United States Government Accountability Office

Report to Congressional Requesters

August 2016

401(K) PLANS

DOL Could Take Steps to Improve Retirement Income Options for Plan Participants

Accessible Version

GAO-16-433

GAO Highlights

Highlights of GAO-16-433, a report to congressional requesters

Why GAO Did This Study

As 401(k) plan participants reach retirement they face the challenge of making their savings last for an unknown lifespan, and many 401(k) plan sponsors do not offer options to help participants with this complex task. GAO was asked to review any related challenges and potential changes to help plan sponsors and participants.

This report examines, among other things, what is known about the adoption of lifetime income options in 401(k) plans, barriers that deter plan sponsors from offering such options, and the defaults that exist for participants who do not choose a lifetime income option. GAO administered a non-generalizable questionnaire to record keepers, conducted a non-generalizable survey of 54 plan sponsors, and interviewed a range of stakeholders.

What GAO Recommends

GAO makes seven recommendations to DOL, including that it clarify the criteria to be used by plan sponsors to select an annuity provider, consider providing limited liability relief for offering an appropriate mix of lifetime income options, issue guidance to encourage plan sponsors to select a record keeper that offers annuities from other providers, and consider providing RMD-based default lifetime income to retirees. DOL generally agreed, and described actions it would take to address the intent of the recommendations.

View GAO-16-433. For more information, contact Charles A. Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

August 2016

401(K) PLANS

DOL Could Take Steps to Improve Retirement Income Options for Plan Participants

What GAO Found

Workers relying in large part on their 401(k) plan in retirement may not always have a feasible way to make their savings last throughout retirement. Responses to GAO's non-generalizable questionnaire from 11 401(k) plan record keepers—entities that manage participant account data and transactions for plans—showed that most plans covered by the questionnaire had not adopted products and services that could help participants turn their savings into a retirement income stream (referred to as lifetime income options in this report). Responses to the questionnaire represented more than 40 percent of all 401(k) assets and about a quarter of plans at the end of 2014. GAO found that of the plans covered by the questionnaire, about two-thirds did not offer a withdrawal option —payments from accounts, sometimes designed to last a lifetime—and about three-quarters did not offer an annuity—arrangements that can guarantee set payments for life.

Concerns about legal risks and record keeper constraints may deter many plan sponsors—typically employers that provide 401(k) plans and establish investment and distribution options—from offering lifetime income options. The Department of Labor (DOL) issues regulations and guidance for plan sponsors and is responsible for educating and assisting them to help ensure the retirement security of workers. For example, DOL has prescribed steps plan sponsors can take to satisfy their fiduciary duties (i.e. act prudently and in the best interest of participants) when selecting an annuity provider for a 401(k) plan. However, according to industry stakeholders GAO interviewed, those steps are not often used because they include assessing "sufficient" information to "appropriately" conclude that the annuity provider will be financially able to pay future claims without definitions for those terms. Without clearer criteria to select an annuity provider, fear of liability may deter plan sponsors from offering annuities. Further, GAO found that a mix of lifetime income options to choose from is not usually available. DOL provides an incentive in the form of limited liability relief to plan sponsors who, among other things, provide participants at least three diversified investment options. However, no such incentive exists for plan sponsors offering a mix of lifetime income options. Without some degree of liability relief, plan sponsors may be reluctant to offer a diverse mix of lifetime income options to their participants. Lastly, stakeholders told GAO that record keepers may make only their own annuities available to the plans they service. DOL provides guidance on selecting service providers, but it does not encourage plan sponsors to seek choices from their service providers, which may prevent plans from having appropriate annuity options available to offer participants.

Required minimum distributions (RMD) can offer a default for those who do not choose a lifetime income option by setting a minimum amount of taxable 401(k) income for those age 70 ½ or older, based on life expectancy. Some plan sponsors know how to administer RMDs, and some already choose to provide RMD payments calculated to last a lifetime. However, DOL's guidance on default lifetime income is focused on a particular annuity type used only by a few plans. By issuing guidance encouraging plans to consider letting RMDs be the default distribution process for retiring participants, DOL may help create lifetime income for participants who do not choose an option.

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Abbreviations

DB	defined benefit
DC	defined contribution
DOL	Department of Labor
EBSA	Employee Benefits Security Administration
ERISA	Employee Retirement Income Security Act of 1974
GMWB	Guaranteed Minimum Withdrawal Benefit
IRA	Individual Retirement Account
IRC	Internal Revenue Code
IRS	Internal Revenue Service
NAIC	National Association of Insurance Commissioners
PPA	Pension Protection Act of 2006
QLAC	Qualifying Longevity Annuity Contract
QDIA	Qualified Default Investment Alternative
RFI	Request for Information
RMD	Required Minimum Distribution
TDF	Target Date Fund
Treasury	Department of the Treasury
TSP	Thrift Savings Plan

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August 9, 2016

The Honorable Robert C. "Bobby" Scott
Ranking Member
Committee on Education and the Workforce
House of Representatives

The Honorable Elizabeth Warren
United States Senate

The importance of 401(k) plans as a source of lifetime income is growing as an unprecedented number of workers are now reaching retirement and facing the responsibility of managing their retirement savings account. Since the inception of 401(k) plans, the Department of Labor (DOL) and the Department of the Treasury (Treasury) have focused on ensuring that plan participants accumulate savings for retirement, and have recently begun to focus on how participants spend down these savings.[1] Plan participants today typically must take responsibility for identifying and developing a retirement strategy to ensure income for the remainder of their lives. Those who fail to do so face the risk of outliving their savings and relying primarily on Social Security.[2]

Plan sponsors have been encouraged to offer options within 401(k) plans that provide some level of guaranteed income over the course of participants' lives. Yet, many plan sponsors may still be reluctant to offer lifetime income options, and plan participants may be inclined to avoid committing to a lifetime income strategy when faced with a distribution decision at retirement. Given the current state of lifetime income options in 401(k) plans, you asked us to review challenges and potential changes to help plan sponsors and participants. This report addresses the following questions.

[1]Created by the Revenue Act of 1978, (Pub. L. No. 95-600, § 135(a), 92 Stat. 2763, 2785-87), 401(k) plans have become the most common employee retirement savings vehicle in the United States.

[2]We have reported that Social Security provides most of the retirement income for about half of households age 65 and over, see GAO, *Retirement Security: Most Households Approaching Retirement Have Low Savings*, GAO-15-419 (Washington, D.C.: May 12, 2015).

1. What is known about the adoption of lifetime income options in 401(k) plans?
2. What barriers, if any, deter plan sponsors from offering lifetime income options?
3. What challenges, if any, do participants face in learning to make informed decisions about lifetime income options?
4. What defaults exist for participants who do not choose a lifetime income option?

To better understand the adoption of lifetime income options in 401(k) plans, we administered a questionnaire to 11 401(k) plan record keepers that together accounted for approximately 42 percent of the 401(k) plan market as measured by plan assets, 46 percent as measured by participants, and 26 percent as measured by the number of plans, as of December 2014. To examine what barriers, if any, deter plan sponsors from offering lifetime income options, we conducted a non-generalizable online survey of plan sponsors through industry organizations such as PLANSPONSOR, the Plan Sponsor Council of America, the National Association of Plan Administrators and BenefitsLink. To assess the challenges participants may face in learning to make informed decisions about lifetime income options, we reviewed a non-generalizable sample of the written information some 401(k) plan sponsors provide to participants when they leave an employer, referred to as separation packets. We obtained separation packets from participants and industry stakeholders we interviewed, as well as from publicly available sources such as plan websites. We also obtained and reviewed examples of information, such as lifetime income illustrations, that some service providers make available for plan sponsors to include in benefit statements or on plan websites to help participants plan for retirement. To examine what defaults exist for participants who do not select a lifetime income option, we coordinated with Boston Research Technologies, a research firm.[3] To review the survey methodologies we interviewed individuals knowledgeable about the methodology and compared selected survey responses against data from other large samples of

[3]Boston Research Technologies agreed to include questions we developed in their survey of defined contribution plan participants and share the results of a second survey they conducted simultaneously. We reviewed the surveys' methodologies and report the surveys' findings.

401(k) participants. We found the survey responses to be reflective of the broader population of 401(k) plan participants and as a result, we generalize the survey responses to that population. To answer all these questions, we reviewed relevant research; industry publications; and federal laws, regulations, and guidance on lifetime income options in 401(k) plans. We also interviewed industry stakeholders, researchers, and government officials—including officials from DOL's Employee Benefits Security Administration (EBSA) as well as from the Department of the Treasury's (Treasury) Office of Tax Policy, Federal Insurance Office, and Internal Revenue Service (IRS). This report builds on a variety of past GAO work in this area, and a list of related reports is included at the end of this product. Appendix I provides additional information on our scope and methodology.

We conducted this performance audit from July 2014 to August 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Lifetime Income Options

At retirement, participants in 401(k) plans enter the distribution—or "spend-down" —phase during which they typically use their savings to meet their retirement needs.[4] Typically, participants can choose to take a payment of their entire account balance, referred to as a "lump sum" payment, or they can roll their account over to an Individual Retirement Account (IRA) to preserve tax advantages on their savings. In contrast,

[4]We have reported on the difficulty many participants have accumulating sufficient assets in a 401(k) plan to meet their retirement needs. See GAO-15-419.

defined benefit plan (DB) participants must be offered an annuity,[5] though a lump sum payment can also be offered. Participants who receive lump sums generally must decide on their own how best to make their money last throughout retirement. Some participants have access to products and services through their plan that can help them turn their savings into a retirement income stream. In 401(k) plans, these generally fall into two categories:

- Withdrawal options are a series of fixed or variable payments from a participant's account. Participants may be able to set monthly payments as a fixed dollar amount, a percent of their account balance, or according to systematic withdrawal strategies designed—but not guaranteed—to stretch their savings over a set period of time or for life.
- Annuities are guaranteed payments, normally purchased through a contract with an insurance company for either a set period or for the participant's life. Annuities come in a variety of forms. For example, deferred annuities enable the participant to delay the start date of payments until as late as age 85.

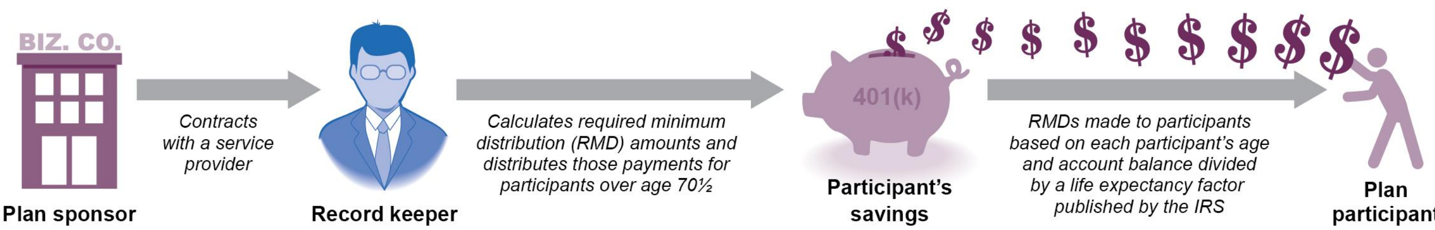
Required Minimum Distributions

Under the Internal Revenue Code (IRC), plan sponsors must comply with required minimum distribution (RMD) provisions under which participants age 70 ½ or older in 401(k) plans must receive minimum annual payments from their plan savings based on their account balance and

[5] 29 U.S.C. § 1055(a) and (b). Pension plans are generally classified as either defined contribution (DC) or defined benefit (DB) plans. 29 U.S.C. § 1002(34) and (35). DB plans typically offer a fixed level of monthly retirement income based upon a formula specified in the plan (which often takes into account factors like years of service and age at retirement), regardless of how the plan's investments perform. In DC plans, benefit levels depend on the contributions made to the plan and the performance of the investments in individual accounts, which may fluctuate in value over time.

remaining life expectancy.[6] Plan sponsors may have their service provider, such as their record keeper or a third party administrator, administer RMDs by calculating and issuing payments to plan participants (see fig. 1). Typically, participants age 70 ½ or older who have not self-initiated withdrawals will automatically receive payments administered by their record keeper or third party administrator pursuant to RMD calculations. For participants who make insufficient withdrawals, the record keeper will typically issue payments for the amount of the difference to meet RMD requirements.[7]

Figure 1: Plan Administration of Required Minimum Distributions (RMD)



Source: GAO analysis of agency and industry documents and stakeholder interviews. | GAO-16-433

Retirement Risks

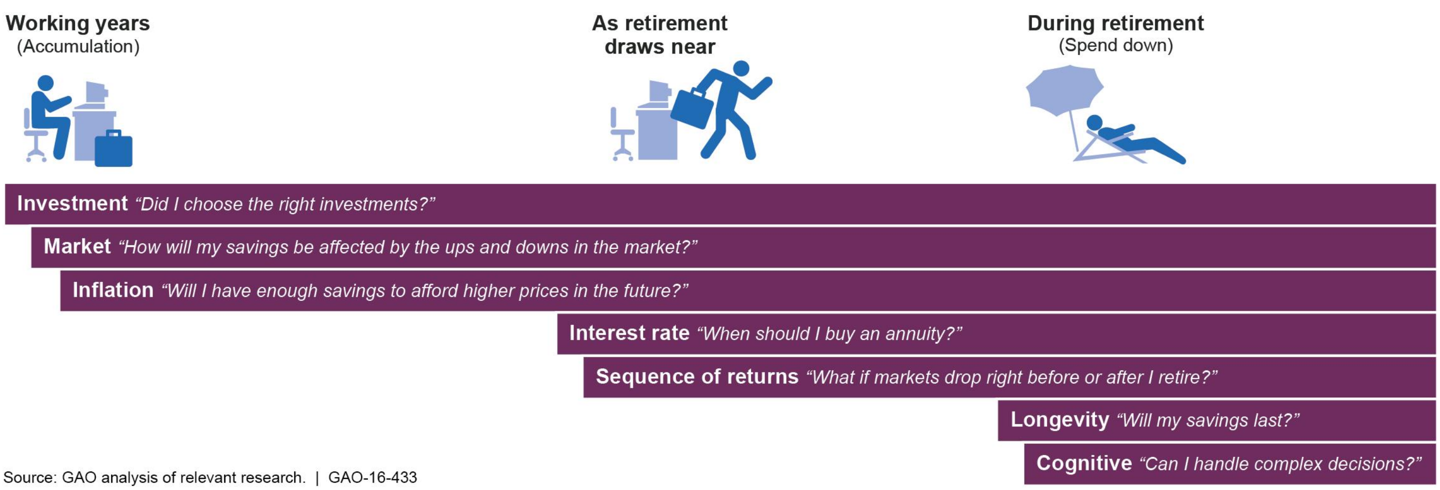
Participants may face various risks as they enter retirement, some of which are new and different from those they may have become accustomed to as they accumulated savings. For example, as shown in

[6]RMDs generally apply to participants who have retired and remain in the plan (or another qualified tax-deferred account) after age 70 ½. 26 U.S.C. §§ 401(a)(9) and 408(a)(6). RMD's do not apply to plan participants older than 70 ½ continuing to work and not yet retired, unless the individual is at least a 5 percent owner of the business sponsoring the retirement plan. 26 U.S.C. § 401(a)(9)(C). An excise tax is imposed equal to 50 percent of the amount by which the RMD exceeds the actual amount distributed during the taxable year, paid by the participant. 26 U.S.C. § 4974. The RMD is generally calculated annually for each account by dividing the prior December 31st account balance by a life expectancy factor that IRS publishes in tables in Publication 590-B. The life expectancy factor is reduced incrementally as the participant ages. Although withdrawal amounts under RMDs will vary year to year due to its calculation method, the payments continue for the life of the participant. Plans remain free, however, to distribute amounts greater than the RMD.

[7]Any previously provided distributions during the year are taken into account before RMDs are paid, and if they equal or exceed the RMD no additional payment is required.

figure 2, during both their working and retirement years participants may face the risk that poor investment returns will lead to lower than expected savings and the risk that inflation may erode the value of their savings as prices rise. Additionally, poor investment returns just prior to or just after retirement can substantially affect how long their savings will last. This is known as “sequence of returns” risk and it can have a serious effect on retired participants who have less ability to make up for lost of savings through increased contributions or longer employment.[8] Participants who use a portion of their savings to purchase an annuity face the risk that low interest rates at the time of their purchase will negatively affect the amount of guaranteed income they can secure. Later in retirement, participants may also face cognitive decline that affects their ability to manage their savings.

Figure 2: Making 401(k) Savings Last for Life May Involve More Risks than Accumulating Savings



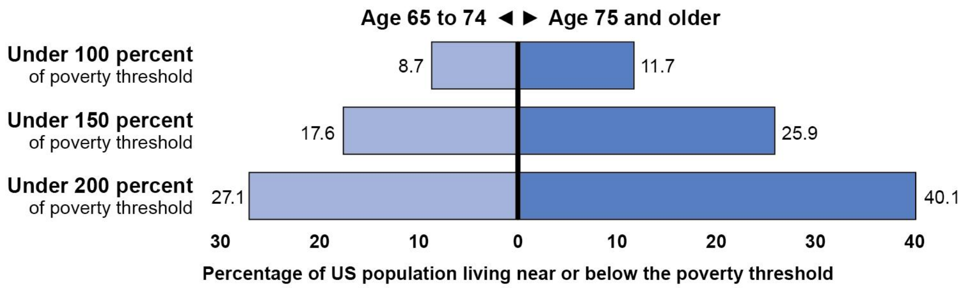
Source: GAO analysis of relevant research. | GAO-16-433

In retirement, participants also face “longevity” risk; that is, the risk that they will outlive their retirement savings. Longevity can be particularly challenging for participants because it poses the overarching risk that the longer a participant lives in retirement, the greater that participant is

[8]For more on the sequence of returns risk, see GAO, *Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices*, GAO-11-400 (Washington, D.C.: June 7, 2011).

exposed to other retirement risks.[9] For example, increased longevity can mean that there is a greater range of potential future investment outcomes and a longer period over which inflation may erode the purchasing power of available savings. Figure 3 may partially reflect the effects of longevity risk, as those over 75 are more likely to find themselves near or below the poverty line.

Figure 3: Aging Americans' Income Relative to the Poverty Threshold



Source: U.S. Census Bureau, Current Population Survey, 2015 Annual Social and Economic Supplement. | GAO-16-433

Note: Data pertain to individual people rather than households. While only those individuals below 100% of the poverty threshold are considered to be living in poverty, the income-to-poverty ratio showing how close individuals are to poverty is one descriptor of an individual's economic well-being. The Current Population Survey Annual Social and Economic Supplement is the source of the official poverty estimates made by the Census Bureau. It is a sample survey of approximately 100,000 households nationwide. These data reflect the conditions in calendar year 2014, the most recent data available.

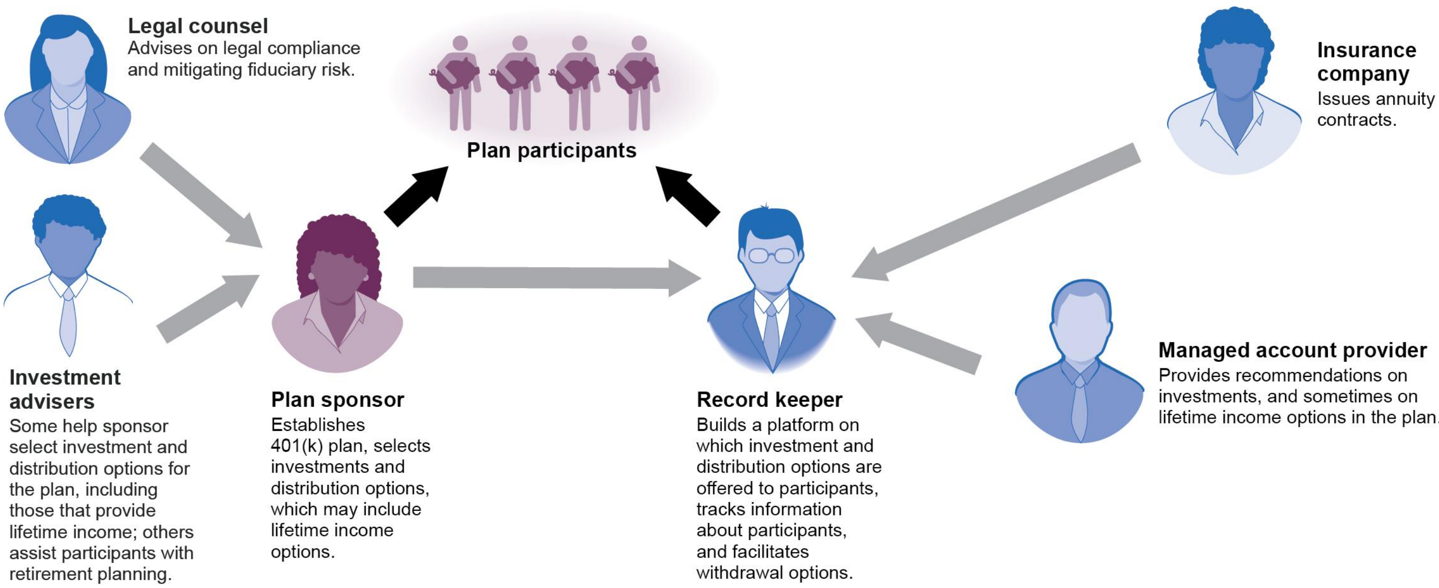
Providers of Lifetime Income Options to 401(k) Plans

Plan sponsors may hire companies to provide services and products that help participants use their savings to generate lifetime income and achieve other retirement goals. As shown in figure 4, service providers, such as legal counsel and investment advisers may help plan sponsors select appropriate lifetime income options for their participants. Record keepers play a particularly important role with respect to in-plan lifetime income options. They both administer withdrawal options for participants and build and maintain the record keeping platforms on which annuities are sometimes made available for plan sponsors to adopt for their participants. Plan sponsors may also contract with one service provider to provide multiple services to the plan. For example, a plan might contract

[9]For more on longevity risk, see GAO, *Retirement Security: Shorter Life Expectancy Reduces Projected Lifetime Benefits for Lower Earners,* GAO-16-354 (Washington, D.C.: March 25, 2016)

with a record keeper that is also an insurance company providing both record keeping and annuities for participants, among other services.

Figure 4: Service Provider Arrangements for Lifetime Income Options in 401(k) Plans



Source: GAO analysis of agency and industry documents and stakeholder interviews. | GAO-16-433

Note: This graphic represents an example of service provider arrangements and demonstrates how different service providers may be involved in working with plan sponsors to arrange for lifetime income options. Plan sponsors may also use one entity, sometimes referred to as a bundled service provider, to provide multiple services to the plan. The bundled service provider directly employs or contracts with an array of service providers to offer a number of services.

