 CFR § 2550.404a-1.

industry is experiencing lawsuits that did not exist 25 years ago, and that the numbers continue to increase from year to year.[83]

Some recent litigation has focused on backward-looking performance of target date funds, even though the standard for determining the prudence of the fiduciary's initial investment decision is whether the fiduciary employed the appropriate methods to investigate the merits of the investment at the time the challenged target date fund was selected.

One witness testified that plan sponsors are not adopting guaranteed lifetime income solutions despite the societal good achieved by longevity risk pooling due to the asymmetric risk of litigation when offering a plan with features that are not required, and which offer value that is difficult to quantify.[84]

Participant Behavior:

LIMRA recently confirmed sixteen consecutive quarterly increases in US annuity sales - where total annuity sales increased 29% year over year to $114.6 billion in the third quarter 2024.[85] Despite those significant increases, annuitization by participants remains modest.

A 2011 article in the *Journal of Economic Perspectives* notes the following: "In his Nobel Prize acceptance speech given in 1985, Franco Modigliani drew attention to the 'annuitization puzzle'… that annuity contracts, other than pensions through group insurance, are extremely rare… Rational choice theory predicts that households will find annuities attractive at the onset of retirement because they address the risk of outliving one's income, but in fact, relatively few of those facing retirement choose to annuitize a substantial portion of their wealth…." [86] The article notes that the same behavioral and institutional factors that help explain savings behavior are also important in understanding:

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[83] Council Hearings of July 9-10 and September 11, 2024, Transcripts of Testimony of Gregory Fox, Aon Investments USA, Inc.; Thomas Clark, Wagner Law Group; Marla Kreindler, Morgan Lewis.
[84] Council Hearing of September 11, 2024, Transcript of Testimony of Michael Kreps, Groom Law Group at 261.
[85] LIMRA: Third Quarter 2024 Marks 16 Consecutive Quarterly Increases in U.S. Annuity Sales – Last 10 in Double Digits, 10/29/24, Accessed 11/6/24 at: https://www.limra.com/en/newsroom/news-releases/2024/limra-third-quarter-2024-marks-16-consecutive-quarterly-increases-in-u.s.-annuity-sales--last-10-in-double-digits/
[86] S. Benartzi, A. Previtero, R. Thaler, Annuitization Puzzles, Journal of Economic Perspectives, vol. 25, no. 4, Fall 2011, pp. 143–64, Accessed November 6, 2024 at: https://www.aeaweb.org/articles?id=10.1257/jep.25.4.143

- Framing is important, it is believed that more would take installment payments if it were framed as consumption, not as an investment.
- Loss aversion is prominent because annuities are not viewed as a risk-reduction feature, instead many people are wary about making an irrevocable purchase and dying prematurely. The perceived risk of loss of principal, prompts many to add a period-certain guarantee, which is a "dominated" annuity feature. This rider is selected when a person prioritizes the return of capital more so than hedging against longevity risk. A person may pay a higher premium to gain the return of capital protection. This is consistent with Watkins testimony.
- Mental accounting and the endowment effect may be limiting the utilization of annuity features because participants value their bigger pot of retirement savings more than a series of smaller checks that are perceived to not be equal in value.

Without being incorporated into a QDIA, participants may not voluntarily fund a guaranteed retirement income solution. This raises the concern of a potential buildup in longevity risk for participants who overspend or undersave, when they ultimately exhaust their DC reserves and are left to rely solely on Social Security as a retirement income backstop. This issue is exacerbated by the declining prevalence of defined benefit plans among retirees.

VI. RECOMMENDATIONS AND RATIONALE

Recommendation #1: The Council recommends the Department issue guidance in the form of a comprehensive "Tips" document or other form of guidance to serve as a road map for plan fiduciaries when selecting and monitoring both non-guaranteed and guaranteed retirement income options, inside or outside of a QDIA. The guidance should include necessary elements and key substantive considerations that will ensure prudent selection and periodic monitoring processes. The Council believes the Department's guidance should be informed by relevant statutes, regulations, stakeholder input, and case law to build an effective road map.

Rationale: A comprehensive set of tips could facilitate greater plan sponsor adoption of appropriate non-guaranteed and guaranteed retirement income options and improve fiduciary decision making and therefore outcomes for participants and beneficiaries. Further, such guidance could lead to improved products and greater transparency from guaranteed and non-guaranteed retirement income providers.

With the passage of the SECURE Act, Congress clearly intended to encourage plan sponsors to consider offering lifetime income features in defined contribution plans by addressing the portability of lifetime income investments and creating a new fiduciary safe harbor for the selection of an insurer for a guaranteed retirement income contract.

According to witness testimony,[87] however, some plan sponsors believe the existing statutory and regulatory safe harbors offer insufficient guidance and protection to meet their fiduciary duties[88] when selecting insurance providers. Further, the opaqueness and complexity of, and lack of transparency in, some retirement income products, especially compared to the investment options historically offered in 401(k) plans, has left some plan sponsors uncertain about how to evaluate these products.

The Council heard witness testimony that litigation exposure has dampened plan sponsors' willingness to implement insurance-based retirement income solutions. One witness testified that

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[87] Council Hearing of July 9, 2024, Transcript of Testimony of Gregory Fox, Aon Investments USA, Inc.
[88] 29 CFR § 2550.404a-1.

plan sponsors are not adopting guaranteed lifetime income solutions despite the societal good achieved by longevity risk pooling due to the asymmetric risk of litigation when offering a plan with features that are not required, and which offer value that is difficult to quantify.[89]

The Council's recommendation specifically requests the "Tips" guidance be informed by key principles from case law regarding the prudence of a fiduciary's investment selection decisions. Examples might include confirming that:

- The fiduciary employed the appropriate methods to investigate the merits of the non-guaranteed and guaranteed retirement income solutions at the time the fiduciary engaged in the challenged transaction, such as a reasoned decision-making process consistent with that used by a prudent person acting in a like capacity, and
- The selection standard is not based on hindsight or the ultimate result of the decision, while
- Outcomes may be relevant in determining whether a fiduciary met their ongoing duty to monitor.