401(k) Plan Market

As of December 31, 2014, 401(k) plans represented more than $4 trillion in assets, nearly 500,000 plans, and more than 60 million participants. As shown in table 1, small defined contribution (DC) plans—those with less than $10 million in assets—represent about 95 percent of DC plans while large plans—those with assets greater than $200 million—make up a majority of assets and participants.[10]

[10]This is based on the results of PLANSPONSOR's 2015 Recordkeeping Survey to defined contribution plan record keepers, which provided the most current data available on the 401(k) plan market at the time of our analysis.

Table 1: Total Defined Contribution Assets, Plans, and Participants by Plan Size, as of December 31, 2014

Plan Size	Assets	Plans	Participants
Small	13%	95%	23%
Mid	23%	5%	29%
Large	64%	<1%	48%

Source: PLANSPONSOR 2015 Recordkeeping Survey. | GAO-16-433

Note: 401(k) plans represent about 73 percent of assets, 64 percent of plans, and 69 percent of participants within the defined contribution market, as of December 31, 2014. We refer to "small" plans as those with assets under $10 million, "mid-size" plans as those with assets between $10 and $200 million, and "large" plans as those with assets greater than $200 million. All figures rounded to the nearest percent.

Retirement Income in Other Countries

We previously reported that other nations with account-based retirement systems have taken steps to help participants develop a lifetime income strategy.[11] Five of the six countries we reviewed generally ensured that participants could choose among a lump sum, a withdrawal option, or an annuity. All six developed innovative approaches and strategies to help mitigate the financial risks participants face in securing adequate retirement income.

Oversight of Retirement Plans

EBSA is the primary agency responsible for protecting pension plan participants from misuse or theft of their pension assets as specified under Title I of the Employee Retirement Income Security Act of 1974 (ERISA). Other statutory provisions applicable to 401(k) plans, such as minimum distribution requirements, are also set out in the Internal Revenue Code. ERISA is generally enforced by DOL's EBSA, while Treasury's IRS enforces applicable provisions of the Internal Revenue Code and is responsible for determining if plans qualify to receive preferential tax treatment. Treasury's Office of Tax Policy develops and implements tax policies and programs and reviews regulations and rulings to administer the Internal Revenue Code. State insurance regulators are responsible for enforcing state insurance laws and regulations, which typically involves reviewing insurance products and

[11]GAO, 401(k) Plans: *Other Countries' Experiences Offer Lessons in Policies and Oversight of Spend-down Options*, GAO-14-9 (Washington, D.C.: Nov. 20, 2013). The six countries we reported on were Australia, Canada, Chile, Singapore, Switzerland, and the United Kingdom.

their rates and examining insurers' financial solvency and market conduct. To carry out its responsibilities, EBSA issues regulations and guidance; investigates complaints involving plan sponsors,[12] fiduciaries, and service providers; seeks appropriate remedies to correct legal violations; and pursues litigation when it deems necessary. As part of its mission, DOL is also responsible for assisting and educating plan sponsors to help ensure the retirement security of workers and their families. Title I sets standards of conduct and requires accountability for the people who run or provide investment advice to plans, known as plan fiduciaries,[13] and requires administrators to provide participants with certain disclosures, including periodic benefit statements as well as summary plan descriptions.

DOL and Treasury Actions on Lifetime Income for Participants and Their Beneficiaries

In recent years, DOL and Treasury have taken a number of steps to protect beneficiaries by attempting to help plan sponsors and their providers offer lifetime income options. For example:

- In 2008, EBSA promulgated a "safe harbor" that describes actions plan fiduciaries can take to satisfy their fiduciary responsibilities when selecting an annuity provider.[14]

[12]We use the term "plan sponsors" generally in this report, but in some circumstances the requirements would apply to plan sponsors, plan fiduciaries, or plan administrators, which may be the same entity or different entities, depending on the situation.

[13]Under ERISA, a fiduciary is anyone, such as a sponsor, trustee, investment adviser, service provider, or other person, to the extent they exercise any discretionary authority or control over plan management or any authority or control over the management or disposition of plan assets, or renders investment advice respecting plan money or property for a fee or other compensation, or have discretionary authority or responsibility for plan administration. 29 U.S.C. § 1002(21)(A).

[14]Selection of Annuity Providers--Safe Harbor for Individual Account Plans. 73 Fed. Reg. 58,447 (Oct. 7, 2008) (codified at 29 C.F.R. § 2550.404a-4). DOL provided guidance on the rule in 2015. It clarified that the duty to periodically monitor an annuity provider stops when the plan stops offering the annuity as a distribution option to plan participants. DOL Field Assistance Bulletin 2015-02 (July 13, 2015). It also clarified application of the relevant statute of limitation on claims that fiduciaries breached their duties when selecting an annuity provider.

- In 2010, Treasury and EBSA published a request for information (RFI) on expanding lifetime income options in 401(k) plans and received 793 submissions.[15]
- In 2012, IRS explained how a plan sponsor with both a defined benefit plan and a defined contribution plan (such as a 401(k) plan) can allow participants to use their defined contribution account balance to increase their defined benefit plan life annuity payments.[16]
- In 2013, EBSA published a notice that it was considering a proposal requiring participant benefit statements to include an illustration of 401(k) account balances as a stream of lifetime income payments.[17]
- In 2014, IRS amended finalized a rule to allow for the use of qualifying longevity annuity contracts (QLAC) in 401(k) plans, and it amended its RMD regulations to provide for specified annuities beginning payments after the participant reaches age 70 ½ to not be included when calculating RMDs.[18] That same year, EBSA and IRS also clarified how a deferred annuity—an annuity that makes payments that begin in the future rather than at the time of purchase—can be included in a target date fund (a common default investment used by 401(k) plans).[19]

[15]Request for Information Regarding Lifetime income Options for Participants and Beneficiaries in Retirement Plans, 75 Fed. Reg. 5253 (Feb. 2, 2010). (Available at http://www.dol.gov/ebsa/regs/cmt-1210-AB33.html).

[16]Rev. Rul. 2012-4, 2012-1 C.B. 386. Amounts transferred to DB plans under this revenue ruling were also given higher priority that other DB benefits in case of plan termination by PBGC. 79 Fed. Reg. 70090 (Nov. 25, 2014). IRS also issued guidance on how qualified joint and survivor annuity rules apply to 401(k) plans. *Rev. Rul. 2012*-3, 2012-1 C.B. 383.

[17]Pension Benefit Statements, 78 Fed. Reg. 26,727 (May 8, 2013).

[18]Longevity Annuity Contracts. 79 Fed. Reg. 37,633 (July 2, 2014). Under the regulations, minimum distribution requirements do not apply to the assets used to purchase a QLAC until payments begin, which can be as late as age 85.

[19]Specifically, IRS issued a notice providing guidance for plans to integrate deferred annuities into target date funds (TDF) intended for workers close to retirement without violating nondiscrimination rules when used as a qualified default investment alternatives (QDIA) under the Internal Revenue Code. IRS Notice 2014-66, 2014-2 C.B. 820. EBSA also clarified that the use of these types of TDFs may meet the requirements of the QDIA regulations. *Letter from Phyllis C. Borzi, Assistant Secretary for Employee Benefits Security, Dept. of Labor, to J. Mark Irwy, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy, Dept. of the Treasury* (Oct. 23, 2014) *(available at http://www.dol.gov/ebsa/regs/ILs/il102314.html).*

DOL, Treasury, and the Administration have also taken steps that may help participants implement a retirement strategy. On April 8, 2016, DOL promulgated regulations that treat as a plan fiduciary anyone who furnishes investment advice or recommendations to an employee benefit plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner; establishes that such investment advice must be in the best interest of participants; and provides for participants to hold those who furnish them investment advice to account under ERISA.[20] Furthermore, in an action that could have an impact on those participants who do not make decisions about their 401(k) account, in September, 2015, President Obama issued a Behavioral Science Insights Policy Directive to encourage the design of government policies that better serve the American people.[21] The President noted that automatic enrollment and escalation in retirement savings plans have made it easier for Americans to accumulate retirement savings, and he called for federal agencies, applying behavioral science insights, to give particular consideration to the selection and setting of default options when individuals are presented with choices.

Most Plans in Our Review Did Not Offer Withdrawal Options or Annuities, and Many Did Not Allow Partial Annuitization

[20]Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 8, 2016).

[21]*Exec. Order No. 13,707, 80 Fed. Reg. 56,365 (Sept. 18, 2015),* and https://www.whitehouse.gov/the-press-office/2015/09/15/executive-order-using-behavioral-science-insights-better-serve-american.

About Two-Thirds of Plans in Our Review Did Not Offer Withdrawal Options

Record keepers reported that most plans covered by the questionnaire did not offer withdrawal options, which unlike annuities, are 401(k) plan account distributions that may be designed, but are not guaranteed, to last for life. In addition to providing lump sums, record keepers reported that roughly a third of plans covered by our record keeper questionnaire adopted some form of a withdrawal option, including installment payments, systematic withdrawals, or managed payout funds.[22] We sent a questionnaire to a non-generalizable sample of plan record keepers that represented about a quarter of the 401(k) plan market at the end of 2014.[23] Plans generally do not have to provide participants with distribution options that will help them secure lifetime income in retirement. Plans can provide lump sum distributions of participants' entire account balances and remove participants from the plan after participants reach the plan's retirement age.[24] However, when made available by plans, withdrawal options allow participants access to their 401(k) plan account throughout retirement. Withdrawal options can be structured in a variety of ways, some designed, but not guaranteed, to stretch a participant's savings throughout retirement (see table 2).

[22]For this report, we categorize each of the following types of arrangements that can help participants secure retirement income over time as a "withdrawal option": installment payments, systematic withdrawals, and managed payout funds. This categorizations is consistent with other research that groups together different 401(k) plan withdrawal strategies where payments are not guaranteed by an insurer. A lump sum distribution (a distribution of the entire account balance) is a distribution option 401(k) plans provide and is not considered to be a withdrawal option in this report. Because plans may comply with Required Minimum Distributions (RMD) using a lump sum rather than with multiple distributions determined under the provisions, we did not consider plans complying with RMD provisions to be offering systematic withdrawals. We do not include allowable pre-retirement distributions, such as hardship withdrawals or loans. About a third of plans covered by our record keeper questionnaire offered installment payments, systematic withdrawals, managed payout funds, or other withdrawal options—excluding RMDs—and some of those plans may offer more than one withdrawal option to participants.

[23]We contacted 22 record keepers that serve 401(k) plans for data on plan adoption and participant use of lifetime income options on their platform. Eleven record keepers responded to our questionnaire, 9 of whom provided data as of the calendar year ending December 31, 2014. The remaining 2 record keepers provided data for more recent reporting periods. Our record keeper questionnaire responses represent about 42 percent of the 401(k) market as measured by plan assets, about 46 percent by participants, and about 26 percent as measured by plans. Our record keeper questionnaire responses are not a representative sample of the 401(k) plan market.

[24]26 C.F.R. § 1.401(a)-1.

Table 2: Descriptions of Selected Types of Withdrawal Options

Withdrawal Option	Basic Description
Installment payments	These self-managed withdrawals are made over a period of time and can include one-time withdrawals of a portion of an account balance, sometimes referred to as partial withdrawals. Installment payments may be used as part of a strategy to meet retirement income needs, but they generally are intended to accommodate a specific one-time or short-term purpose.
Systematic withdrawals	These withdrawals are initiated by the participant and administered by the plan record keeper and stretch a participant's savings across retirement. Withdrawal amounts may be set by participants for a specific monthly or annual amount (e.g., $1,000) or for a percentage (e.g., 4 percent) of their remaining account balance, and can either be fixed or adjusted for inflation. Systematic withdrawals can also be informed by strategies and rules, such as those determined through a participant's use of planning tools or by applying calculations the Internal Revenue Service (IRS) uses to determine a participant's required minimum distributions.
Managed payout funds	These investments are designed to generate a regular monthly distribution amount for participants. Participants invest in managed payout funds as they would other investments made available by the plan sponsor with monthly payments made by the investment manager or adviser company. The monthly amount can vary from time to time based on the performance of the underlying investments, and can be structured to liquidate the entire balance over a set period of time or pay out a percentage of assets in perpetuity.

Source: GAO analysis of government and industry documents. | GAO-16-433

Record keepers reported that mid-size and large plans covered by our questionnaire had the highest adoption rates of withdrawal options and were also more likely to make sophisticated withdrawal options available to participants.[25] As shown in figure 5, these mid-size and large plans had higher adoption rates of both installment payments and systematic withdrawals than small plans.[26] One plan adviser we interviewed suggested this variation in adoption rates is due to small plans' persistent view of 401(k) plans principally as an asset accumulation vehicle and a lack of focus on helping participants with their retirement income needs.

[25]We refer to "small" plans as those with assets of less than $10 million, "mid-size" plans as those between $10 and $200 million, and "large" plans as those with assets greater than $200 million. Our record keeper questionnaire requested information on plan adoption and participant use of lifetime income options in the aggregate and across plan size categories by total assets—less than $10 million; between $10 and $200 million; greater than $200 million to $1 billion, and over $1 billion. See Appendix I for more details.

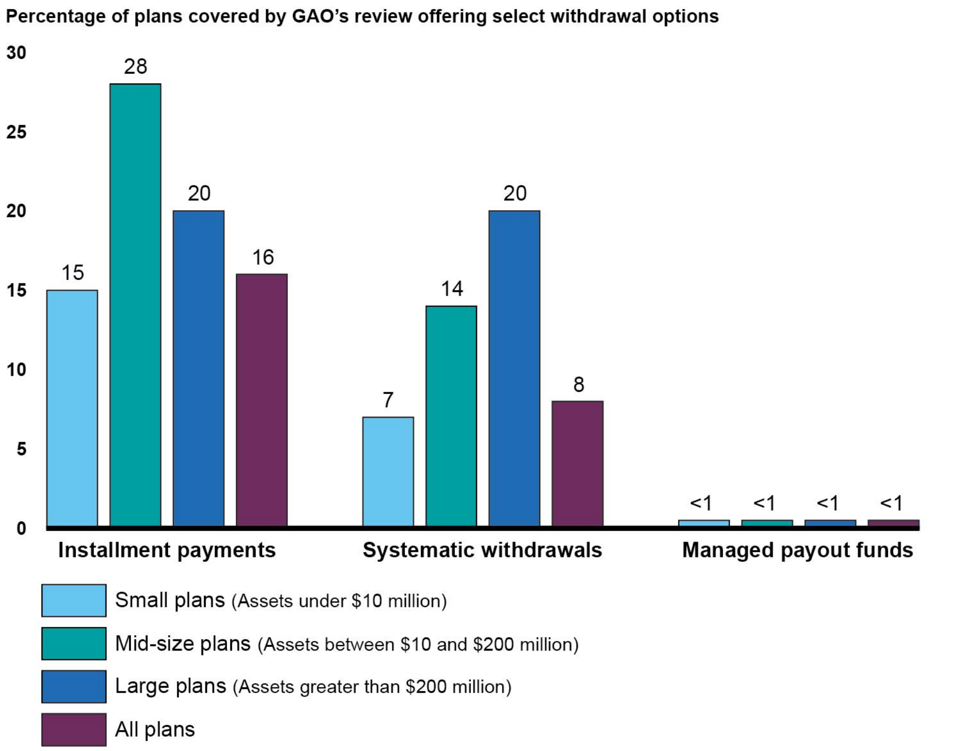
[26]Two record keepers who responded to our questionnaire noted that their information systems do not distinguish between an "installment program" and "systematic withdrawals" as we have defined them and provided plan adoption data on withdrawal options in the aggregate, which are not included in this comparison.

Further, this plan advisor and other industry stakeholders noted that sponsors of larger plans are better positioned to negotiate reductions in, or waivers from, the fees record keepers charge for administering withdrawal options, which could affect their adoption.[27] Similarly, figure 5 shows record keepers reported that mid-size and large plans covered by our questionnaire had at least twice the adoption rate of systematic withdrawal options as small plans. Industry stakeholders indicated that systematic withdrawal options are generally more prevalent among larger plans because they have more experience offering withdrawal options. These industry stakeholders explained that because of this greater level of experience with offering withdrawal options, larger plans may also be more comfortable offering more sophisticated options like systematic withdrawals. Record keepers reported that a few plans covered by our questionnaire adopted managed payout funds, but unlike other withdrawal options, such as installment payments and systematic withdrawals, that are available among all the record keepers who responded to our questionnaire, industry stakeholders told us managed payout funds are not readily available as an in-plan option.[28] In addition, industry stakeholders told us that managed payout funds are found primarily outside of 401(k) plans in the retail market.

[27]Industry stakeholders told us that record keepers might typically charge participants anywhere from $25 to $50 for each withdrawal distribution from participant accounts per withdrawal. They indicated that medium and large plans are more likely to have the leverage with their record keeper to reduce or waive these fees. In contrast, they noted that smaller plans may not be able to negotiate similar terms because record keepers cannot recoup these fees as easily as they can from larger plans.

[28]According to our record keeper questionnaire, three plans adopted managed payout funds. Aside from managed payout funds, all 11 of the record keepers who responded to our questionnaire are able to accommodate plans providing some form of a voluntary withdrawal arrangement, including installment payments and systematic withdrawals.

Figure 5: Selected 401(k) Plan Adoption Rates for Withdrawal Options by Plan Size



Source: GAO analysis of 401(k) plan record keeper questionnaire data. | GAO-16-433

Note: "Adoption rates" refer to the percentage of plans that had adopted each withdrawal option by plan size. Some plans may make more than one withdrawal option available to participants. All figures rounded to the nearest percent.

For an illustration of how RMDs can provide monthly retirement income from 401(k) plans savings, see our interactive retirement models at www.gao.gov/products/gao-16-433.
Source: GAO | GAO-16-433

Although RMDs have not been identified by EBSA or IRS as a default systematic withdrawal option, RMDs can serve that purpose for retirees who remain in the plan beyond age 70 ½ if they are calculated to provide minimum amounts based on a retiree's life expectancy and account balance. Plans may and do also adopt other methods that satisfy the RMD provisions. Withdrawals can satisfy those provisions as long as the distributions from those options are as much or more than the applicable RMDs, such as when plans only offer lump sum withdrawals of the entire account balance. Therefore, the RMD provisions can be met without providing participants with payments based on life expectancy. In fact, industry research has shown that many plans do not allow retired participants to take partial withdrawals; instead, retirees must either withdraw their entire account balance or forgo withdrawing any funds.[29] Further, according to a record keeper, some plans may require participants to take lump sum distributions of their entire account balance before reaching age 70 ½ to avoid having to administer RMDs.[30] Similarly, a lump sum distribution for a participant age 70 ½ or older would also allow a plan sponsor to meet RMD requirements. However, none of these practices help to provide participants with lifetime retirement income.

About Three-Fourths of Plans in Our Review Did Not Offer an Annuity Option

Record keepers reported that about three-quarters of plans covered by our questionnaire did not offer an income annuity. Among the options offered by roughly a quarter of plans in our record keeper questionnaire were fixed immediate annuities, guaranteed minimum withdrawal benefits (GMWB),[31] and deferred annuities (see table 3 for a description of each option).[32] Plans adopt annuity options to allow participants to secure guaranteed income for retirement from their 401(k) plan savings. Annuity options are structured in a variety of ways, such as the timing of its

[29]According to a recent study by Vanguard, 87 percent of plans for which they serve as record keeper require terminated participants to take a distribution of their entire account balance if a partial distribution is desired. The same study reported that fewer than 1 in 5 retired participants remain in their plan 5 years after they left their employer and cited the influence of plan rules for partial distributions on participant behavior. Young, Jean A., Retirement Distribution Decisions Among DC Participants—An update. Vanguard (September 2015).

[30]One record keeper indicated that some plans impose a “70½ and out” rule; that is, they require participants to take a full lump sum distribution by age 70½ to avoid having to calculate and pay RMDs to participants that could lead to errors resulting in legal liability and plan disqualification.

[31]GMWBs are products that may also be referred to as GLWB, which stands for Guaranteed Lifetime Withdrawal Benefit.

[32]For this report, we categorize the following types of arrangements that can help participants secure guaranteed lifetime income as an “annuity option”: fixed immediate annuities, GMWBs, deferred annuities, and annuity shopping platforms (see table 3). This categorization is consistent with other research that generally groups together products that are guaranteed by an insurer as “annuity options”. All 11 record keepers who responded to our questionnaire accommodate at least one annuity option on their platform. Some plans may make more than one annuity option available to participants.

purchase or the beginning of payments, to meet different guaranteed retirement income needs of participants.

Table 3: Descriptions of Selected Types of Annuity Options

Type of annuity option	Basic description
Fixed immediate	This type of annuity provides an immediate guaranteed fixed income stream for a predetermined period of time, such as for the life of the contract holder or a specified number of years. Also known as a single-premium immediate annuity, this type of annuity is traditionally purchased in one transaction where, for example, a participant could buy it at retirement using a single payment from their retirement account. The price for a fixed immediate annuity is based on prevailing interest rates and longevity assumptions, among other considerations.
Guaranteed Minimum Withdrawal Benefit (GMWB)	This type of an annuity option is an insurance contract that can provide a guaranteed income stream, based on the performance of underlying investments, in exchange for recurring income guarantee fees. They are a hybrid of an investment and insurance product that allows participants to remain invested in the stock and bond markets and benefit from potential returns while providing an opportunity to generate guaranteed lifetime income at retirement. This hybrid also provides participants with continued liquidity and specified levels of guaranteed income in retirement, even if the invested account balance becomes insufficient or is depleted as a result of market downturns.
Deferred	These annuities provide a guaranteed fixed income stream that starts at a future date in exchange for a single premium or a series of premium payments beginning at the point of purchase. The income stream can begin a few or many years into the future. As a general principle, the longer an annuity is deferred, the higher the benefit payment. Deferred annuities with payments that do not begin until well after retirement are generally known as longevity annuities, with a qualifying longevity annuity contract (QLAC) being one that, among other things, defers payments to no later than the participant's 85th birthday. 26 C.F.R. § 1.401(a)(9)-6 at A-17(a)(2).
Annuity shopping platform	This option allows participants to compare and shop for annuities from competing insurers under uniform criteria and at rates that may be lower than in retail markets. To facilitate comparisons, the products available on platforms are generally standardized, and one platform provider told us it only offers fixed immediate and deferred annuities.

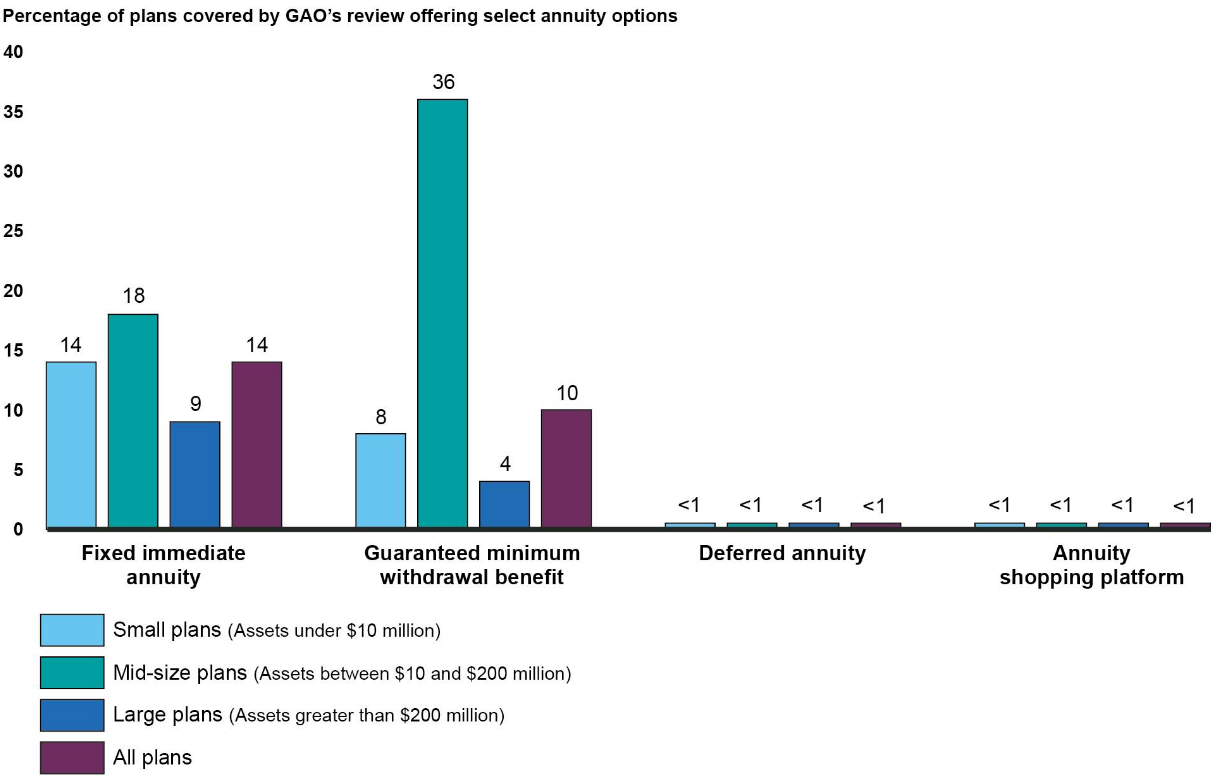
Source: GAO analysis of government and industry documents. | GAO-16-433

Record keepers reported that plans covered by our questionnaire most frequently adopted a fixed immediate annuity, a simple and traditional form of annuity benefit found in 401(k) plans that offered annuities. As shown in figure 6, small and mid-sized plans in our review had slightly higher adoption rates than large plans.[33] Some industry stakeholders told

[33]Among plans covered by our record keeper questionnaire that had adopted a fixed immediate annuity, small plans represented about 90 percent, mid-size plans nearly 10 percent, and large plans just under 1 percent. Small plans represent about 91 percent of plans covered by our record keeper questionnaire, mid-size plans about 8 percent, and large plans about 1 percent.

us that smaller plans generally have higher adoption rates of in-plan annuity options because they are more likely to use record keepers that are insurers and participate in group annuity contracts.

Figure 6: Selected 401(k) Plan Adoption Rates of Annuity Options by Plan Size



Source: GAO analysis of 401(k) plan record keeper questionnaire data. | GAO-16-433

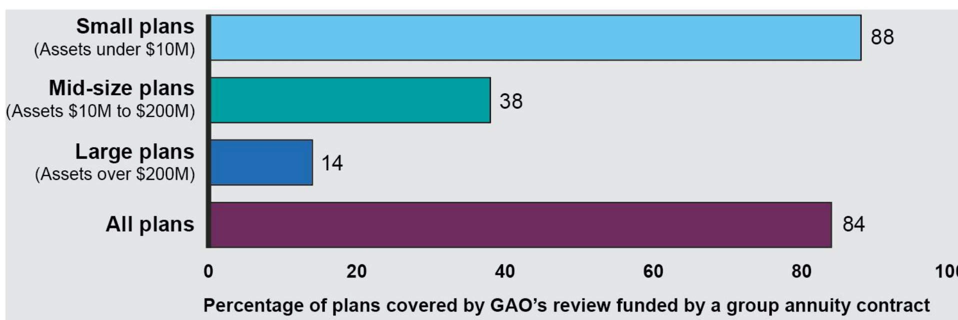
Note: "Adoption rates" refer to the percentage of plans that had adopted annuity options by plan size and are rounded to the nearest percent. Some plans may make more than one annuity option available to participants, see appendix 1 for more information.

What Are 401(k) Plan Group Annuity Contracts?

Record keepers reported that most small plans covered by our questionnaire are funded through the use of group annuity contracts, as shown in Figure 7. Group annuity contracts place a “wrapper” of benefits, namely an annuity or a minimum death benefit, around a bundle of investments that are similar to mutual funds. See Appendix III for an illustration of how group annuity contracts are used as a plan funding mechanism. We previously reported that some plan sponsors may be unaware that their plan is funded through a group annuity contract or may not know to consider the terms of the option. Industry stakeholders explained that even though group annuity contracts have provisions—including terms and rates—for participants to purchase or receive an annuity at retirement, they are principally used as a funding mechanism for insurers to administer plan assets and are therefore rarely used to provide lifetime income. One insurer said that the cost to administer a plan through a group annuity contract is competitive with those administered directly with investment funds. However, we previously reported that fees associated with group annuities can add significant costs to a plan (see GAO-12-325).

Source: GAO analysis of 401(k) plan record keeper questionnaire data, interviews with industry stakeholders, and previous GAO work | GAO-16-433

Figure 7: Selected 401(k) Plans Funded Using a Group Annuity Contract by Plan Size



Source: GAO analysis of 401(k) plan record keeper questionnaire data. | GAO-16-433

For an illustration of how a fixed immediate annuity purchase might affect projected retirement income provided by 401(k) plan savings, see our interactive retirement models at www.gao.gov/products/gao-16-433.

Source: GAO | GAO-16-433

Industry stakeholders also told us that a fixed immediate annuity is the most straightforward and simple annuity that plans can offer participants because they are typically purchased in one transaction at retirement and provide a specified benefit. Further, one stakeholder noted that fixed immediate annuities are relatively standardized and that their simplicity facilitates comparisons of providers' products. Several record keepers noted that products that are easier for participants to understand and for record keepers to implement, such as fixed immediate annuities, are more likely to be adopted by plans.

Small and mid-sized plans also represented nearly all of the plans from our record keeper questionnaire that adopted GMWBs, a more complicated product introduced in recent years to the in-plan market.[34] Similar to fixed immediate annuities, some stakeholders told us that GMWBs may be more prevalent among smaller plans because insurers, many of whom offer their own GMWB product, often perform recordkeeping and administrative functions for smaller plans and make their own product readily available. Industry stakeholders told us that because GMWBs are a hybrid investment and insurance product, they can provide unique benefits, but can also be difficult to understand. Some stakeholders told us that GMWBs can be beneficial for plans that focus on helping participants accumulate their savings because the product allows participants to remain invested in the stock and bond markets and benefit from potential returns while guaranteeing income against market downturns.[35] Because GMWBs allow participants to benefit from potential returns, the levels of guaranteed minimum withdrawal payments may also increase. In contrast, some other stakeholders indicated that the features of GMWBs that make it a flexible annuity option result in higher costs as

[34]According to our record keeper questionnaire, small and mid-sized plans represent more than 99 percent of all plan sponsors that had adopted GMWBs. One provider told us they launched their version of the product to select plans in recent years and another said they anticipated introducing their product soon.

[35]GMWBs provide a minimum level of insured lifetime income based on the value of investments in the product provided the participant does not withdraw more than a specified amount during retirement. Should the investments in the product become depleted by reasons of permitted withdrawals and/or adverse investment performance, the insurance company will continue payments of a guaranteed amount. The specifics of guarantees and resulting fees vary among different GMWB products. See Appendix II for an expanded general description of these products.

compared with other types of annuities. See Appendix II for an illustration of the ownership phases of a typical GMWB.

Despite recent agency actions to help facilitate the use of some types of deferred annuities, plan adoption of this form of annuity is limited. Record keepers reported that less than 1 percent of plans covered by our record keeper questionnaire had adopted any deferred annuity option. Treasury recently promulgated regulations on the use by plans of QLACs, a type of deferred annuity.[36] Two insurers told us that they have begun to offer QLACs to plans, but the products are relatively new to the market. Accordingly, record keepers reported that that no plans covered under our questionnaire had adopted QLACs as an in-plan option. Similarly, DOL recently affirmed that a deferred annuity embedded in a target date fund (TDF) can be used as a qualified default investment alternative (QDIA)[37], but industry stakeholders told us that few service providers have developed these products and, plan adoption has been very limited. Industry stakeholders also told us that they expect adoption of deferred annuities, such as QLACs and deferred annuities embedded in target date funds, to increase in the future as more providers introduce their products to the in-plan market and more plans adopt them as a default solution.

Record keepers reported that less than 1 percent of plans covered by our questionnaire adopted an annuity shopping platform to help participants select and buy an annuity outside the plan using rollover funds. Annuity shopping platforms allow participants to compare and shop for annuities from competing insurers. They can be offered in-plan, but one provider told us that they generally are not because of sponsors' concerns about

[36]Longevity Annuity Contracts, 79 Fed. Reg. 37,633 (July 2, 2014). A QLAC is a tax-qualified deferred annuity meeting specific requirements under which its value is not included in the calculation of RMDs. 26 C.F.R. §§ 1.401(a)(9)-5 at A-3(d) and 1.401(a)(9)-6 at A-17. For example, payments may be deferred no longer than the participant's 85th birthday.

[37]*Letter from Phyllis C. Borzi, Assistant Secretary for Employee Benefits Security Administration, Dept. of Labor, to J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy*, Dept. of the Treasury (Oct. 23, 2014) (available at http://www.dol.gov/ebsa/regs/ILs/il102314.html). A QDIA is an investment alternative into which plan fiduciaries may invest a participant's plan funds in the absence of participant direction without risking liability for any resulting losses. 29 C.F.R. § 2550.404c-5.

the fiduciary responsibilities associated with insurer selection.[38] The provider also suggested that the annuity shopping platform to select and buy an annuity outside the plan using rollover funds is the easiest option for plans to facilitate participant access to guaranteed lifetime income options because, among other reasons, sponsors do not have to assume the fiduciary responsibilities associated with insurer selection.

According to Stakeholders, Many Plans Do Not Allow Partial Annuitization

For an illustration of how multiple lifetime income options, including an annuity, can be combined together to generate retirement income, see our interactive models at www.gao.gov/products/gao-16-433.

Source: GAO | GAO-16-433

Industry stakeholders and Treasury officials indicated that many plans lack partial annuitization options, which means many participants who have access to an annuity option through their plan must either annuitize their entire account balance or none of it. Agency officials and industry stakeholders have said that allowing participants to partially annuitize their account balance helps participants to combine multiple lifetime income options and purchase only the amount of annuity that they need.[39] Partial annuitization also allows participants to purchase an amount of annuity that makes sense for their situation in consideration of not only their plan savings but also income sources outside the plan, such as from Social Security or the resources of a spouse. Research has also shown that when offered, partial annuitization increases both the percentage of people who annuitize and the average percentage of balances that are annuitized.[40] An industry stakeholder noted the increase in the purchase of annuities through the Federal Thrift Savings Plan (TSP) after partial annuitization was introduced. When the TSP began in 1986, the annuity

[38]Annuities offered in 401(k) and other ERISA-covered plans must be offered based on gender-neutral prices. *Ariz. Governing Comm. for Tax Deferred Annuity & Deferred Comp. Plans v. Norris*, 463 U.S. 1073 (1983). The Supreme Court opinion so holding was limited, however, to the employer-sponsored context and annuities offered outside of that context may reflect gender-distinct pricing.

[39]Some stakeholders we interviewed suggested that individuals should rely on guaranteed income (e.g., Social Security, defined benefit plan, or annuities) to cover their expected non-discretionary expenses in retirement and use withdrawals options for discretionary expenditures.

[40]Beshears, John, James J. Choi, David Laibson, Brigitte C. Madrian, and Stephen P. Zeldes, "What Makes Annuitization More Appealing?" *National Bureau of Economic Research*, Working Paper 18575 (November 2012).

option was an “all or nothing” choice.[41] In 2004, TSP amended the plan to include partial annuitization and saw an increased use of annuities. For example, although the take up of TSP annuities in general remains low, more participants annuitized after TSP introduced partial annuitization. According to the insurer that has been the exclusive annuity provider to the TSP since its inception, 784 annuities were purchased in 2003.[42] From 2004 to 2008, after partial annuitization was implemented, the number of annuity purchases—including partial or full annuitization—increased to an average of 1,645 per year, a 110 percent increase in the number of participants annuitizing at least a portion of their account balances. In addition, the insurer noted that the average purchase amount of annuities increased 60 percent from $66,000 to $106,000.

All-or-nothing decisions to annuitize can have adverse effects on participants. When annuity purchase decisions are framed as an “all-or-nothing” choice, most participants will bypass the annuity option and opt for a lump sum, which does not allow them to benefit from in-plan options that could help secure lifetime income. On the other hand, industry stakeholders noted that full annuitization using 100 percent of a plan account balance may not be suitable because it does not leave savings that may be necessary for emergencies, such as for healthcare expenses, or for other purposes, such as bequest motives. Similarly, they noted that full annuitization may also be inappropriate for most individuals because they may already have sufficient income through Social Security and other retirement benefits that provide an annuity benefit, such as a defined benefit plan.

DOL is responsible for assisting and educating plan sponsors to help ensure the retirement security of plan participants. According to a Treasury fact sheet on retirement security, all-or-nothing choices may lead many participants to decline a plan’s annuity option, leading some

[41]The Federal Employees’ Retirement System Act of 1986 created the Thrift Savings Plan (TSP) to, among other things, provide options for retirement planning and encourage personal retirement saving among the federal workforce. Pub. L. No. 99-335, § 100A, 100 Stat. 514, 516.

[42]Sollmann, Robert E. Jr., Executive Vice President of Retirement Products, Metlife. Written testimony for hearing on certain issues relating to lifetime income options for participants and beneficiaries in retirement plans to DOL, Treasury, and IRS. September 2010.

plan sponsors to perceive participant demand to be low and the option to be unnecessary.[43] Treasury noted one of its goals is to make it easier for plans to offer participants a combination of retirement income options that avoid an all-or-nothing choice. However, 401(k) plans are not required to offer partial annuitization and our interviews with industry stakeholders and agency officials indicate that plan sponsors are not incentivized to offer partial annuitization and may not be aware of the benefits to participants. Recent collaborations by Treasury and DOL have tried to encourage plans to allow participants the ability to combine multiple options to receive their retirement benefits. For example, the actions taken by Treasury approving the use of QLACs and by DOL facilitating the use of deferred annuity contracts embedded within a target date fund have made it easier for plans to offer partial annuitization options. However, partial annuitization is not encouraged broadly through general guidance applicable to all 401(k) plans, such as DOL's *Meeting Your Fiduciary Responsibilities* publication. Agency officials have told us that many plans continue to frame annuity purchases as an "all-or-nothing" choice even though one Treasury official said that there is nothing prohibiting plans from offering partial annuitization. With DOL guidance encouraging plans to allow partial annuitization and enabling their participants to purchase the amount of annuity that they need, participants will be able to make annuity purchases that are most appropriate for their individual circumstances and support their lifetime income needs.

[43]Treasury, *Treasury Fact Sheet: Helping American Families Achieve Retirement Security by Expanding Lifetime Income Choices*, Feb. 2, 2012.

Concerns about Legal Risk may Deter Plan Sponsors from Offering Annuities, and Record Keeper Limitations may Constrain the Options Plans Can Make Available

Fear of Legal Liability May Deter Plan Sponsors from Offering Annuities

Plan Sponsor Survey Respondent on Legal Risk

"There is a not a single bit of upside to me as a plan sponsor in offering an option that participants don't want, particularly when it is a complex offering with lots of room for 20/20 hindsight by plaintiff's counsel, and one that tends to be more expensive. I care about our participants, but I have to balance that against my personal liability, as well as that of my employer."

Source: GAO Plan Sponsor Survey | GAO-16-433

Industry associations and other stakeholders told us that concerns about legal liability are the primary barrier deterring plan sponsors from offering annuities to participants. Of the 54 plan sponsors responding to our survey, 39 did not offer an annuity, and 26 of them said their decision was influenced by the resources required to obtain liability relief. In 2008, DOL promulgated a "safe harbor" rule that sets out procedures 401(k) plan sponsors can follow to satisfy their fiduciary duties when selecting an annuity provider.[44] To obtain fiduciary relief under the safe harbor rule, for example, plan sponsors must perform an analytical search for annuity providers and consider the provider's ability to pay claims in the future, in addition to the costs and benefits of the annuity. According to the rule, plan sponsors and other fiduciaries following the safe harbor when selecting an annuity provider fulfill their fiduciary duty and should, therefore, not be subject to corporate or personal liability for that selection.

[44]Selection of Annuity Providers—Safe Harbor for Individual Account Plans, 73 *Fed. Reg.* 58,447 (Oct. 7, 2008) (codified at 29 C.F.R. § 2550.404a-4). Authors of one journal article have provided their perspective on how to satisfy the safe harbor. Ashton, Bruce; Kronheim, Steven and Fred Reish. *Fiduciary Considerations in Selecting a Lifetime Income Provider for a Defined Contribution Plan*, New York University Review of Employee Benefits and Executive Compensation-2014 9-1 (Alvin D. Lurie ed., Lexis Nexis Matthew Bender 2014).

Stakeholders we interviewed indicated that the safe harbor for selecting an annuity provider is not helpful and the primary challenges stem from the requirements that plan sponsors appropriately:

- Consider information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract.
- Conclude that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract. Plan sponsors must also periodically review the appropriateness of the conclusion over time as the provider continues to issue annuity contracts.

To facilitate the availability of annuity options in 401(k) plans, the 2005 ERISA Advisory Council Working Group on Retirement Distributions and Options recommended DOL change sponsor responsibilities for selecting an annuity provider. The Pension Protection Act of 2006 (PPA), required DOL to promulgate regulations clarifying the fiduciary standards applicable to the selection of an annuity contract as a form of distribution for a DC plan.[45] In 2007, in the preamble to the proposed safe harbor rule, developed in response to the PPA requirement, DOL stated that plan sponsors had frequently cited their fiduciary liability as a reason for not offering an annuity spend down option. However, by DOL's own estimates, the safe harbor was unlikely to make plan sponsors substantially more willing to offer annuities because it estimated when it proposed the rule that the safe harbor would increase the share of participants offered an annuity by only 1 percentage point.[46]

Assessing the future financial health of an insurer can be a difficult task for a plan sponsor, and many plan sponsors responding to our survey indicated they would be more likely to offer an annuity if the benefits of

[45]Pub. L. No. 109-280, § 625, 120 Stat. 780, 980. Before the safe harbor rule all plan sponsors were directed to select the "safest available" annuity by DOL Interpretive Bulletin 95-1. 60 Fed. Reg. 12,328 (Mar. 6, 1995). This interpretive bulletin was later amended to limit its application to the selection of annuity providers for defined benefit plans. Amendment to Interpretive Bulletin 95-1, 73 Fed. Reg. 58.445 (Oct. 7, 2008).

[46]Selection of Annuity Providers for Individual Account Plans, 72 Fed. Reg. 52,021, 53,023 (Sept. 12, 2007).

the safe harbor were more readily attainable.[47] Members of Congress in both parties introduced legislation that would have, among other things, amended ERISA to permit plan sponsors and fiduciaries to rely more heavily on state regulators when selecting an annuity provider.[48] Additionally, the Director of the Federal Insurance Office told us plan sponsors should not be expected to look at an insurer's annual report to assess its financial liabilities or know more about an insurer than the research and metrics a rating agency or other entity might make publicly available. Officials we spoke with at the National Association of Insurance Commissioners (NAIC) also told us the safe harbor should have verifiable criteria. For example, the plan sponsors responding to our survey who did not offer annuities responded that any single criterion provided would make them more likely to offer them, as shown in table 4.

Table 4: Plan Sponsor Survey Responses to Annuity Provider Selection Criteria

Which of the following would make you more likely to offer annuities?	Yes	No
A list of insurance companies that plans could prudently select as an annuity provider	30	14
A specified minimum rating an insurer must receive from certain named credit rating agencies to be deemed a prudently selected annuity provider	24	19
Documentation from the annuity provider asserting that the criteria for legal protection for prudently selecting it have been met	28	17

Source: GAO Survey of Plan Sponsors | GAO-16-433

Note: There was a total of 54 responses to our plan sponsor survey, but the totals in the table do not add up to 54 because in addition to the "yes" and "no" responses, the survey also allowed respondents to choose "don't know" or "no response".

DOL is responsible for educating and assisting plan sponsors to help ensure the retirement security of workers and their families. However, the

[47]In our discussions with representatives of one annuity provider, they told us there were only a few big consulting firms that would be able to help plan sponsors meet the requirements under the safe harbor, and it would be expensive to contract with them. We talked to one of these consulting firms who told us they do not select annuity providers for plan sponsors because the costs and liability risks of doing so are prohibitive.

[48]For example, the SAFE Retirement Act of 2013, S. 1270, 113th Cong. (not enacted); SAVE Act of 2014, H.R. 5875, 113th Congress (not enacted); USA Retirement Funds Act, S. 1979, 113th Cong. (2014) (not enacted) and H.R. 5828, 113 Cong. (2014) (not enacted); and Lifetime Income Disclosure Act, S. 1145, 113th Cong. (2013) (not enacted).

annuity selection safe harbor can only translate into increased retirement security if it is used, and it does not provide sufficiently detailed criteria that plan sponsors feel they can use to obtain the liability protection it offers. The safe harbor requires plan sponsors to consider "sufficient" information to "appropriately" reach a conclusion about the annuity provider's future solvency without defining the terms "sufficient" and "appropriate." In 2010, a DOL official told us the agency was considering addressing industry concerns that plan sponsors have to second-guess state insurance regulators to assess insurers' financial viability, and in 2014, DOL published information indicating that it would be developing proposed amendments to the safe harbor to provide plan fiduciaries with more certainty that they have discharged their obligations when contracting to provide an annuity option.[49] DOL officials told us one advantage of revising the annuity selection safe harbor would be that it could provide greater clarity for plan sponsors and thus lead to more annuity options for participants. NAIC officials mentioned a standard proposed by an association of insurers, which would include, among other criteria, that the insurer be licensed in at least 26 states. RFI responses from two participant advocates suggested that annuity providers should also be licensed in states with strong regulatory protections. A DOL official told us that because the ERISA standard of prudence requires plan fiduciaries to exercise some degree of judgement in making the annuity provider selection, it precludes development of a simple and easily verifiable checklist. However, clarifying how to comply with the annuity selection safe harbor to the greatest extent possible may help encourage plan sponsors to offer plan participants an annuity option.