Recommendation #2: The Council recommends the Department provide and update guidance to plan sponsors and other fiduciaries to improve participant education, notices, transparency, and disclosures regarding the actual investments held within the QDIA in all phases of participation (accumulation, transition, decumulation) as well as non-guaranteed and guaranteed retirement income solutions offered within or outside the QDIA.

Rationale: Witness testimony highlighted the need to re-evaluate and update past education bulletins and required notices and disclosures, to improve transparency and participant education regarding QDIAs, given:

- The inclusion of non-traditional asset classes such as insurance-based products and private markets in QDIAs,
- Data reflects the explosive growth in the use of QDIAs, especially TDFs,
- Studies that show many participants do not read or understand required notices and disclosures,[90] and

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[89] Council Hearings of July 9-10 and September 11, 2024, Transcripts of Testimony of Gregory Fox, Aon Investments USA, Inc.; Thomas Clark, Wagner Law Group; Marla Kreindler, Morgan Lewis; Michael Kreps, Groom Law Group.
[90] Council Hearings of July 9 and September 12, 2024, Transcripts of Testimony of Gregory Fox, Aon Investments

- Data that shows many participants do not understand their QDIA investments, longevity risk, etc.[91]

Council members believe participants would benefit from updates of educational materials such as the TDF bulletin or the Department's Lifetime Income calculator or new materials like a longevity risk calculator, a "break even" calculator comparing non-guaranteed versus guaranteed lifetime income, or illustrations of welfare improvements from annuitization, whether whole or partial.

Recommendation #3: The Council recommends the Department amend the safe harbor for automatic rollovers to individual retirement plans (29 CFR § 2550.404a-2) to allow use of QDIAs (29 CFR § 2550.404c-5) as the investment safe harbor for involuntary, automatic rollovers. The new investment default options would be in addition to, not in lieu of, the existing capital preservation default.

Rationale: The Department's 2004 safe harbor guidance[92] pre-dates the 2007 QDIA regulations. The 2004 regulations require involuntary distributions from employer-sponsored plans to Individual Retirement Accounts (IRAs) to use an investment default that will "…preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity."[93] However, the enabling legislation did not mandate the use of capital preservation investments even though capital preservation was more frequently used as a QDIA at the time those regulations were finalized.[94] The 2004 guidance is not consistent with the subsequent 2007

USA, Inc.; David Certner, AARP.

[91] Council Hearings of July 8-10 and September 11, 2024, Transcripts of Testimony of Michael Finke, The American College of Financial Services ;Preet Prashar, Mercer; James Watkins, Invest Sense LLC.

[92] Fiduciary Responsibility Under the Employee Retirement Income Security Act of 1974 Automatic Rollover Safe Harbor, September 28, 2004, Accessed November 6, 2024 at: https://www.federalregister.gov/documents/2004/09/28/04-21591/fiduciary-responsibility-under-the-employee-retirement-income-security-act-of-1974-automatic

[93] Id.

[94] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, Section 657. "AUTOMATIC ROLLOVERS OF CERTAIN MANDATORY DISTRIBUTIONS. … (c) FIDUCIARY RULES.— (2) REGULATIONS.— … (A) AUTOMATIC ROLLOVER SAFE HARBOR.—Not later than 3 years after the date of enactment of this Act, the Secretary of Labor shall prescribe regulations providing for safe harbors under which the designation of an institution and investment of funds in accordance with section 401(a)(31)(B) of the Internal Revenue Code of 1986 is deemed to satisfy the fiduciary requirements of section 404(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104(a)). (B) USE OF LOW-COST INDIVIDUAL RETIREMENT PLANS.— The Secretary of the Treasury and the Secretary of Labor may provide, and shall give consideration to providing, special relief with respect to the use of low-cost individual retirement plans for purposes of transfers under section 401(a)(31)(B) of the Internal Revenue Code of 1986 and for other uses that promote the preservation of assets for

regulations that provide QDIAs for employer-sponsored plans (with an exception for the 120-day period following a participant's first contribution).

An Employee Benefits Research Institute study showed 22.7% of Traditional Rollover IRAs had balances less than $5,000, where 55.6% of owners were under age 45, and 27.2% of those accounts were more than 7 years old.[95] Because IRA investment defaults are just as sticky as other defaults, more than 75% of the accounts established 7–11 years before the analysis year and more than 85% of the accounts established in the analysis year continued to be solely invested in capital preservation.

To illustrate the cost/opportunity, consider a 25 year-old worker with a $7,000 involuntary rollover to an IRA as of January 1, 2025, where monies were invested in capital preservation investments earning 3% for 42 years, until age 67 – which would accumulate to $24,225. That same $7,000 rollover, in a balanced fund (60% equity and 40% bonds) earning 8% per year would accumulate to $177,376 – a difference of $153,151.

retirement income purposes. …"

[95] Employee Benefits Research Institute (EBRI), Losing Ground Safely: Small IRAs' Large Stake in Money, October 1, 2020, Accessed Otober 30, 2024 at: https://www.ebri.org/docs/default-source/fast-facts/ff.364.ira2017.1oct20.pdf?sfvrsn=637a3a2f_8