Concern about Legal Liability May Deter Plan Sponsors from Offering a Mix of Lifetime Income Options

For an illustration of how multiple lifetime income options, including an annuity, can be

[49]Introduction to the Regulatory Agenda of Federal Regulatory and Deregulatory Actions, 79 Fed. Reg. 895, 1024 (Jan. 7, 2014).

combined together to secure retirement income, see our interactive models at www.gao.gov/products/gao-16-433.

Source: GAO | GAO-16-433

According to researchers we spoke to, participants should have multiple lifetime income options because no one solution works for everyone. Treasury officials told us that participants can benefit by combining options to diversify their sources of lifetime income and help them manage multiple risks in retirement. For example, participants could use a portion of their savings to purchase an annuity and leave the balance invested in their plan for a withdrawal option.

A variety of products and services could be offered in the plan environment to provide participants with a mix of annuity and withdrawal options. For example, managed payout funds provide for automated withdrawals, and annuity providers offer a wide variety of guaranteed income options.[50] Furthermore, plans can also offer participants access to an online annuity shopping platform, and with it, comparable information on multiple products from multiple providers. See Appendix IV for further details.

However, there is no agency guidance available to help plan sponsors minimize their legal risks when offering participants a mix of annuity and withdrawal options within a plan. The current safe harbor for the selection of an annuity provider is available to plan sponsors only offering an annuity product from a single annuity provider. Based on our analysis, a plan sponsor could increase its risk of legal liability for each option it offers. For example, a plan sponsor that offers an in-plan annuity increases its risk by adding withdrawal options. Of the 12 plan sponsors responding to our survey who did not offer withdrawal options, 8 responded that the fiduciary responsibilities for managing participant assets in the draw-down phase influenced their decision.[51]

[50]Research has found that too many choices can also result in suboptimal outcomes. Keim, Donald B. and Olivia Mitchell. Simplifying Choices in Defined Contribution Retirement Plan Design. University of Pennsylvania, November 2015.

[51]DOL regulations provide guidance on information to be provided participants should an investment option allocate contributions toward the future purchase of a stream of retirement income guaranteed by an insurance company—in other words, an annuity. 29 C.F.R. § 2550.404a-5(d)(1)(vii). DOL has not issued any guidance, however, on how plan sponsors might minimize their legal risk of offering a mix of lifetime income options, including both annuity and withdrawal options.

The results of our record keeper questionnaire indicate that most plan sponsors are not offering a mix of lifetime income options. In contrast, plan sponsors are required to diversify the plan investments they offer.[52] In addition, when 401(k) plans permit participants to exercise control over their investment choices and, among other things, offer participants a broad range of investment alternatives, plan sponsors or other fiduciaries are not liable for any losses that result solely from a participant's exercise of that control.[53]

DOL has not provided an incentive for plan sponsors to provide participants a mix of lifetime income options and information about them. EBSA's mission is to assure the security of the retirement, health, and other workplace-related benefits of America's workers and their families, and without lifetime income options in workplace 401(k) plans, those benefits may not remain secure throughout retirement. Accordingly, DOL is engaged in an initiative with Treasury to encourage plan sponsors to offer prudent lifetime income options. Currently, each additional lifetime income option plan sponsors offer potentially exposes them to additional legal risk, unless that option is an annuity selected in a process pursuant to the safe harbor for annuity selection. DOL has not established a process plan sponsors can use to prudently select an appropriately diverse mix of annuity and withdrawal options offered to participants. Consequently, DOL has not determined the types of products—such as those on an online annuity shopping platform—that might appropriately be included in such a mix. DOL officials told us the decision to offer any lifetime income option is still a fiduciary one, and that even if they provided such relief, plan sponsors would still have some fiduciary responsibility associated with providing participants lifetime income. However, if plan sponsors and others are protected from liability when participants exercise control choosing among lifetime income options in a way comparable to how they are protected when participants exercise control in choosing investments to accumulate retirement savings,

[52] 29 U.S.C. § 1104(a)(1)(C).

[53] 29 U.S.C. § 1104(c). Implementing regulations specify that such plans must, among other things, provide participants with a choice of at least three investment alternatives with differing risk profiles. 29 C.F.R. § 2550.404(c)-1(b)(3)(i)(B). They also ensure plan sponsors have an incentive to provide certain information, including a comparative chart allowing participants to compare the fees and other characteristics of those options before making a decision. 29 C.F.R. §§ 2550.404c-1(b)(2)(i)(B) and 2550.404a-5.

sponsors may be more likely to offer a mix of lifetime income options from which participants can choose in their plan.

Plan Sponsors May Cause Participants to Lose Lifetime Income When They Change Record Keepers or Annuity Providers

Another deterrent to plan sponsors offering annuities,[54] according to representatives of annuity providers, is the possibility of plan participants having to lose lifetime income guarantees when the plan sponsor changes service providers. To serve the best interests of participants, plan sponsors may at times be required to change service providers, including annuity providers and record keepers. Plan sponsors have a legal obligation to establish and follow a formal review process at reasonable intervals to decide whether to continue to use a service provider or look for replacements.[55] However, lifetime guarantees—insurance policies offering lifetime income—can be difficult to transfer.

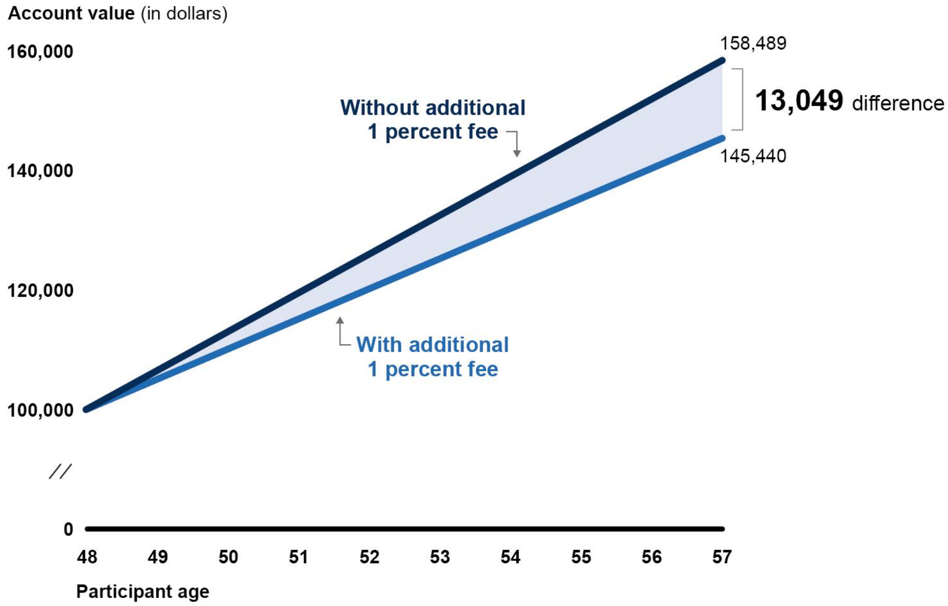
When participants contribute over time to a guaranteed lifetime income product such as a deferred income annuity or a GMWB, they are purchasing both an investment product and a guarantee of lifetime income. Purchasing an annuity in small amounts over time can have certain advantages, such as managing interest rate risk (see app V). When the plan sponsor changes record keepers or annuity providers, the investment will transfer, but the lifetime income guarantee may not. Some products might charge a guarantee fee of 1 percent or more every year and, as such, there is the potential for participants to have committed substantial resources to the guarantee before losing it due to a service provider change (see fig. 8). For example, a guarantee fee of 100 basis points (1 percent) for a GMWB may not be unrealistic. A representative of one plan sponsor told us that the plan's Request for Proposals from

[54]Rather than distributions of annuities offered at the point of retirement, the risk of benefit loss applies to the accumulation of annuities, to which a portion of contributions are diverted over time to provide for guaranteed lifetime income in retirement.

[55]DOL Field Assistance Bulletin 2015-02. Monitoring includes following up on participant complaints, reviewing service providers performance and compensation, and reading any reports service providers provide. A plan sponsor could decide to change service providers for any number of reasons, such as because they discover fee information they did not previously know about. We previously reported that many 401(k) plan sponsors were unaware of or did not fully understand both the fees charged to their plans and their participants as well as the fee arrangements used by plan service providers (see GAO-12-325).

401(k) service providers for a GMWB did not return a single bid for less than 100 basis points per year.

Figure 8: Potential Effects on a 401(k) Account Balance of Paying a 1 Percent Guarantee Fee Over 10 Years



Source: GAO analysis of agency documentation and stakeholder interviews. | GAO-16-433

Note: An additional 1 percent fee can substantially reduce a 401(k) account over time. This figure contrasts total fees of 75 basis points (higher line) with total fees of 175 basis points (lower line), and assumes a 6 percent nominal investment returns in both cases.

Representatives of one service provider told us that in general it is difficult to transfer annuities among annuity providers because it is difficult for providers to absorb the risk of another provider's insurance products. For a product with a lifetime income guarantee to transfer from one record keeper to another, the new record keeper's platform must either have the capacity to support the annuity product, or use third party software to allow a link to product information on the platform.[56] Representatives of one annuity provider told us that given the complexities in effectively

[56]Stakeholders told us some insurers service only proprietary annuity products on their record keeping platform, leaving them unprepared to service products of other providers.

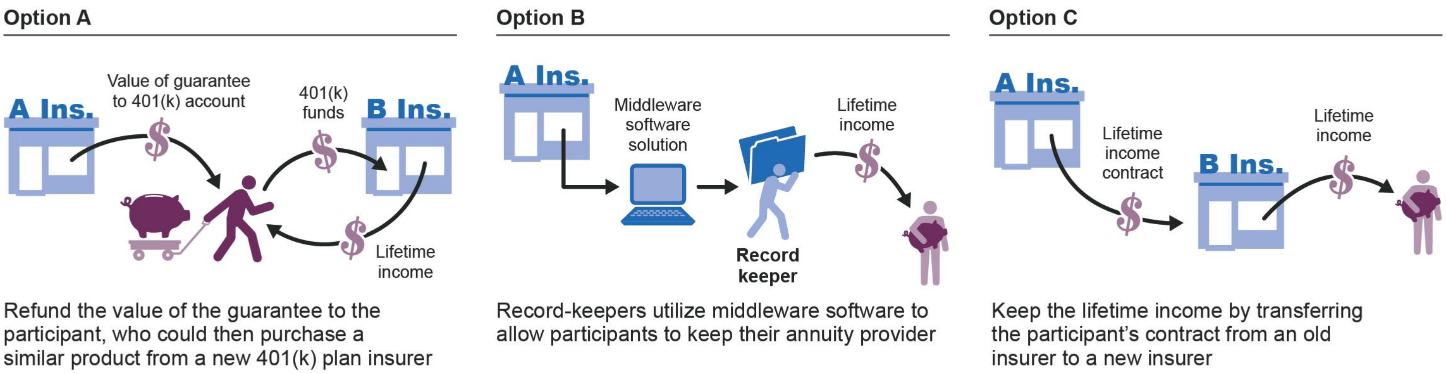
managing such a situation and the confusion about whether those efforts would be successful, many plan sponsors may be reluctant to offer annuities.

According to examples provided by industry officials, options needed to protect participants already exist, whether by refunding, preserving, or transferring their lifetime income guarantees, and some annuity providers and record keepers have taken steps to preserve participant benefits when plans change record keepers or annuity providers. For example, an association of defined contribution plans' record keepers has developed common data standards for tracking annuity products, which are intended to simplify the transfer of annuity data among record keepers. In another example, one annuity provider representative offers participants a refund of fees if they lose their lifetime income guarantee, returning to them some value that could replace the lost lifetime income. Further, another annuity provider representative told us his company paid the lifetime income guaranteed by another annuity provider's product, effectively transferring the annuities from provider to provider.[57] An additional approach to preserving such benefits would be to allow participants to roll over their 401(k) plan annuity into an IRA version of the annuity provider's product in the retail market if it would otherwise be lost. However, such distributions would move some 401(k) plan benefits while leaving others, increasing the likelihood of participants having to manage benefits in multiple places, which we previously reported can be challenging for participants.[58] Figure 9 shows how steps similar to those already taken by some providers could preserve participant benefits despite service provider changes.

[57]One annuity provider told us if a plan wanted to switch to its product from the product of another provider, it would also consider paying the income guaranteed by the other provider's product to make it portable.

[58]GAO, *401(k) Plans: Greater Protections Needed for Forced Transfers and Inactive Accounts,* GAO-15-73 (Washington, D.C.: Nov. 21, 2014).

Figure 9: Three Ways Industry Can Preserve Participant Benefits through Service Provider Changes



Source: GAO analysis of interviews with agency stakeholders. | GAO-16-433

Note: This graphic depicts three possible options to protect participant benefits through service provider changes, not the universe of possible options. Note also that not all 401(k) participants accumulating a lifetime income guarantee lose that lifetime income guarantee when a plan sponsors changes service providers.

DOL is responsible for educating and assisting plan sponsors to help ensure the retirement security of workers and their families. Federal internal control standards also state that management should ensure there are adequate means of communicating with external stakeholders that may have a significant impact on an agency achieving its goals.[59] Representatives of one annuity provider told us service provider changes have already caused some participants to lose lifetime guarantees. DOL officials told us on this subject that some plan fiduciaries may not examine insurance contract details as closely as the details of investment vehicles, and in such situations, they need to be more careful. However, DOL has not issued guidance encouraging plan sponsors to consider whether a service provider contract ensures future service provider changes do not cause participants to lose the value of lifetime income guarantees. While options to prevent lifetime income guarantee loses may exist, it is not clear how widespread they are in practice. However,

[59]Internal controls are the plans, methods, policies, and procedures that an entity uses to fulfill its mission, strategic plan, goals, and objectives. GAO/AIMD-00-21.3.1. The most recent version of these standards was issued in September 2014. GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: Sept. 10, 2014). These new standards became effective October 1, 2015. We used the previous version of the standards because we began our audit work prior to October 1, 2015.

by following such guidance from DOL, plan sponsors could make such options more widespread by requesting them, and they may be more willing to allow participants to accumulate in plan annuities in the future, if they are confident that a service provider change will not amount to a benefit reduction for participants.

Plans' Access to Annuities May be Limited by Their Record Keeper

Industry stakeholders we interviewed told us that plan sponsor access to annuity options is often dependent on the options their record keeper makes available. Plan sponsors make annuity options available in their plans similar to the way they make investment options available. For example, plan sponsors who want to offer an annuity option may work with a number of service providers to determine the appropriate annuity options to offer their participants. However, several industry stakeholders, including some record keepers, told us that sponsors' choices of annuity options may be limited because of cost considerations and business affiliations.

- **Cost.** Industry stakeholders told us that, among other things, it is costly to integrate plan record keeper systems with those of an insurer, especially for complex and non-standardized annuity products like GMWBs, which require daily transmittal of information between systems. In contrast, stakeholders indicated that fixed immediate annuities may be the least costly annuity option that plan sponsors can adopt because they are simple and straightforward for record keepers to implement. Stakeholders also told us that some record keepers may offer an open record keeping platform that either already supports competing annuity products or can be customized at the sponsor's request to do so. However, a number of record keepers told us that even for providers that offer an open platform, the process of integrating the systems for annuity products like GMWBs can be costly absent strong demand for them from plan sponsors.
- **Business affiliation.** Industry stakeholders told us that many record keepers are affiliated with specific insurers, financial service providers, and investment managers. In such instances, the services or products offered by their respective affiliates may influence the annuity products that the record keeper platform supports. Some stakeholders also told us that financial services companies that are focused on the retail annuity and investment markets may not want their affiliated record keeper to make in-plan annuity options available because their business is either based on or is comprised significantly of participants rolling over their savings into a retail IRA. Similarly, some stakeholders indicated that record keepers may not offer

annuities because some record keepers are also investment managers who may be compensated based on assets managed, which decrease with annuity purchases. Some stakeholders also said that insurers that have proprietary annuity products, especially GMWBs, have an interest in only offering their own products on their affiliated record keeping platform. As a result, plan sponsors that want to offer an annuity option generally must choose their record keeper's product or forego the option altogether.[60]

In general, plans' ability to persuade their record keepers to make annuity options available can be limited, similar to investment management services as we previously reported.[61] Industry stakeholders have indicated that larger sponsors are generally more likely to have the leverage or resources to persuade their record keeper to support competing products and services from multiple providers on their recordkeeping platform. Smaller sponsors may not be able to affect this change and may need to select a different record keeper to implement their desired annuity option or forego adopting an annuity option altogether.[62] While our record keeper questionnaire suggests that small plans are more likely to offer some form of lifetime income option, this data may be a reflection of a greater likelihood that smaller plans are administered by an insurance company that offers annuities.

[60]Two industry stakeholders, including one insurer, cited the high cost and complexities to integrate the information system of the record keeper with the insurer as a reason why some insurers only offer their proprietary GMWB product on their affiliated recordkeeping platform. One insurer who currently offers their GMWB only on their affiliated recordkeeping platform told us that they would like to make their product available on other recordkeeping platforms though they did not comment as to how they could do that. Another insurer told us they offer their competitors' fixed immediate annuity products on their recordkeeping platform because they do not offer in-plan versions of this type of annuity.

[61]We previously reported that plans' choice of a managed account provider may be limited by the options—sometimes only one—offered by their record keeper. Managed accounts are services under which providers manage participants' 401(k) savings over time by making investment and portfolio decisions for them. See GAO-14-310.

[62]Although large plans in our record keeper questionnaire had lower adoption rates of fixed immediate annuities and GMWBs than small and mid-size plans, large plans represent a significantly larger proportion of 401(k) plan participants. In our record keeper questionnaire, large plans represented about 58 percent of participants as compared with small plans which represent about 17 percent and mid-size plans about 26 percent. Large plans had more than 12,000 participants on average, as compared with small plans which had less than 50 participants on average and mid-size plans about 700.

Nearly all the plans covered by our record keeper questionnaire that offered GMWBs were either small or mid-size.[63] Stakeholders told us that because GMWBs have more features than other types of annuities, they are generally more expensive. Due to the complexity of the product, participants who do not fully understand GMWBs risk making withdrawal decisions that could decrease benefits.[64]

One of DOL's roles is to enforce Title I of ERISA by educating fiduciaries on how to carry out their responsibilities, which include selecting service providers. DOL's guidance in its *Meeting Your Fiduciary Responsibilities* publication recommends that, to ensure a meaningful selection, plan fiduciaries should survey a number of potential service providers before hiring one, but the guidance does not specifically include or discuss consideration or adoption of annuities or lifetime income options.[65] The guidance specifies that diversifying plan investments—which can include annuities—and paying only reasonable plan expenses for service providers and plan investments are among a sponsor's fiduciary responsibilities. DOL also underscores the importance of plan fiduciaries' responsibility to compare potential providers' services to appropriately assess their reasonableness. However, DOL's guidance does not encourage plan fiduciaries to use a record keeper that supports products from competing providers. While factors like cost and business affiliation may prevent some record keepers from supporting a variety of products, DOL officials told us participants would benefit from their plans having the ability to access non-proprietary products along with proprietary products. We previously recommended that DOL provide guidance to plan sponsors that addresses, among other things, the importance of considering multiple providers when choosing a managed account provider, and the importance of requesting from record keepers a choice

[63]Small and mid-size plans represent more than 99 percent of the plan sponsors in our record keeper questionnaire who adopted GMWBs.

[64]We previously reported that GMWBs could pose a risk that certain withdrawal decisions by consumers in withdrawing their assets, such as the timing and size of the withdrawals, could affect them negatively, such as reducing or eliminating guaranteed benefits and result in additional fees that further reduce their assets. See GAO, *Retirement Security: Annuities with Guaranteed Lifetime Withdrawals Have Both Benefits and Risks, but Regulation Varies across States*, GAO-13-75 (Washington, D.C.: Dec. 10, 2012).

[65]Department of Labor, Employee Benefits Security Administration, *Meeting Your Fiduciary Responsibilities* (Washington, D.C.: February 2012).

of more than one provider.[66] By considering similar guidance encouraging plan sponsors to use a record keeper that supports competing annuity product providers on its platform, plan sponsors could be more likely to find options that serve their participants and adopt them.

Participants May Not Have the Information, Education, or Adviser Needed to Make Informed Decisions about Lifetime Income Options

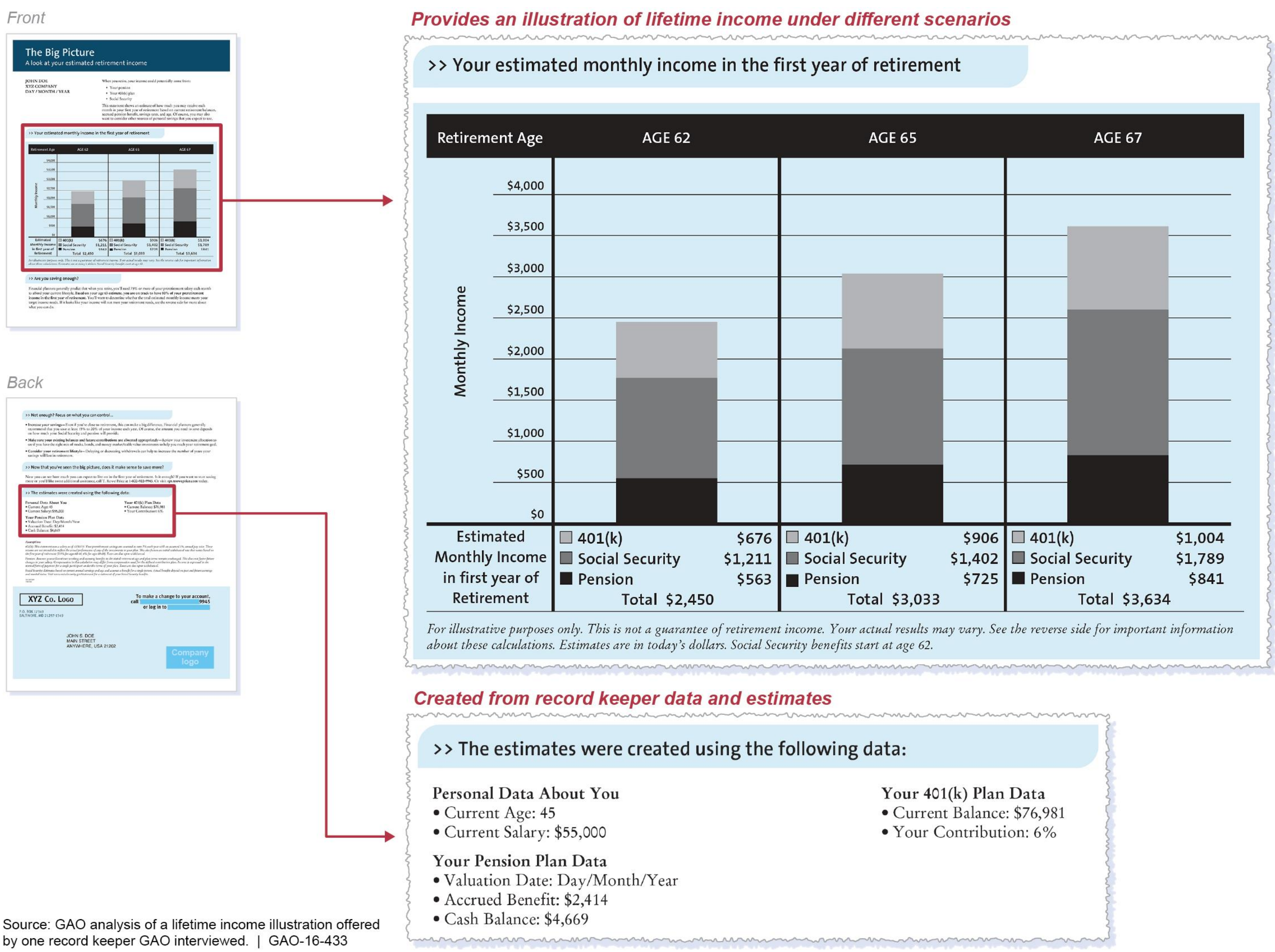
Participants Currently May Not Have Information That Can Help Them Understand How Much Income Their Savings Will Provide in Retirement, which DOL Is Taking Steps to Address

Lifetime income illustrations show participants a projection of the monthly or annual income their 401(k) savings may generate for retirement, but industry research indicates most plan sponsors do not use them. According to representatives of one service provider, showing participants a projection of their account balance as monthly income helps them determine how much they need to save to cover anticipated expenses in retirement. Similarly, representatives of another service provider said showing participants a projection of their account balance as annual income helps them determine how much they need to save to replace their current annual salary. In contrast, showing an account balance as a lump sum payment does not give participants a way to compare their savings to their monthly expenses or annual salary. Service providers can give plan sponsors the ability to present lifetime income illustrations in ways that can help participants think about how to use their 401(k) savings in conjunction with other sources of retirement income. For example, figure 10 shows how one record keeper can incorporate into a 401(k) plan's benefit statements an estimate of a participant's Social

[66] In its response, DOL indicated that it would consider our recommendation that it issue guidance to help sponsors better select and oversee managed account providers (see GAO-14-310).

Security benefit, as well as information about a defined benefit plan if the participant has one.

Figure 10. Lifetime Income Illustrations Help Participants Think about Their 401(k) Account as One Source of Lifetime Income



Source: GAO analysis of a lifetime income illustration offered by one record keeper GAO interviewed. | GAO-16-433

Note: This is an example of information a lifetime income illustration can provide participants. Provision of this information is not currently required.

Industry stakeholders also said it is beneficial for participants to see information that helps them set lifetime income goals and address shortfalls through a “gap” analysis that compares their goal against the anticipated results of their current savings behavior. As shown in figure 11, service providers can use such an analysis to help participants think of their account in terms of either monthly or annual retirement income. Representatives of four service providers told us they have the capacity to generate a lifetime income goal for their participants using recordkeeping data.[67] Participants we surveyed in coordination with a research firm reported that two important things to know for retirement planning are how much money they will need in retirement and how much lifetime income they can expect their savings to generate—information that lifetime income goals and a gap analysis are designed to communicate.[68] One service provider told us their historical testing indicates that one out of five participants who used their tool for developing lifetime income goals subsequently increased their contributions by an average of 5 percent to address savings shortfalls.[69] Despite its benefits, industry research indicates that only a limited number of plans communicate these types of information to participants. For

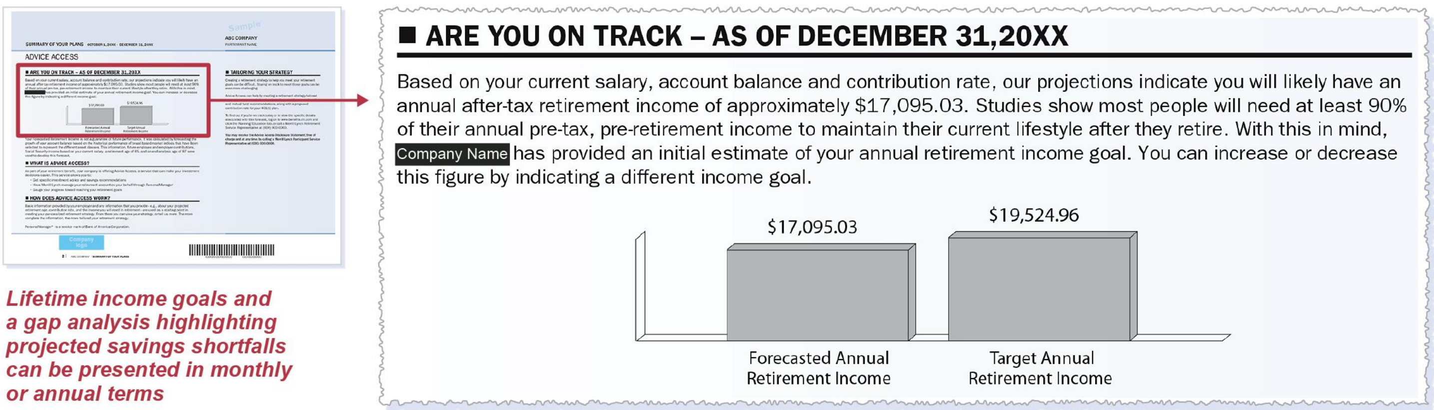
[67]Service providers reported using varying criteria to set lifetime income goals for participants. For example, one record keeper told us they set lifetime income goals at 80 percent of a participant's salary, while a managed account provider told us they set lifetime income goals at 100 percent of a participant's "take-home" pay, defined as salary after taxes, retirement contributions, and health insurance premiums.

[68]Specifically, we asked survey respondents to pick as many as three pieces of information from a list of six that would be most helpful in determining how to spend-down their savings. Sixty-four percent of participants selected knowing how much money they will need in retirement and nearly half selected knowing their potential payments in retirement, based on their plan's lifetime income options. Smaller percentages of participants selected information such as the tax implications of various options (about 46 percent), how options affect payments to a spouse or beneficiary (about 28 percent), and how payments are affected by factors such as inflation (about 26 percent).

[69]The record keeper told us they also highlight secondary savings goals for participants, such as increasing contributions to maximize employer matching contributions, even if this does not completely address a savings shortfall. We previously reported that a variety of factors can affect a worker's target replacement rate. GAO, *Better Information on Income Replacement Rates Needed to Help Workers Plan for Retirement,* GAO-16-242 (Washington, D.C.: Mar. 1, 2016).

example, according to one industry survey, at most about 48 percent of plan sponsors make a gap analysis available to their participants.[70]

Figure 11. Lifetime Income Goals Help Participants Take Action to Address Savings Shortfalls



Source: GAO analysis of a lifetime income illustration offered by one record keeper GAO interviewed. | GAO-16-433

Note: This is an example of information a lifetime income illustration can provide participants. Provision of this information is not currently required.

Recognizing the value of providing 401(k) participants with income projections, DOL issued an Advance Notice of Proposed Rulemaking in 2013 to address the low adoption of lifetime income illustrations by plan sponsors.[71] The rule being considered would require plan sponsors to include lifetime income illustrations alongside the account balance in participant benefit statements. DOL officials told us they were considering this requirement based on the experience of the Thrift Savings Plan, the defined contribution plan for federal employees that is similar to 401(k) plans. According to DOL officials, contributions to the Thrift Savings Plan

[70]Plan Sponsor Council of America, *57th Annual Survey of Profit Sharing and 401(k) Plans* (Chicago, IL: 2014). According to the survey, plan sponsor adoption varied by plan size and by how the survey refers to the gap analysis. Specifically, when asked if they provide a retirement gap analysis, plan sponsors reported adoption rates ranging from a low of 2.2 percent among sponsors of plans with 50 – 199 participants to a high of 8.3 percent among sponsors of plans with 5,000 or more participants. However, when asked if they provide retirement gap calculators, plan sponsors reported higher rates of adoption, ranging from a low of 30 percent among sponsors of plans with 50 – 199 participants to a high of 47.5 percent among sponsors of plans with 5,000 or more participants.

[71]Pension Benefit Statements. 78 Fed. Reg. 26,727 (May 8, 2013).

increased substantially once participants saw how much lifetime income they could expect in retirement based on their current savings behavior. Research has shown similar increases in participant contributions in other circumstances in response to the introduction of lifetime income illustrations. We previously reported on research suggesting that participants in Chile's defined contribution retirement system made additional contributions to improve their retirement prospects after Chile required that plans include projections of retirement income in participants' annual statements starting in 2005.[72] Researchers reported that these projections helped individuals better align their savings behavior with lifetime income goals.[73] In a separate study, researchers found that participants in defined contribution plans similar to 401(k) plans who received lifetime income illustrations increased contributions by more than those who did not.[74]

Information Participants Receive May Not Sufficiently Educate Them about Lifetime Income Options

The materials plan sponsors provide participants to educate them about lifetime income options may in many cases not be adequate to help them learn to make informed use of their plans' withdrawal options and annuities. Although participants we surveyed in coordination with a research organization cited separation packets some plan sponsors send to participants in or near retirement as a key source of education about lifetime income options, we reviewed 16 plans' separation packets and found they were missing most of the elements we identified as critical in

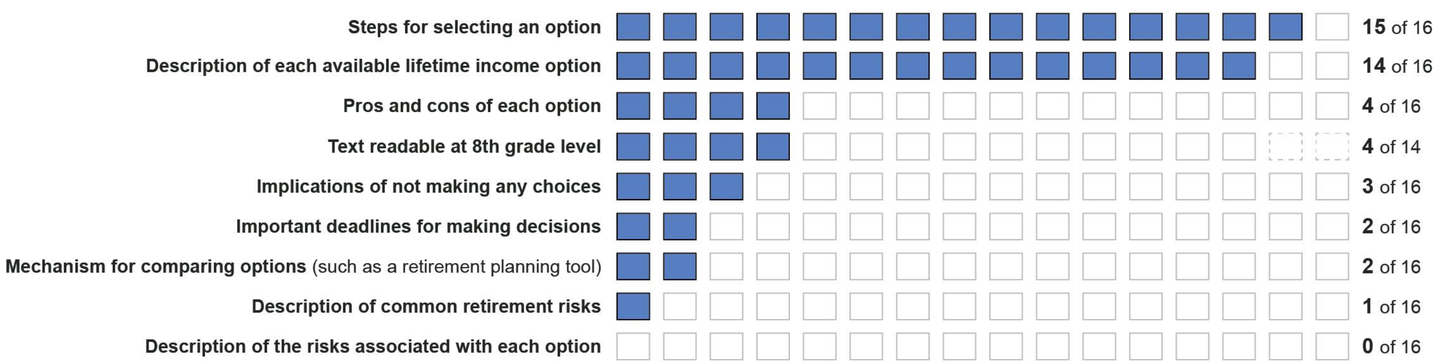
[72]GAO-14-9.

[73]E. Fajnzylber and G. Reyes, "Knowledge, Information, and Retirement Saving Decisions: Evidence from a Large-Scale Intervention in Chile," *Economía*, Volume 15, Number 2, Spring 2015. The researchers reported that their findings run counter to literature on behavioral economics suggesting that participant inertia is so strong that improving information is unlikely to result in significant changes in actual savings decisions. The researchers also noted that improving the information provided to participants about lifetime income options is an attractive option for policy makers, given its relatively low cost when compared with massive financial education or awareness campaigns.

[74]National Bureau of Economic Research, *What Will My Account Really Be Worth? An Experiment on Exponential Growth Bias and Retirement Saving* (NBER Working Paper No. 17927, Mar. 2012).

helping participants learn about their options at retirement (see fig. 12).[75] For example, we identified education on the possible advantages and disadvantages of each available lifetime income option as important because it helps participants weigh the pros and cons of different options.[76] Although a majority of the packets we reviewed provided descriptions of available options at retirement, few included discussions of the advantages and disadvantages of these options. We also found that most packets were not written in a way that participants can easily and clearly understand.[77]

Figure 12. Some Separation Packets We Reviewed Provided More Information than Others on Lifetime Income Options



Source: GAO analysis of a non-generalizable sample of 16 401(k) separation packets. | GAO-16-433

[75]We did not reach any determinations as to the extent to which individual plan sponsors complied with any applicable federal requirements. About 34 percent of surveyed participants identified separation packets as a source of education most likely to assist them in selecting lifetime income options available through their plan. Smaller percentages identified other sources of education. For example, about 30 percent identified web-based calculators and retirement planning tools that allow them to compare their options; about 25 percent identified in-person seminars, workshops, or webinars, and; about 15 percent of participants identified call-in centers.

[76]GAO-11-400 and GAO-14-9.

[77]We have also reported that existing federal requirements do not ensure plan sponsors provide complete and timely information on distribution options when participants separate from employment, and we recommended the Secretary of Labor develop a concise, written summary (see GAO-13-30). As a result, separation packets may arrive too late to be of use because, according to one service provider, once a participant separates from an employer it is likely too late to discuss lifetime income options with them.

Note: We did not reach any determinations as to the extent to which individual plan sponsors complied with any applicable federal requirements. Also, we did not assess the readability of two separation packets due to electronic security restrictions on the documents.

DOL has acknowledged the importance of educating participants on, among other things, how to estimate their future retirement income needs and make informed selections from among plan offerings. According to DOL, this kind of education is particularly important because more participants are in defined contribution plans that require them to make decisions about what to do with their savings. Additionally, DOL officials told us education on lifetime income options needs to be in place before more plans begin offering these options.

Participants in Our Review Cited Investment Advice as a Key Factor in Implementing a Sound Retirement Strategy, but Access to Advice through Plans is Limited

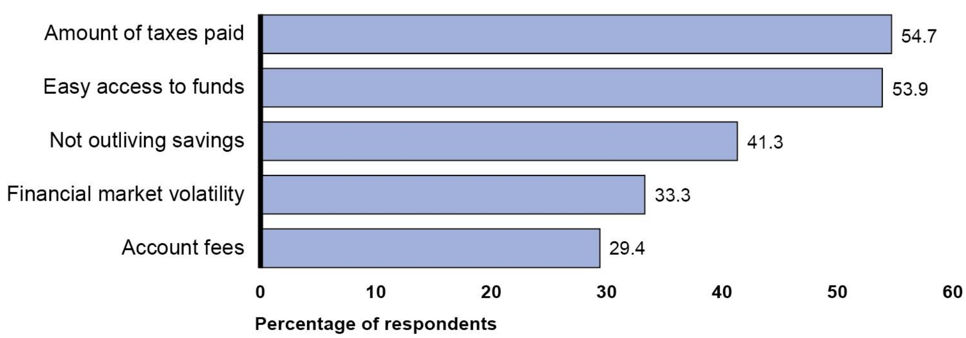
Participants we surveyed in coordination with a research organization cited obtaining advice as a key step in selecting lifetime income options offered by a 401(k) plan. We asked participants to check all the steps they would take to assess what lifetime income options are right for them, and almost 50 percent of respondents reported they would seek advice. Our surveys also found that participants preferred to obtain financial advice through their plans as opposed to other sources. We asked participants to select from a list the types of individuals they would consult in selecting among a plan’s lifetime income options. Fifty-nine percent of respondents selected a financial adviser provided by the plan. In comparison, fewer than 40 percent of respondents selected a tax professional or lawyer (39 percent) or a financial advisor outside of a plan (about 36 percent).

Retirement planning decisions can create substantial challenges for participants who lack access to an adviser. One study of lifetime income options notes that participants must make decisions about how to deploy their savings in the context of other important retirement considerations such as when to claim Social Security; when to stop working; and home equity, taxes, and longevity. Additionally, providers of a managed account service told us participants need to consider not just how, but also when and where they deploy their savings. Specifically, the order in which participants draw on their various sources of income, as well as tax laws in the state where they live, can affect how much they pay in taxes during retirement.

Determining how long their savings will last can also be challenging for participants. Research shows that without access to an adviser, participants tend to underestimate how long they may live and may spend down their savings too quickly. One researcher warned that participants tend to look to potentially misleading regulatory cues to inform retirement planning decisions. For example, they might interpret statutory provisions providing that the tax penalty on premature 401(k) distributions cease at age 59 ½[78] as a signal to start drawing down their savings at this age even if they would be better served by staying invested in their plan until a later date.[79] Participants also tend to overestimate their ability to generate investment returns and underestimate the value of longevity protection.

Our survey in coordination with a research firm also found that participants had competing priorities for their retirement savings, which can ultimately drive them towards complex products. As shown in figure 13, participants cited both securing easy access to savings and protecting from the risk of outliving their savings as top priorities. Service providers told us that options like GMWBs that embody both these characteristics are among the most complex and difficult for participants to understand. One insurance company told us they had to remove some features from their GMWB because it was too confusing for participants. A few possible consequences of not fully understanding such a product include losing longevity protection for failure to abide by withdrawal restrictions and paying fees for benefits not received.

Figure 13. Taxes and Easy Access to Funds Are Top Priorities for Surveyed Participants



Source: GAO survey of defined contribution plan participants in coordination with Boston Research Technologies. | GAO-16-433

[78]26 U.S.C. § 72(q)(2)(A).

[79]We previously reported that federal policies provide incentives for both early and late retirement. GAO, *Retirement Decisions: Federal Policies Offer Mixed Signals about When to Retire,* GAO-07-753 (Washington, D.C.: July 11, 2007).

Despite broad recognition of the need for participants to consult an adviser on lifetime income options before they make any decisions, industry research indicates only a minority of plan sponsors make advisers available to plan participants. In a 2013 survey of more than 600 plan sponsors, less than one-third reported offering access to any kind of advice to participants.[80] One industry stakeholder told us plan sponsors are reluctant to provide access to investment advice, in part because of concerns about the costs. One survey reported this is true even though participants can get advice on withdrawal options through their plan for less than half the cost they would pay on their own.[81] In addition, legal liability may also be a concern for plan sponsors. Lawyers representing 401(k) plans told us they counsel their clients against providing access to advice because of legal liability.

Industry research indicates that service providers already have some capacity to offer participants the opportunity to work with an investment adviser. According to one survey, over 35 percent of plans offered participants access to advice through a financial adviser affiliated with their plan provider, with the most widespread use among smaller plans.[82] About twenty-six percent provided advice through a registered investment adviser (RIA).[83] Further, a majority of sponsors who make advice available to participants choose to do so through one-on-one meetings in person with an adviser. One record keeper operates a call center

[80]Investment advice was offered by 32.5 percent of respondent companies. Plan Sponsor Council of America, *57th Annual Survey of Profit Sharing and 401(k) Plans* (Chicago, IL: 2014). Provision of advice through plan sponsors varied by plan size and ranged from a low of 22.7percent among sponsors of plans with 50 – 199 participants to a high of 38.7 percent among sponsors of plans with 1 – 49 participants.

[81]Stanford Center on Longevity, *The Next Evolution in Defined Contribution Retirement Plan Design* (Stanford, CA: September 2013).

[82]Plan Sponsor Council of America, *57th Annual Survey of Profit Sharing and 401(k) Plans* (Chicago, IL: 2014).

[83]RIAs are registered with the Securities and Exchange Commission. They have a legal duty to provide their services in the best interest of their clients. U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, at iii (January 2011).

participants can use to speak with an adviser and obtain advice about their plan's withdrawal options and annuities, depending on their needs. A plan consultant we spoke with uses a network of financial advisers who will spend a week at their client's business meeting with participants. Participants opting for a managed account can also get advice through that service.

DOL is responsible for educating and assisting plan sponsors to help ensure the retirement security of workers and their families. DOL officials told us it was a good idea to encourage sponsors to offer participants access to investment advisers in-plan, though sponsors should diligently vet prospective advisers before they are allowed to make open presentations to participants. However, in DOL's publication *Meeting Your Fiduciary Responsibilities*, plan fiduciaries are not encouraged to provide access to an investment adviser knowledgeable about lifetime income strategies.[84] Despite the absence of such guidance, some plan sponsors have already ensured that their participants have the chance to speak with an investment adviser about their plans' annuities and withdrawal options, enabling participants to talk to professionals before they leave their plan or make a decision that can jeopardize their retirement security. Without guidance about the importance of providing their participants access to an adviser at the point of retirement to discuss in-plan lifetime income options, plan sponsors may continue to not offer such a service.

[84]Department of Labor, Employee Benefits Security Administration, *Meeting Your Fiduciary Responsibilities* (Washington, D.C.: February 2012). Among the professionals that have been identified as having educational requirements focused on retirement income strategies are those with the designations of Certified Retirement Counselor, Retirement Income Certified Professional and Retirement Management Analyst . Finke, Michel S, and Benjamin F. Cummings. Models of Financial Advice for Retirement Plans. Society of Actuaries, Committee on Post Retirement Needs and Risks, December 2014.

For Participants Who Do Not Choose a Lifetime Income Option for Retirement, Default Lifetime Income May Be Beneficial

Even with better information and an opportunity to receive advice, there are some participants for whom lifetime income decisions can be overwhelming or of no interest. As a result, they may disengage from making decisions regarding their income stream in retirement. We previously reported that about 17 percent of employees who lack a retirement plan have access to one but do not enroll.[85] Sponsors have used automatic enrollment as a way to help ensure adequate retirement savings for employees, sometimes because other efforts, such as e-mails and educational materials, were not effective.[86] Some participants did not enroll thinking they were ineligible, but researchers have noted many fail to enroll because of a behavioral tendency to follow the path that does not require an active decision.[87] In six automatic enrollment studies we reviewed in 2009, automatic enrollment in a plan increased participation by at least 18 percent.[88]

The results of our record keeper questionnaire suggest relying on participants to make proactive decisions to ensure lifetime income has resulted in few participants selecting such options. Less than 1 percent of participants in plans covered by our record keeper questionnaire chose annuities, and less than 1 percent of participants chose systematic

[85]GAO-10-31.

[86]GAO-10-31. Two plan sponsors told us they adopted automatic enrollment because they had closed their DB plan, which typically provides for both automatic enrollment and lifetime income.

[87]We previously reported that alternatives and complements to financial education, including appropriate defaults, have been shown to improve consumer behavior. Insights from behavioral economics, which blends economics with psychology, have been used to design strategies apart from education to assist consumers in reaching financial goals without compromising their ability to choose approaches or products. These strategies recognize the realities of human psychology, including procrastination and inertia, inability to stick to plans, difficulty in processing complex information, and the desire for conformity. (see GAO-11-614).

[88]GAO, *Retirement Savings: Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges*, GAO-10-31 (Washington, D.C.: Oct. 23, 2009).

withdrawals.[89] We previously reported that because people are prone to inertia and procrastination, a default option often becomes the most common choice when making financial decisions.[90]

Although default contributions for participants who do not make such decisions during the accumulation phase are allowed, provided certain requirements are met, little has been done to facilitate lifetime income defaults. Several industry representatives we spoke to, and others who reported to DOL and Treasury in 2010, indicated that defaults can lead participants to use lifetime income options. Over 70 percent of participants we surveyed in coordination with a research organization for this report indicated that if their employer automatically invested a small percentage of their future contributions in a competitively priced guaranteed retirement income product, they would stay invested in the product.[91] Figure 14 illustrates deferred annuity payments (deferred annuities begin payments later than the time of purchase), showing how such a default can hypothetically guarantee some income and longevity protection while leaving most of the account available for other purposes.

DOL has previously acted to encourage defaults that provide retirement income. DOL clarified in a 2014 letter to Treasury that a deferred annuity embedded in a target date fund qualifies as a qualified default investment

[89]This percentage may be low even though most participants may not have had the opportunity to access such options. Data we collected from record keepers indicates about a quarter of 401(k) plans covered by our questionnaire offered an annuity, and about a third of 401(k) plans covered by our record keeper questionnaire offered withdrawal options. Furthermore, one record keeper told us in the 10 years it has had a lifetime income option available, only six clients have adopted it and only three participants have elected it. Another record keeper said that 27 percent of new plans were adopting a lifetime income option but that less than 1 percent of participants in those plans selected it.

[90]GAO. *Financial Literacy: A Federal Certification Process for Providers Would Pose Challenges,* GAO-11-614 (Washington, D.C.: June 28, 2011).

[91]Ten percent of contributions was the amount used for this survey question. Of 5,804 responding participants, 4,103 said they would stay invested, 660 said they would opt out, and 1,041 said they did not know what they would do. For more on this survey of plan participants, see Appendix I. We previously reported that some participants may see default policies as implicit advice from the plan sponsor, who is required to act solely in their best interest. GAO, *Defined Contribution Plans: Key Information on Target Date Funds as Default Investments Should Be Provided to Plan Sponsors and Participants*, GAO-11-118 (Washington, D.C.: Jan. 31, 2011).

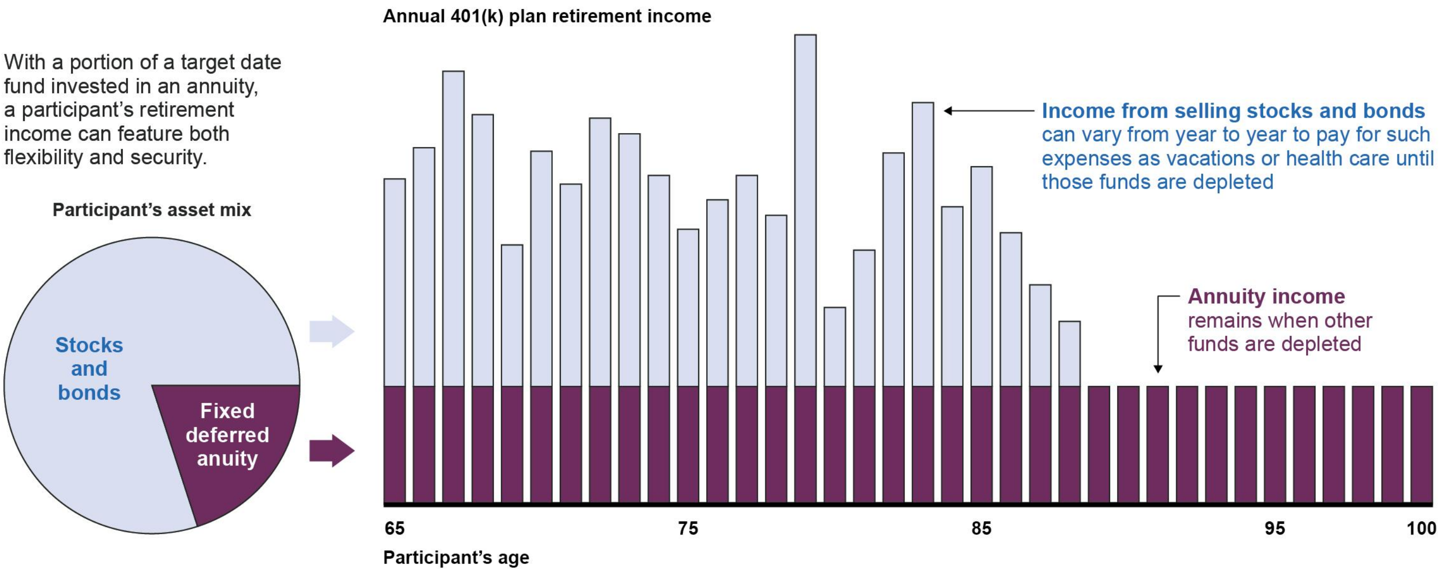
alternative (QDIA).[92] Accumulating an annuity over time in such a way has certain advantages, as detailed in Appendix V. The DOL letter describes a circumstance where each fund available to participants age 55 or older holds deferred annuity contracts and funds available to participants under age 55 do not.[93] As participants age, a larger portion of their assets are devoted to annuities, and at the target date, fund members receive an annuity that provides lifetime income payments.[94]

[92]As required under the Pension Protection Act of 2006 (Pub. L. No. 109-280 § 624, 120 Stat. 780, 980) (codified at 29 U.S.C. § 1104(c)(5)), DOL promulgated regulations under which participants in 401(k) plans will be deemed to have exercised control over their accounts when, in the absence of investment directions from the participant, the plan invests them in a QDIA. Default Investment Alternatives Under Participant Directed Individual Account Plans. 72 Fed. Reg. 60,452 (Oct. 24, 2007).

[93]Letter from Phyllis C. Borzi, Assistant Secretary for Employee Benefits Security, Dept. of Labor, to J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy, Dept. of the Treasury (Oct. 23, 2014) (available at http://www.dol.gov/ebsa/regs/ILs/il102314.html).

[94]For example, if a fund's asset mix contains a 50 percent investment in deferred annuity contracts, half of each participant's account balance would be devoted to the annuity. Prior to retirement, individuals have the opportunity to move their assets out of the target date fund at least as often as quarterly, and the group annuities used are interchangeable among participants exiting and joining the fund as they age.

Figure 14: A Deferred Annuity Can Provide Longevity Protection



Source: GAO analysis of industry and federal agency documents and stakeholder interviews. | GAO-16-433

Note: This graphic depicts an annuity that is purchased with a portion of 401(k) plan contributions during employment and has payments deferred until retirement at age 65.

On September 15, 2015, President Obama directed executive branch agencies to give particular consideration to selecting and setting default options.[95] One option already in place that can provide a default for participants in 401(k) plans is the provision of required minimum distributions (RMD). A plan can be disqualified under the Internal Revenue Code if they do not follow the RMD provisions.[96] Under these provisions, participants are required to begin receiving at least minimum payments starting after the participant retires and reaches the age of 70 ½. RMD calculations based on life expectancy provide lifetime income by design. Some plan sponsors are willing to administer RMDs as lifetime income by providing the minimum distribution to the participant in the plan rather than requiring participants to take a lump sum. As a result,

[95]Exec. Order No. 13,707, 80 Fed. Reg. 56,365 (Sept. 18, 2015) and https://www.whitehouse.gov/the-press-office/2015/09/15/executive-order-using-behavioral-science-insights-better-serve-american.

[96]26 U.S.C. § 401(a)(9)(A).

participants who do not proactively commit to a lifetime income strategy may still get lifetime income through a plan that complies with RMD provisions by making distributions on the regulated minimum schedule. Default income based on RMD provisions can also begin when a participant retires and is in need of income, even though a distribution is generally not required until after the participant turns 70 1/2. For example, the Thrift Savings Plan for federal employees offers a series of monthly payments computed by the TSP based on IRS life expectancy tables.[97]

President Obama's executive order directs agencies to specifically consider using default options, and RMDs can function as such for lifetime income. However, DOL does not communicate that the RMD methodology can be used this way in its *Meeting Your Fiduciary Responsibilities* publication. Currently, the only default option for lifetime income that DOL has formally supported is a deferred annuity, which was offered by less than 1 percent of the plans represented by record keepers who responded to our questionnaire. In contrast, many record keepers already know how to administer RMDs, so DOL could leverage that experience by providing guidance on how to use the methodology to produce lifetime income for participants. DOL officials told us they had not considered this approach and would need time to do so. However, without leveraging a default that is widely available in plans, few participants are likely to be impacted, and RMDs are essentially the only type of distributions that all 401(k) plans are required to make. Unless DOL begins encouraging plan sponsors to consider providing RMD-based default income, many retirees who do not select a lifetime income option may continue to receive a single lump sum payout that may not be used for lifetime income.

Conclusions

Since the enactment of section 401(k) of the Internal Revenue Code in 1978, 401(k) plans have become the most common retirement savings vehicle in the United States. As a growing number of 401(k) participants retire, agencies have begun to realize the importance of helping those retirees create lifetime income from their 401(k) plan savings.

[97]Each year, on the anniversary of the first monthly payment, the TSP will recalculate the amount of the monthly payments. The recalculation will be based on the participant's age and account balance at the end of the preceding year.

DOL can take action to address fiduciary barriers that deter plan sponsors from offering lifetime income options to participants. First, most plan sponsors are unlikely to be equipped to judge the long-term viability of an insurer, yet they currently must do so under the existing safe harbor. Providing clearer criteria for making this determination likely would encourage more sponsors to seek fiduciary relief for offering annuities. Second, DOL offers fiduciary relief when savings are accumulated in an appropriate mix of investments, but it offers no such relief for plans offering a mix of lifetime income options. Extending this relief to plan sponsors could encourage more plans to make a mix of options available and, therefore, allow participants to create a better retirement strategy by selecting and combining annuity and withdrawal options.

DOL can also provide additional guidance, in its *Meeting Your Fiduciary Responsibilities* publication or elsewhere, for fiduciaries as they consider how their participants' account balance will translate into retirement income. DOL guidance can encourage plan sponsors to use a record keeper that includes annuities from other providers on its record keeping platform and increase the likelihood the plan sponsor will have access to annuities that the plan sponsor considers to be in the best interest of the plan participants. DOL guidance can encourage fiduciaries to offer participants the option to partially annuitize their account balance, allowing participants to purchase the amount of guaranteed lifetime income most appropriate for them. DOL guidance can also help plan sponsors plan for future service provider changes when offering an annuity. The fear of causing participants to lose annuity guarantees due to a service provider switch may cause plan sponsors to stay in a less than ideal service provider relationship or not offer an annuity. Guidance can encourage plan fiduciaries to consider whether a lifetime income contract could cause participants to lose lifetime income guarantees under such a circumstance before entering into the contract. DOL guidance can also encourage plan sponsors to provide an expert in retirement income strategies for participants to talk to about the plan's distribution options. Enabling participants to receive advice about in-plan lifetime income options given their individual circumstances will better ensure they make retirement income decisions that can be directly applied to their specific circumstances.

Lastly, DOL can encourage participants who have not chosen a lifetime income option at retirement toward income security with defaults. These participants may be less likely to take advantage of advice when offered. RMD-based default income can stretch out the account balances of these participants throughout retirement if sponsors and participants understand how they can be administered and used. Unless DOL encourages plan sponsors to consider providing RMD-based default income, many retirees who do not select a lifetime income option may continue to receive a single lump sum payout that may not be used for lifetime income.

Recommendations for Executive Action

We are making seven recommendations to the Secretary of Labor.

We recommend the Secretary of the Department of Labor (DOL) help encourage plan sponsors to offer lifetime income options by:

1. Clarifying the safe harbor from liability for selecting an annuity provider by providing sufficiently detailed criteria to better enable plan sponsors to comply with the safe harbor requirements related to assessing a provider's long-term solvency.
2. Considering providing legal relief for plan fiduciaries offering an appropriate mix of annuity and withdrawal options, upon adequately informing participants about the options, before participants choose to direct their investments into them.

To guide fiduciaries as they consider how the account balances of their participants will translate into financial security in retirement, DOL should modify its *Meeting Your Fiduciary Responsibilities* publication or issue new guidance to encourage plan sponsors to:

3. Use a record keeper that includes annuities from multiple providers on their record keeping platform.
4. Offer participants the option to partially annuitize their account balance by allowing them the ability to purchase the amount of guaranteed lifetime income most appropriate for them.
5. Consider whether a contract with a service provider ensures future service provider changes do not cause participants to lose the value of their lifetime income guarantees.
6. Include participant access to advice on the plan's lifetime income options from an expert in retirement income strategies.
7. Consider providing RMD-based default income–plan distributions as a default stream of lifetime income based on the RMD methodology–beginning, unless they opt-out, when retirement-age participants separate from employment, rather than after age 70 ½.

Agency Comments and Our Evaluation

We provided a draft of this report to the Department of Labor and the Department of the Treasury. The agencies provided technical comments, which we have incorporated where appropriate. DOL also provided written comments, which are reproduced in Appendix VI.

In its written comments, DOL agreed that today workers face greater responsibility for managing their assets for retirement, both while employed and during their retirement years. As we note in our report and DOL stated in its comments, DOL is committed to continuing to explore steps to advance lifetime income options in individual account retirement plans, such as 401(k) plans. DOL expressed reservations about GAO's recommendations but described actions consistent with their intent, as discussed below. Regarding the recommendation to clarify the steps a plan sponsor must take to assess the long term solvency of an annuity provider when selecting one in accordance with DOL's safe harbor, DOL stated that a clarification might erode consumer protections by degrading the oversight of fiduciaries making such selections. We commend DOL for placing a high value on consumer protections and wanting to uphold the requirements placed on fiduciaries. However, our report notes on page 26 the relatively challenging process for plan sponsors prudently offering an in-plan annuity. DOL's suggested alternative is that the plan fiduciaries outsource these decisions to a financial institution as an investment manager under Section 3(38) of ERISA. We agree with DOL that it has identified a promising strategy, and commend DOL for doing so transparently. However, this strategy relies on a plan having access to something rather specific, which is a deferred annuity embedded in a target date fund. While they may be used more often in the future, as our report notes on page 52, less than 1 percent of plans covered by our record keeper survey offered deferred annuities. At this time, we are not confident that relying on a strategy available to so few plans will effectively resolve the challenges posed by the current version of the annuity provider selection safe harbor. While we agree that outsourcing can bring helpful expertise to the complex fiduciary task of selecting an insurer, it is not clear whether such a service would be available and affordable to the bulk of 401(k) plan sponsors. For example, we report on page 27 that a large consulting firm told us they do not select annuity providers for plan sponsors because the costs and liability risks of doing so are prohibitive.

Regarding the recommendation to consider providing fiduciary relief to plan fiduciaries offering an appropriate mix of annuity and withdrawal options, DOL expressed concern that it could shift the responsibility for annuity selection from the fiduciary to the participant. However, we believe that a concern is unwarranted, and the change would not adversely affect participants. DOL already offers certain fiduciary relief under section 404(c) related to the investments offered under a plan. Once plans have performed their fiduciary duty in selecting a broad range of at least three investment alternatives with differing characteristics and provided participants with educational information on them, the participant bears the risk of selecting from among them. Analogously, we believe it would be appropriate for DOL to provide, once plans have exercised their fiduciary duty to select an appropriate mix of annuity and withdrawal options, for participants to bear the risk of selecting from among them. While it raised these concerns, DOL stated in its letter that it is open to considering alternative regulatory approaches. DOL also noted that it has an active regulatory agenda but will include the recommendations as part of its ongoing development and prioritization of its agenda.

Finally, with respect to the recommendations to provide guidance to fiduciaries on how the account balances of their participants will translate into financial security in retirement, DOL stated that it will review its publications along the lines of the recommendations to explore ways in which to encourage use of products and arrangements designed to provide participants and beneficiaries a lifetime income stream after retirement, and take steps to better educate participants and plan sponsors about the need to think about retirement savings as lifetime income. DOL also noted that the *Meeting Your Fiduciary Responsibilities* publication may not be the appropriate vehicle for addressing some of the subject matter in the recommendations. However, the recommendation also states that DOL could alternatively issue new guidance. We specifically cited the *Meeting Your Fiduciary Responsibilities* publication because it covers a wide range of topics and may reach a wider audience than other forms of guidance. Further, as stated in the publication, while some decisions are plan design decisions and not fiduciary decisions, there may still be fiduciary responsibilities involved in carrying them out.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Secretary of Labor, Secretary of the Treasury, and other interested parties. In addition, the report will be available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or jeszeckc@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in Appendix VII.

Charles Jeszeck, Director
Education, Workforce, and Income Security Issues

Appendix I: Objectives, Scope, and Methodology

Our objectives were to examine 1) the adoption of lifetime income options in 401(k) plans; 2) the barriers, if any, that deter plan sponsors from offering lifetime income options; 3) the challenges participants face, if any, in learning to make informed decisions about lifetime income options; and 4) the defaults that exist for participants who do not choose an option.

To address these objectives, we reviewed relevant research, responses to the Request for Information (RFI) by the Department of Labor (DOL) and the Department of the Treasury (Treasury) in 2010,[1] federal laws, regulations, and guidance on lifetime income options. We identified relevant research to review with the help of a GAO librarian, through stakeholder interviews, by reviewing the sources cited in documents we obtained, and through limited internet searches driven by stakeholder and documentary evidence. We shared key studies with a GAO actuary for review. We reviewed the 2010 RFI responses, when available, of stakeholders we interviewed or were considering interviewing. We interviewed a non-generalizable sample of 29 service providers to 401(k) plans including record keepers, insurance companies, asset managers, managed account service providers, lawyers and advisers to plan sponsors. We also interviewed representatives of industry advocacy groups, researchers, and officials from DOL's Employee Benefits Security Administration (EBSA) and Treasury's Office of Tax Policy, Federal Insurance Office, and Internal Revenue Service (IRS) as well as representatives of the National Association of Insurance Commissioners (NAIC). We worked with a GAO methodologist to select stakeholders to interview. We selected industry stakeholders to interview who could provide information on a large number of participants or assets, who offered unique products and services facilitating 401(k) plan lifetime income, or were in roles working closely and directly with plan sponsors or participants. We selected researchers and participant advocates to interview with published work on retirement income. We included questions in a generalizable survey of defined contribution plan participants conducted by an independent research firm. We also conducted a non-generalizable online survey of 54 plan sponsors. We collected and analyzed data on plan sponsor adoption and participant use

[1]Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans, 75 Fed. Reg. 5253 (Feb. 2, 2010).

of lifetime income options from 11 record keepers to 401(k) plans. We assessed a non-generalizable sample of 16 separation packets that some plan sponsors make available to participants at or near retirement. We obtained and reviewed examples of information, such as lifetime income illustrations, that some service providers make available for plan sponsors to include in participant benefit statements or on plan websites to help participants plan for retirement. Lastly, we developed two interactive retirement models to illustrate the factors, such as inflation, that can affect the amount of retirement income a participant's savings may generate and depict ways in which participants can use their 401(k) savings in coordination with other sources of retirement income, such as Social Security.

We conducted this performance audit from July 2014 to August 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Surveys of Defined Contribution Participants

Boston Research Technologies agreed to include questions we wrote to collect data for this report in a survey of plan participants conducted in April 2015. We are reporting survey results from that survey as well as a second survey of participants conducted by Boston Research Technologies at the same time. We reviewed the methodologies of these surveys and concluded they were suitable for our purposes. The first survey included questions we provided about participants' experiences with lifetime income options offered through their plan and had 5,804 completed responses. The target population of this survey was full-time workers who participate in a defined contribution plan. The second survey, with 3,594 completed responses, included questions about managing retirement savings in multiple accounts. The target population of this survey was full-time, part-time, and contract workers whose current employer offers a defined contribution plan. Since both surveys represent only a sample of the potential population, they are subject to sampling error. For the first survey, we estimate that the sampling error is approximately 1.7 percent at the 95 percent confidence interval. We estimate that the sampling error for the second survey is 1.5 percent at the 95 percent confidence interval. While Boston Research Technologies took great efforts to ensure the sample population correctly represented the true population, we do not have an exact response rate and therefore cannot directly calculate non-sampling error, which could occur if survey responses differed in some systematic way from the true population. Additionally, each survey included a few respondents who reported participating in other types of defined contribution plans such as 457 plans, which are for state and local governments and tax-exempt organizations.[2] Participants in these types of plans may exhibit different behavior with respect to lifetime income options than that of 401(k) participants. For these reasons, to determine whether we considered the survey population, sample and question results reflective of the larger population, we compared sample demographic characteristics and selected survey responses against data from other large samples of 401(k) participants and found the population broadly similar in characteristics such as participant age and job tenure.[3] As a result, we generalize the survey responses as the views of the broader population of 401(k) participants.

Survey of Plan Sponsors

We created a web-based survey of plan sponsors on 401(k) lifetime income and conducted it between May 18th and July 24th, 2015. We received 54 completed responses. We publicized the survey to the membership of industry organizations such as PLANSPONSOR, the Plan Sponsor Council of America, the National Association of Plan Administrators, BenefitsLink, and Pensions and Investments. These organizations distributed the survey to their members, but they did not collect survey responses, which were sent directly to GAO. To develop the questions and answer sets, we analyzed information gathered through stakeholder interviews and our review of relevant regulations and legislation. We pre-tested questions with stakeholders external to GAO with the assistance of GAO methodologists. We provided text fields to allow respondents to elaborate qualitatively or provide additional insights. Data collected through the survey are not generalizable and reflect the

[2] 26 U.S.C. § 457. Approximately 76 percent and 80 percent, respectively, of respondents in the two surveys reported participating in a 401(k) plan.

[3] For example, we compared survey responses to data derived from the Participant Directed Retirement Plan Data Collection Project, a database of 401(k) plan participants maintained by the Employee Benefits Research Institute and the Investment Company Institute. As of December 31, 2013, the database included statistical information about 26.4 million 401(k) plan participants in more than 72,000 401(k) plans, holding approximately $1.9 trillion in assets.

views and experiences of the respondents and not the entire population of 401(k) plan sponsors. Responses may be more indicative of the practices of larger plans. Of the plans represented in the survey, 16 plans had fewer than 100 participants, and 32 had 500 participants or more. Also, 401(k) plans voluntarily participating may be more proactively managed than others.

401(k) Plan Record Keeper Questionnaire

We collected data on plan adoption and participant use of lifetime income options in 401(k) plans from 11 record keepers who together represent about 42 percent of the 401(k) market as measured by assets, 46 percent as measured by participants, and 26 percent as measured by plans.[4] To ensure our analysis reflected the broadest possible range of participants in differing circumstances, we obtained data from a variety of different types of record keepers serving different portions of the 401(k) market. For example, we obtained data from record keeping platforms operated by both insurance companies and mutual fund companies. We also obtained data from record keepers that focus on serving smaller plans as well as those that principally serve large plans. We collected data on the number of plans that offered different withdrawal options and annuities, though some record keeper respondents did not provide data for some products and services. We aggregated and analyzed the responses we received to determine plan adoption of each individual withdrawal or annuity option. Plans that made multiple withdrawal or annuity options available would be included in the totals for more than one option. We did not independently verify the systems used to produce record keepers' data. However, we met with representatives from 10 of the 11 record keepers to discuss the lifetime income options they currently make available to plans and determined the data the record keepers provided accorded with these discussions. We concluded that record keeper data were reliable for our purposes and provide a reasonably accurate depiction of a non-generalizable sample of plans in the 401(k) market.

[4]These record keepers reported serving a total of more than 129,000 plans with almost 28 million participants, holding nearly $1.8 trillion in assets as of December 31, 2014, the most recent full calendar year period for which data was available at the time of our data collection. Eleven record keepers responded to our questionnaire, 9 of whom provided data as of the calendar year ending December 31, 2014. The remaining 2 record keepers provided data for more recent reporting periods.

Assessment of Separation Packets Provided to Participants

We assessed a non-generalizable sample of 16 separation packets that some 401(k) plan sponsors provide to participants near or in retirement. We obtained separation packets from participants and industry stakeholders we interviewed, as well as from publicly available sources such as plan websites. In some instances, we obtained separation packets for specific plans while in other instances we received templates that service providers make available to their plan sponsor clients. As shown in table 5, the separation packets we reviewed represented a broad range of plans as measured by characteristics like plan assets and average account balance. We cannot determine the extent to which the separation packets we assessed are reflective of all separation packets that some plan sponsors make available to their participants. However, given the variety of plans represented in our sample, our assessment can provide valuable insights on the extent to which separation packets include factors we identified that can help participants make informed choices among lifetime income options.

Table 5. The Sample of 16 Separation Packets Reflects a Wide Variety of Plan Characteristics

401(k) Plan Characteristics	Range Reflected in Sample of 16 Separation Packets We Assessed
Plan assets	$1.7 million to $4.3 billion
Number of participants	7 to 48,000
Average account balance	$16,000 to $370,000
Industry	Finance and Insurance Healthcare and Social Assistance Manufacturing Wholesale Trade Legal

Source: GAO analysis of separation packets and publicly available data on selected retirement plans reported by Brightscope, a financial information and technology company that, among other things, collects data on retirement plans. | GAO-16-433

Note: We examined the characteristics of plans where the plan sponsors were readily identifiable. We did not determine the characteristics of plans that use the templates for separation packets we obtained from service providers.

To assess the separation packets, we identified five factors that can help participants make informed decisions about the use of lifetime income options and determined the extent to which the packets address them.[5] We developed these factors from our past work and our review of relevant literature.[6] We obtained a review of the factors from a GAO research methodologist and incorporated feedback on them from three external parties: a researcher who studies the use of lifetime income options in 401(k) plans and representatives of two firms that help employers provide their employees with independent financial guidance and education. To ensure that we applied our factors appropriately to the 16 separation packets, two reviewers independently evaluated the separation packets against criteria we identified in conjunction with a GAO methodologist as subjective, and a third analyst arbitrated any discrepancies between the two reviewers. See table 6 for a more complete description of the five factors and the results of our assessment.

Table 6: Overview of Informational Review of 16 Participant Separation Packets

Factors that can help participants make informed choices about the use of lifetime income options	• Specific elements we looked for to assess whether separation packets address each factor [and the number of separation packet containing each element]
Are the participant's options described?	• Is a description of each option—for example, staying invested in the plan or rolling the account balance over to an individual retirement account—provided? [14 of 16] • If yes, are the advantages and disadvantages of each option provided? [4 of 16] • Are common risks in retirement—such as the longevity risk of outliving savings—described? [1 of 16] • Are the risks associated with each option described? [0 of 16]
Is the information readable?	• Is the separation packet written to the reading level of an eighth grader, based on a Flesh-Kincaid Grade Level test?[a] [4 of 14]

[5]We did not reach any determinations as to the extent to which individual plan sponsors complied with applicable federal requirements.

[6]Past GAO work that we used to help develop these factors included the following. GAO, *Private Pensions: Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Income,* GAO-15-74 (Washington, D.C.: Jan. 27, 2015); GAO, *Private Pensions: Participants Need Information on Risks They Face in Managing Pension Assets at and during Retirement,* GAO-03-810 (Washington, D.C.: July 29, 2003); GAO, *Private Pensions: Clarity of Required Reports and Disclosures Could Be Improved,* GAO-14-92 (Washington, D.C.: Nov. 21, 2013).

Is there a mechanism whereby participants can compare their options?	• Does the separation packet include a tool, such as a retirement income calculator, or links to such tools that can help participants compare their options? [2 of 16]
Are there instructions for accepting an option?	• Are the steps to accept an option noted? [15 of 16] • Are important deadlines noted, such as a deadline for submitting paperwork? [2 of 16] • Are the potential outcomes and implications of not choosing an option, also referred to as a "default option," noted?[b] [3 of 16]
Is a contact provided to whom the participant go for help with understanding options and answering logistical questions?	• Is a contact provided along with contact information, to whom participants can direct their questions? [12 of 16] • Is contact information provided for assistance from the federal government in answering participant questions? [0 of 16] • Is reference made to federally-funded retirement planning resources and tools, such as guidance developed by the Department of Labor and the Department of the Treasury? [1 of 16]

Source: GAO analysis of participant separation packets offered by plan sponsors and service providers | GAO-16-433

Note: We did not reach any determinations as to the extent to which individual plan sponsors complied with any applicable federal requirements.

[a]Flesch-Kincaid tests are readability tests widely used to determine the readability of a text based on the number of words in each sentence and the number of syllables in each word. We use the Flesch-Kincaid grade level formula, which states the readability of text in terms of the grade level of education needed to understand a text. We were unable to conduct Flesch-Kincaid tests on two separation packets due to security protections on the text of the separation packet.

[b]For example, does the separation packet note if participants with balances under $5,000 may be subject to a forced transfer of their account balance into an individual retirement account.

Interactive retirement models

We developed two interactive retirement models to provide contextual information on lifetime income options:

- The first interactive retirement model we developed is based on a similar retirement model we developed for a prior report.[7] The new version of this interactive retirement model allows users to view expected retirement income generated by two types of payment options under a range of circumstances: (1) systematic withdrawal strategies with payments that are (a) a fixed dollar amount, unadjusted for inflation; (b) a percentage of the account balance at retirement, increased annually for inflation; and (c) based on life expectancy at each age of withdrawal, using factors published by the IRS for purposes of complying with required minimum distributions

[7]To view the retirement model from our prior report, see GAO, *401(k) Plans: Other Countries' Experiences Offer Lessons in Policies and Oversight of Spend-down Options*, GAO-14-9 (Washington, D.C.: Nov. 20, 2013).

(RMD) and determining substantially equal periodic payments, and (2) an immediate annuity that makes level payments based on the lifetime of an individual retiree. We developed, in consultation with GAO's actuaries and an external actuary who has expertise in annuity pricing, a formula that was calibrated to approximate annuity prices similar to those found in U.S. retail annuity markets in July 2013.[8] Because we simulated retail annuity prices, the annuity payment differs by gender. Annuities offered inside a 401(k) plan would not differentiate pricing by gender and may be rated differently than retail annuities.[9] All income streams illustrated by the model are presented in real dollars, which reflects an assumed annual inflation rate of 2.25 percent throughout the projection period. The interest rates and investment return assumption ranges were based on analysis of current and historical capital market data and consideration of professional forecasts of key economic indicators. We also consulted with GAO's actuaries and two GAO economists in setting these ranges. 401(k) account balance options are for illustrative purposes only, and are not intended to be representative of actual account balances held by 401(k) plan participants as of publication. As such, the amount of income illustrated by the model also should not be considered representative of what actual 401(k) participants could generate with their savings as of publication.

- The second interactive retirement model illustrates potential lifetime income strategies that combine different options for generating retirement income, including several Social Security claiming options, systematic withdrawals from a 401(k) account, and partial annuitization of a 401(k) account balance. The systematic withdrawal strategy is structured to provide a level amount of total inflation-adjusted income when combined with Social Security and annuity income that is purchased with plan savings. The model and the systematic withdrawal strategy assume that retirees live to age 100, unused account balances earn 3 percent real return, and inflation grows at 2.25 percent per year. The model does not reflect the effect that actual lifespan, investment returns, and inflation could have on

[8]We used the same annuity pricing information as we did in a prior report (see GAO-14-9).

[9]Annuities offered in 401(k) plans and other employer-sponsored retirement plans must be offered on a gender-neutral basis. *Arizona Governing Committee v. Norris*, 463 U.S. 1073 (1983). By contrast, annuities offered in other market segments are not subject to this ruling, and pricing may vary based on gender.

the illustrated retirement strategy. The model allows users to include or exclude a fixed immediate annuity based on the age of the illustrated retiree and purchased from the 401(k) account balance in the illustration. We obtained annuity prices from an annuity shopping platform provider who provided averaged quotes across multiple annuity providers as of January 2016. As such, modeled annuity prices reflect the pricing available through a platform provider and differ by gender. Annuities offered inside a 401(k) plan would not differentiate pricing by gender and may be rated differently than other market segments. The model includes Social Security retirement benefits, and allows users to defer the age at which benefits are first claimed if retirement occurs before age 70. Social Security benefit amounts were obtained from the Social Security Administration's Social Security Quick Calculator, using data for the illustrated retiree as inputs. The model assumes retirement occurs at the end of 2015, regardless of the retirement age selected. 401(k) account balance options are for illustrative purposes only and are not intended to be representative of actual account balances held by 401(k) plan participants as of publication. As such, the amount of income illustrated by the model also should not be considered representative of what 401(k) participants could generate with their savings as of publication. We also consulted two external stakeholders with expertise on lifetime income options regarding our model.

The ranges, calibration of the annuity rates, and estimated Social Security benefits provide illustrative context for the report but are not material to the findings, conclusions, or recommendations. However, the assumptions and methodology used to develop the models, as well as numerous test cases, were reviewed by a GAO actuary. The retirement income depicted in the interactive retirement models does not reflect federal or state taxes. Dollar amounts in the interactive retirement models are for illustrative purposes only, and should not be considered representative of individual circumstances or the pricing of annuities available in the market. The model is provided for illustrative purposes only and modeled results should not be construed or used as financial advice.

Appendix II: Accumulation, Withdrawal, and Insured Phases of a Guaranteed Minimum Withdrawal Benefit

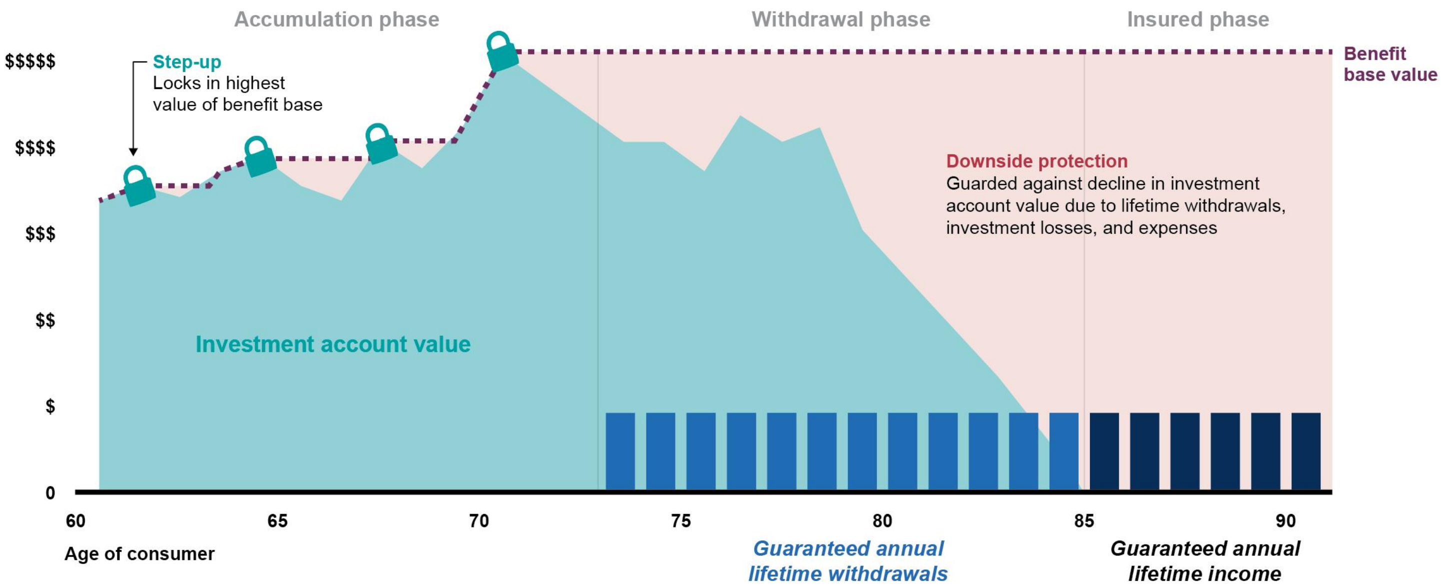
The contract terms for guaranteed minimum withdrawal benefits (GMWB) vary across providers but generally consist of an accumulation, withdrawal, and insured phase (see fig. 15).

Accumulation: The accumulation phase begins when a participant purchases a GMWB contract, which establishes the benefit base from which lifetime withdrawals are made. This benefit base is the amount to which lifetime withdrawal percentages will be applied to determine minimum insured lifetime income. The investment account value represents the total value of the participant's investments. During this phase the participant decides how to allocate investment assets among various options made available. The insurer monitors the participant's account value and automatically adjusts or steps-up the benefit base periodically should additional contributions or investment gains increase the value of the account. Once a benefit base is stepped up, it typically does not later decline because of investment losses that may reduce the participant's investment account value. However, the benefit base is separate from the account value, cannot be withdrawn as a lump sum or annuitized, and is not payable as a death benefit.

Withdrawal: The withdrawal phase starts when a participant begins taking withdrawals. The maximum withdrawal amount that a participant can take in a year (without incurring a reduction in their benefit base) is generally calculated as a percentage of the participant's benefit base at the time of the first withdrawal. As in the accumulation phase, the insurance company will typically increase the benefit base if a participant's account value, net of withdrawals and fees, increases above the existing benefit base, which may in turn increase the minimum insured lifetime income and the maximum withdrawal that the participant may take without reducing the benefit base.

Insured: A participant enters the insured phase if their investment account value has been reduced to zero as a result of withdrawals, investment losses, or any expenses, fees, or other charges. In such cases, the participant's benefit base (the amount to which the withdrawal percentage is applied) remains unchanged, but the participant's investment account value is zero. The funds needed to continue paying benefits to the participant would then come from the insurance company's assets, and participants would receive payments from the insurance company equal to the minimum insured lifetime income, generally a percentage of the benefit base determined at the time of the first withdrawal amount. Once the insurance company begins paying the agreed-upon insured payment, the fees that the participant had been paying for that protection would cease, as would any investment management and other fees paid for other benefits. Once the insured phase begins, all rights and benefits under a GMWB product terminate except those related to continuing benefits, and all lifetime withdrawal benefits will continue to be paid to the participant on the established schedule and generally cannot be changed.

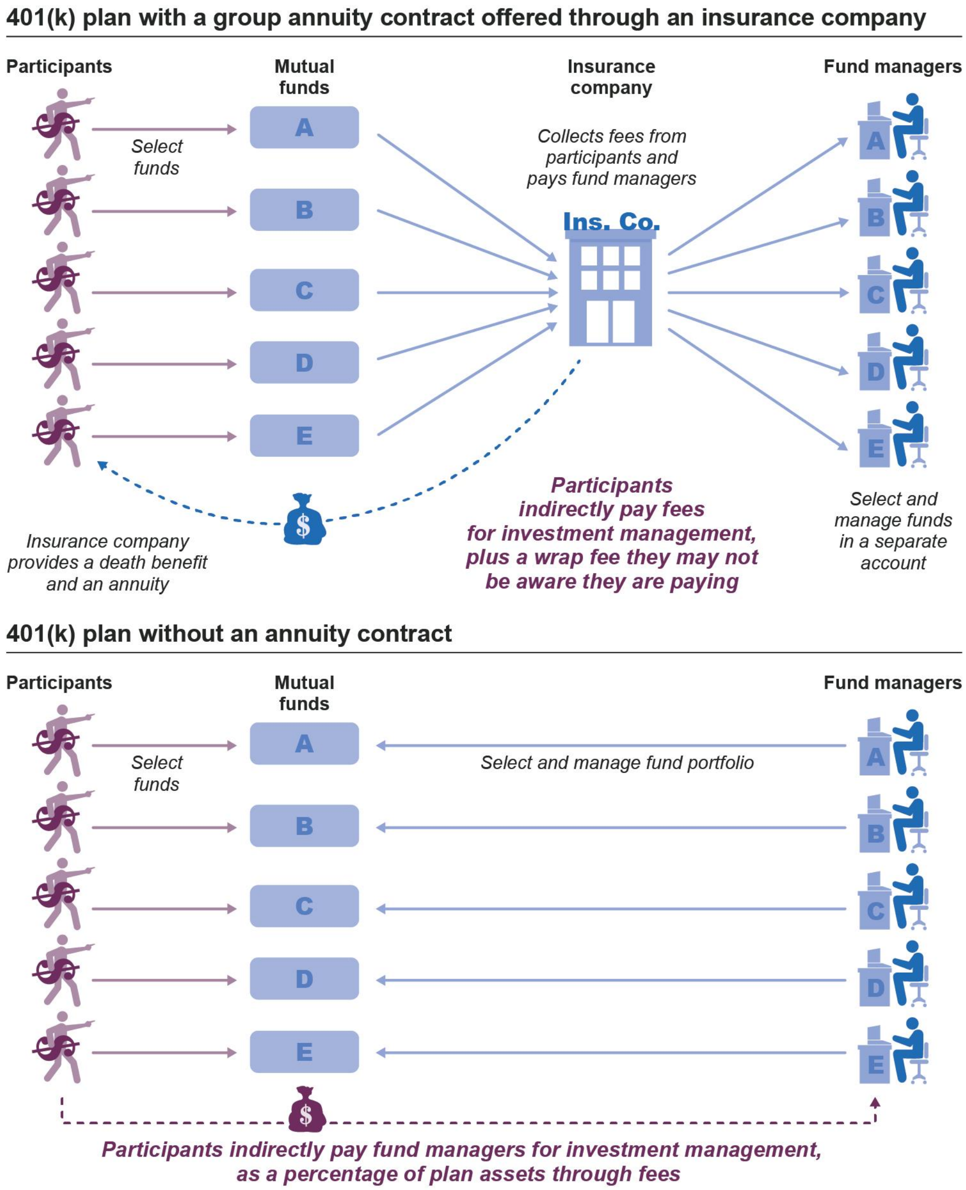
Figure 15: Accumulation, Withdrawal, and Insured Phases of a Guaranteed Minimum Withdrawal Benefit



Source: GAO analysis of product information provided by insurers for GAO-13-75. | GAO-16-433

Appendix III: Illustration of Plan Funding Mechanisms

Figure 16: Comparison of 401(k) Plans Funded with and without a Group Annuity Contract



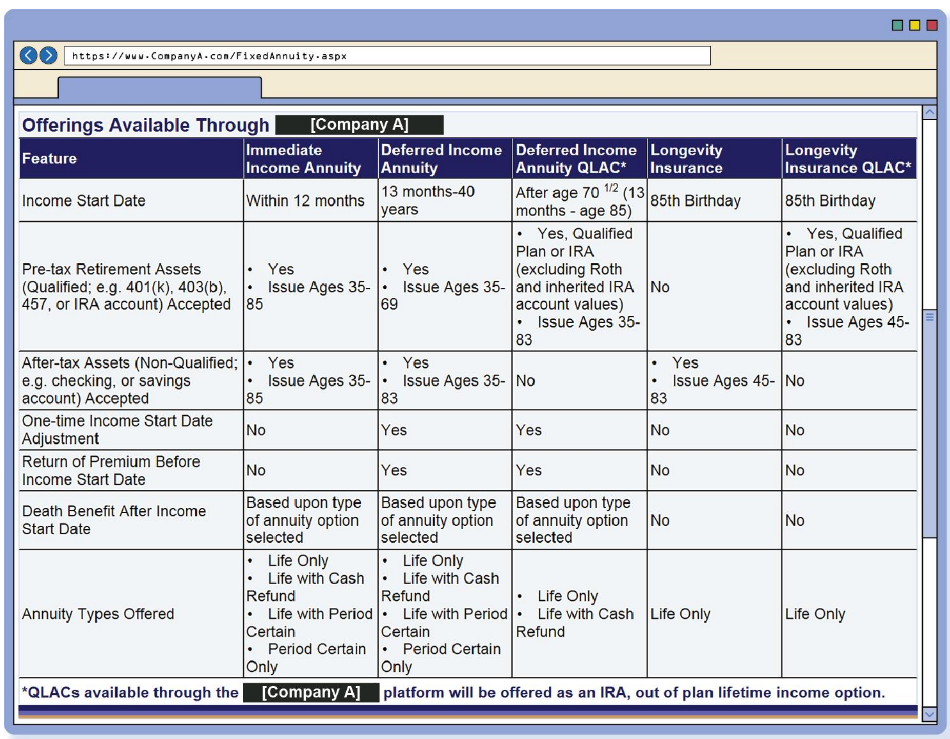
Source: GAO analysis of information from industry practitioners for GAO-12-325. | GAO-16-433

Note: Insurance companies have traditionally used group annuity contracts as a funding mechanism for the plans they administer. Group annuity contracts are used as a mechanism for insurers to administer plan assets. The insurance company contracts with fund managers and pays fees to create separate accounts that look like publicly available mutual funds, but which are available only as investments to participants in plans that contract with that insurance company.

Appendix IV: Online Annuity Shopping Platforms

Annuity shopping platform technology offers certain benefits to 401(k) participants. Such technology can offer multiple, competing products on a single interface where participants can comparison shop by price. Participants may be able to input information about what they are looking for, allowing them to customize the annuity to fit their financial plan. Participants may be able to choose how much of their account to devote to the annuity, their income starting date, and select or unselect features like death benefits to view the resulting price change. For example, a participant might choose to set aside an amount as small as $10,000 to manage longevity and cognitive risk without losing access to the rest of their savings. An official of one platform compared their platform to the way technology now allows shoppers in other markets to compare prices on airplane flights and hotels. An official at another platform told us it sells annuities for a 1 percent commission as opposed to the 6 or 7 percent commission stakeholders told us was typical of the retail market. According to that official, the annuity shopping platform also offers its own education and advice services apart from those offered by the plan. Figure 17 shows products available on one platform.

Figure 17: Products Available on One Annuity Shopping Platform



Offerings Available Through [Company A]

Feature	Immediate Income Annuity	Deferred Income Annuity	Deferred Income Annuity QLAC*	Longevity Insurance	Longevity Insurance QLAC*
Income Start Date	Within 12 months	13 months-40 years	After age 70 1/2 (13 months - age 85)	85th Birthday	85th Birthday
Pre-tax Retirement Assets (Qualified; e.g. 401(k), 403(b), 457, or IRA account) Accepted	• Yes • Issue Ages 35-85	• Yes • Issue Ages 35-69	• Yes, Qualified Plan or IRA (excluding Roth and inherited IRA account values) • Issue Ages 35-83	No	• Yes, Qualified Plan or IRA (excluding Roth and inherited IRA account values) • Issue Ages 45-83
After-tax Assets (Non-Qualified; e.g. checking, or savings account) Accepted	• Yes • Issue Ages 35-85	• Yes • Issue Ages 35-83	No	• Yes • Issue Ages 45-83	No
One-time Income Start Date Adjustment	No	Yes	Yes	No	No
Return of Premium Before Income Start Date	No	Yes	Yes	No	No
Death Benefit After Income Start Date	Based upon type of annuity option selected	Based upon type of annuity option selected	Based upon type of annuity option selected	No	No
Annuity Types Offered	• Life Only • Life with Cash Refund • Life with Period Certain • Period Certain Only	• Life Only • Life with Cash Refund • Life with Period Certain • Period Certain Only	• Life Only • Life with Cash Refund	Life Only	Life Only

*QLACs available through the [Company A] platform will be offered as an IRA, out of plan lifetime income option.

Source: Annuity shopping platform website. | GAO-16-433

Based on our record keeper questionnaire, less than 1 percent of plans adopted an annuity shopping platform. According to a representative of one annuity shopping platform provider, plan sponsors were not using it as an in-plan option because of concerns about legal risks associated with selecting annuity providers.[1] The other two annuity shopping platforms we found to be in operation also appeared to cater exclusively to the retail market rather than to participants in employer-sponsored plans.

One online annuity shopping platform offers a means for plan sponsors to make the platform available to participants in a way that the provider believes makes it an out-of-plan option. According to a representative of the platform, at retirement the shopping platform can appear on the participant's distribution form as part of a lump sum option labeled "IRA/Annuity Platform". When selected, a participant's funds are rolled into an IRA and the participant is provided the opportunity to make an annuity purchase from among choices provided through the platform. In 2010, this annuity shopping platform was available to over a thousand plans and millions of participants, but 98 percent of plans adopting it were doing so through this type of arrangement involving an IRA. According to this provider, because it is an out-of-plan option, employers often require participants to acknowledge a disclaimer stating that the employer does not endorse the platform or its choices, which according to the provider contributes to more than 50 percent of participants exiting the platform without obtaining an annuity. The provider's IRA rollover solution was intended to resolve plan sponsors fiduciary liability concerns in 2005, but according to that provider, those concerns remain today.

[1] While the annuity shopping platform's website does not profess to have drawn conclusions about the ability of all participating insurers to make all future payments, it provides a profile on each, including ratings from three credit agencies. According to its 2010 RFI submission, it also augments its internal research and expertise with an independent research firm that specializes in insurance company analysis.

Appendix V: Lifetime Income Options in 401(k) Plans and Retail Markets

In-Plan Options Use a Familiar Environment

Experts have identified the workplace as potentially being a particularly effective venue for providing financial education and helping individuals improve their financial decision making. Employers have the potential to reach large numbers of adults in a cost-effective manner at a place where they make important financial decisions regarding retirement. Financial literacy—the ability to use knowledge and skills to manage financial resources effectively—is becoming increasingly important.[1]

Participants make decisions about lifetime income options in the same plan environment in which they have become accustomed to making decisions to accumulate savings, (e.g., on the plan website or by submitting a form). The authors of a report on lifetime income options noted that by simplifying the steps needed to select and combine lifetime income options, plan sponsors can help participants overcome inertia to make complex retirement planning decisions about their retirement income strategies.[2] One way to do this is to integrate the selection of lifetime income options into the routine tasks participants may perform. For example, each time participants change their investment allocation using a plan website designed by one record keeper we interviewed, they are also given the option to invest some of their savings in a fund that will gradually and automatically turn into a guaranteed minimum withdrawal benefit (GMWB) as the participant nears retirement. In a second example, a managed account service provider told us participants can typically implement their recommendations on a plan's lifetime income options at the click of a button.

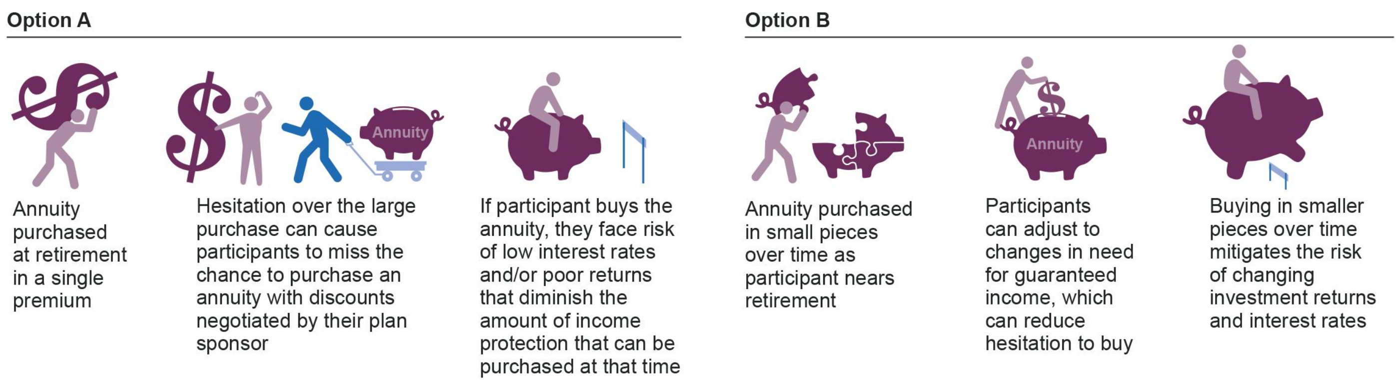
In-plan annuities can be offered as an investment option purchased in smaller amounts over time as the participant nears retirement. For example, more than 44 percent of the mid-size 401(k) plans represented in our record keeper questionnaire that adopted GMWBs allow participants to purchase those benefits over time through periodic contributions. Figure 18 shows how purchasing annuities in this way can help participants address, for example, the risk of purchasing a single,

[1] GAO, *Highlights of a Forum, Financial Literacy: The Role of the Workplace,* GAO-15-639SP. (Washington, D.C.: July 7, 2015).

[2] Stanford Center on Longevity, *The Next Evolution in Defined Contribution Retirement Plan Design: A Guide For DC Plan Sponsors To Implementing Retirement Income Programs* (Stanford, CA: September 2013).

large annuity when interest rates might be unfavorably low ("interest rate risk"). Breaking up annuity purchases into smaller amounts can also help participants address the hesitation associated with a single, large purchase. For example, one independent financial adviser told us splitting up annuity purchases helps build her clients' comfort with the idea of annuitizing a modest portion of their retirement savings. It also gives them time to react to changes in their health or financial status that could change their need for annuitization.

Figure 18: Purchasing an Annuity at One Time or in Small Pieces



Source: GAO analysis of stakeholder documents and interviews, past GAO work, and our record keeper questionnaire. | GAO-16-433

The Protections of In-Plan Options

Most plan sponsors we surveyed cited the potential regulatory protections provided through ERISA as an additional advantage of in-plan lifetime income options.[3] We have reported on these protections, including the requirement that plan fiduciaries act solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing plan benefits and defraying the expense of plan administration.[4] Other protections, as shown in table 7, include the selection and monitoring of

[3]Specifically, 35 of the 54 plan sponsors we surveyed cited as an advantage the ability to keep participants under the fiduciary protections of their plan. Similarly, 38 of the 54 plan sponsors we surveyed reported access to cheaper options through institutional pricing as an advantage of in-plan lifetime income options.

[4]GAO-13-30

appropriate investment options and holding down and clearly disclosing fees.

Table 7: In-Plan and Retail Market Protections Identified in Prior GAO Work

Key differences	401(k) plan	Retail Market
Investment selection and monitoring	Plan fiduciaries are responsible for selecting and monitoring investment options in the best interest of the participant.	Individual is solely responsible for selecting and monitoring investments.
Fees	Plans may offer low-fee mutual fund investments through institutional pricing.	IRA providers generally offer retail mutual funds and reserve less costly share classes for only those individuals with large balances.
Fee disclosure	Subject to DOL regulations regarding disclosure of fee information intended to make it easier for participants to understand and compare fees.	Not subject to DOL regulations regarding disclosure of fee information, but SEC requires certain disclosures in individual mutual fund prospectuses and summary prospectuses.

Source: Excerpts of GAO research and interviews conducted for GAO-13-30. | GAO-16-433

Note: Regulatory actions by EBSA have recently established arrangements through which investment advisers in the retail market may, under certain circumstances, be obligated to provide descriptions of the types of fees and compensation they may receive in connection with recommended transactions. Best Interest Contract Exemptions, 81 Fed. Reg. 21,002, 21,079-80 (April 8, 2016).

Plan sponsors can typically obtain lower fees for lifetime income options. We have reported that participants generally pay lower fees through their plan than they would on their own because plan sponsors can use participants' combined savings to negotiate with service providers.[5] An industry report noted this may benefit participants with smaller balances because in a 401(k) plan, all participants typically pay the same relative costs, such as the same annual fee as a percentage of their investment in

[5]In 2009, we reported that plan sponsors may be able to negotiate with insurance companies for lower fees on annuities, take advantage of economies of scale to secure a lower per-participant charge from their record keeper, and take advantage of "breakpoints"—the designated dollar amounts at which management fees are reduced—often provided by mutual funds for investors with higher volume. Plan sponsors can also issue a request for proposals (RFP) to lower costs and decrease fees charged to participants. In response to an RFP, service providers submit bids describing their services and fees to the sponsor, who may then choose service providers who meet participants' needs and charge lower fees. GAO, *Retirement Savings: Better Information and Sponsor Guidance Could Improve Oversight and Reduce Fees for Participants*, GAO-09-641 (Washington, D.C.: Sep. 4, 2009).

a lifetime income option.[6] According to a study of lifetime income options, under certain conditions participants who remain invested in their plan can increase retirement income from certain withdrawal options by more than 20 percent after 20 years.[7] Industry stakeholders also reported that in-plan annuities are generally less expensive than their retail-market counterparts in part because plan sponsors can reduce or eliminate the commissions paid to make annuities available for sale on an individual basis. Representatives of one 401(k) plan told us that in-plan, they could access an annuity product for their participants at less than half the cost of comparable retail options. According to one association of insurance and financial services companies, assets covered by an in-plan guarantee totaled $3.6 billion in 2014, while retail annuity sales that same year totaled more than $235 billion.[8]

Product Variety, Gender Pricing and Consolidation in 401(k) Plans

Several industry stakeholders reported that retail annuity markets offer a wider variety of options than are available for use in 401(k) plans. Additionally, retail versions of annuities may have more sophisticated features than those available as in-plan options. One insurance company explained how the retail version of a GMWB they offer allows individuals to “lock in” positive investment returns on a daily basis. However, this feature was too complicated for the in-plan version, which instead only allows participants to lock in investment gains once a year. Similarly, one researcher told us the withdrawal options currently available to participants may not be sophisticated enough to adapt to fluctuating investment returns and other changes in a participant’s circumstances. One managed account service provider we interviewed told us the service can help participants develop more responsive withdrawal strategies that change from year to year depending on participants’ circumstances.

[6]Ashton, Bruce; Kronheim, Steven and; Reish, Fred*, Fiduciary Considerations in Selecting a Lifetime Income Provider for a Defined Contribution Plan*, New York University Review of Employee Benefits and Executive Compensation—2014 9-1 (Alvin D. Lurie ed., LexisNexis Matthew Bender 2014).

[7]Stanford Center on Longevity, *The Next Evolution in Defined Contribution Retirement Plan Design: A Guide For DC Plan Sponsors To Implementing Retirement Income Programs* (Stanford, CA: September 2013).

[8]See LIMRA Secure Retirement Institute™, *In-Plan Income Guarantee Availability and Election Tracking Survey* (Windsor, CT: April 2015). Also see *LIMRA Secure Retirement Institute U.S. Individual Annuities Sales Survey* (Windsor, CT: March 2015).

However, as we reported in 2015, managed account services still represent a small, if growing, portion of the 401(k) market.[9]

We have also reported that annuity pricing in 401(k) plans may create instances where male participants are better off purchasing an annuity in retail markets rather than through their plan.[10] Retail annuities typically vary based on gender. As a result, men, who tend not to live as long as women, can generally secure higher monthly payments from an annuity than women with otherwise similar characteristics. In contrast, annuities offered in 401(k) plans must be priced on a gender-neutral basis. This requirement stems from a Supreme Court decision ruling that employers sponsoring plans offering annuities that make smaller monthly payments to women than to men violate a ban on gender-based employment discrimination.[11] According to Treasury officials and researchers, the effects of gender on in-plan annuity prices may be offset by other factors such as the plan sponsor's ability to negotiate lower fees. One researcher added that the potential effects of an annuitant's gender on the pricing of in-plan annuities is also limited because prices for opposite sex joint and survivor annuities take into account both male and female longevity and so are priced more similarly in institutional and retail markets.[12]

Participants may also have trouble consolidating multiple 401(k) accounts to manage their retirement savings from a single account. As evidenced by our survey of defined contribution plan participants in coordination with a research firm, a vast majority of participants are likely to accumulate more than one account over their career.[13] The majority of participants we surveyed reported they would likely pay for a service that consolidates their accounts into their current plan if their plan sponsor offered one.

[9]GAO, *401(K) Plans: Clearer Regulations Could Help Plan Sponsors Choose Investments for Participants*, GAO-15-578 (Washington, D.C.: Aug. 25, 2015).

[10]GAO-14-9.

[11]*Arizona Governing Committee for Tax Deferred Annuity & Deferred Compensation Plans v. Norris, 463 U.S. 1073 (1983).*

[12]A joint and survivor annuity continues to make payments until the later of the participant's or the participant's partner's death.

[13]See Appendix I for a description of our coordination with independent research firm Boston Research Technologies on two surveys it conducts of defined contribution participants.

Almost all participants we surveyed would view such a service as a valuable benefit if their plan sponsor made it available, as compared with other workplace benefits they might receive (see fig. 19).

Figure 19: Participants Surveyed Value the Ability to Consolidate 401(k) Accounts

Most participants would appreciate help from their current plan sponsor in consolidating their accounts

63 percent of participants would be likely to pay for a service to help them consolidate accounts from past employers in their current DC plan.

81 percent of participants would be likely to pay for a service to help them consolidate an Individual Retirement Account (IRA) in their current DC plan.

93 percent of participants would view such a service as a good or excellent benefit relative to other benefits their employer might provide.

Source: Boston Research Technologies 2015 Study of Defined Contribution (DC) Participants' Portability Behaviors, Experiences, Needs, and Attitudes. | GAO-16-433

Appendix VI: Comments from the U.S. Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

MAY 1 8 2016

Mr. Charles A. Jeszeck
Director, Education, Workforce, and Income Security
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review your draft report (GAO-16-433) entitled "401(k) Plans: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants." The draft report concerns challenges 401(k) plan participants encounter in making their retirement savings last for their entire lifetime and the legal risks and constraints that may deter many plan sponsors from offering lifetime income options in their 401(k) plans.

The draft report recommends that the Department of Labor (Department) amend its safe harbor regulation at 29 CFR §2550.404a-4 applicable to the selection of a distribution annuity in an individual account plan to provide more detailed criteria related to the requirement that the fiduciary assess the insurer's solvency and long-term ability to pay benefits promised under the annuity contract. Second, the draft report recommends that the Department provide additional fiduciary relief, similar to that available under ERISA section 404(c), when the plan offers an "appropriate mix" of annuity and lifetime income withdrawal options for employees to choose among. Third, the draft report recommends that the Department issue new guidance or amend EBSA's publication "Meeting Your Fiduciary Responsibilities" to encourage employers to offer and employees to use lifetime income options in defined contribution plans.

We agree that workers today face greater responsibility for managing their assets for retirement, both while employed and during their retirement years. This greater responsibility is primarily a result of the trend away from defined benefit plans, where a worker's retirement benefit is typically a specified monthly payment for life, and toward defined contribution plans, where typically contribution, asset allocation, and drawdown decisions are assigned to the participant. Managing finances in order to provide income for life for oneself and one's spouse is a tremendously difficult but important task.

In view of the importance of this issue, the Department and the Department of the Treasury, jointly and separately have taken a variety of actions, noted in your draft report, in connection with 401(k) and other defined contribution plans to explore ways to facilitate access to, and use of, lifetime income or other arrangements designed to provide a lifetime stream of income after retirement. Thus, there can be no dispute that we are committed to continuing to explore steps to advance lifetime income options in individual account retirement plans. The Department, however, has reservations about your recommendations.

Under the annuity selection safe harbor, the selection of an annuity provider and contract for benefit distributions from an individual account plan satisfies the requirements of section 404(a)(1)(B) of ERISA if the fiduciary: (1) engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities; (2) appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract; (3) appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract; (4) appropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and (5) if necessary, consults with an appropriate expert or experts for purposes of meeting these conditions.

As to your first recommendation, we do not believe that the best approach to the issues identified in your draft report is to have the Department attempt to "help plan sponsors minimize their legal risks" by defining detailed criteria that would satisfy ERISA's prudence and loyalty requirements for selecting an insurer to guarantee lifetime payment of an employee's accrued benefits. Rather than strengthening consumer protections for plan participants and beneficiaries, we are concerned that your suggestion carries the risk of degrading the oversight required of a fiduciary responsible for protecting the rights and interests of plan participants and beneficiaries. Moreover, the approach in the annuity selection safe harbor regulation is consistent with the approach in the ERISA regulation at section 2550.404a-1 regarding fiduciary obligations in connection with investment duties in general.

With respect to your second recommendation, we are concerned that adopting your suggestion could in effect result in a transfer of the responsibilities associated with the selection of the annuity provider from a responsible fiduciary to an individual employee when he or she selects a lifetime income option. Moreover, it is unclear how conditioning the fiduciary relief on the plan offering an "appropriate mix" of annuity and lifetime income withdrawal options changes in any material way the issues for the fiduciary responsible for the selection of the annuity because the fiduciary would still need to make a prudent selection of the lifetime income providers and the products.

We believe a better approach to the issues identified in your draft report is to explore efficient and cost effective ways to put the evaluation of the annuity provider in the hands of fiduciaries with financial expertise who are capable of satisfying ERISA's requirements without the need of a regulation that would reduce the obligations fiduciaries have to protect the interests of plan participants and beneficiaries. As noted in your draft report, such an approach is reflected in the EBSA October 23, 2014, information letter from Phyllis C. Borzi to J. Mark Iwry. In that case, the Department concluded that a series of target date funds with investments in unallocated deferred annuity contracts could serve as "qualified default investment alternatives" within the meaning of 29 CFR §2550.404c-5 (QDIA regulation). The investment product incorporated a financial institution acting as an ERISA fiduciary responsible for conducting a prudent evaluation of the unallocated deferred annuity contracts in the TDFs. We understand similar product innovations are already being developed for the retirement plan marketplace. In fact, your report states that "[i]ndustry stakeholders also told us that they expect adoption of deferred annuities, such as QLACs, embedded in target date funds, to increase in the future as more providers introduce their products to the in-plan market and more plans adopt them as a default solution." That approach would also be consistent with the suggestion in your report that federal

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agencies give particular consideration to the selection and setting of default options when individuals are presented with choices.

Furthermore, we understand that financial institutions are innovating in other ways in this area, such as by developing fiduciary services where they will conduct a reasonable, independent investigation and evaluation of the risks and other characteristics of a proposed annuity provider for the employer who is interested in offering lifetime income solutions to employees. Your report states that representatives of one annuity provider told GAO that there were only a few big consulting firms that would be able to help plan sponsors meet the requirements under the safe harbor regulation, and that it would be expensive to contract with them. It was not clear from your report, however, whether you also spoke with financial institutions that have recently announced that they are adding this kind of fiduciary service to their business models. We also note that the 2014 ERISA Advisory Council recently conducted a study and issued a report on "outsourcing" employee benefit plan services with a particular focus on functions that historically have been handled by employers, such as ''named fiduciary'' responsibilities.[1] We believe that having a financial institution assume ERISA fiduciary responsibility as an investment manager for these decisions under Section 3(38) of ERISA better preserves ERISA's prudence and loyalty duties in annuity selection decisions while also addressing plan sponsors' concerns about not having the requisite education, experience or skill to prudently select and monitor an annuity provider.

The Department, nonetheless, is open to considering alternative regulatory approaches of the sort identified in your draft report. Implementing either of your first two recommendations would require a public notice and comment regulatory process. EBSA already has an active regulatory agenda focused on implementing top priority objectives established by the Secretary and the Administration. As noted in your report, we have a regulatory project on the agenda relating to possible amendments to the annuity selection safe harbor. That project was recently moved to "long term action" status because of our need to focus on higher priority regulatory projects. We will, however, include your recommendations as part of our ongoing development and prioritization of EBSA's regulation agenda.

With respect to your recommendation on retirement savings education activities, we believe that our outreach programs, retirement savings education campaign, and numerous publications reflect our commitment to helping America's retirement savers make more informed decisions regarding their retirement plans and benefit distribution options. We will review our publications along the lines of the recommendation in your draft report to explore ways in which we may take steps to better educate participants and plan sponsors about the need to think about retirement savings in terms of lifetime income and to encourage use of products and

[1] The Council report includes the following observation: "Outsourcing of benefit plan functions, administrative, investment and otherwise, is a practice that predates ERISA. However, its prevalence and scope have grown significantly since ERISA's passage, and has accelerated over the last ten years. Certain functions by their nature must be outsourced to a third party (*e.g.,* auditing a plan's financial statements), while others for practical reasons have been outsourced by most plan sponsors (*e.g.,* defined contribution recordkeeping). In addition, there appears to be an emerging trend toward outsourcing functions that have traditionally been exercised by plan sponsors or other employer fiduciaries (*e.g.,* administrative committee, investment committee, etc.), including functions such as investment fund selection, discretionary plan administration, and investment strategy." The Council's report is available at *http://www.dol.gov/ebsa/publications/2014ACreport3.html.*

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In conclusion, EBSA is committed to protecting the retirement benefits of workers, retirees, and their families. We appreciate having had the opportunity to review and comment on the draft report. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,

Phyllis C Borzi

Phyllis C. Borzi
Assistant Secretary

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Appendix VII: GAO Contact and Staff Acknowledgements

GAO Contacts

Charles Jeszeck, (202) 512-7215 or jeszeckc@gao.gov.

Staff Acknowledgments

In addition to the contact named above, Tamara Cross (Assistant Director), Tom Moscovitch and Ted Leslie (Analysts-in-Charge), and David Lin made key contributions to this report. Also contributing to this report were James Bennett, Ted Burik, Diantha Garms, Gene Kuehneman, Sheila McCoy, Meredith Moore, Ernest Powell, Joseph Silvestri, Anne Stevens, Frank Todisco, Kathleen van Gelder, Walter Vance, and Craig Winslow.

Appendix VIII: Accessible Data

Agency Comment Letter

Text of Appendix VI: Comments from the U.S. Department of Labor

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Department of Assistant Secretary for

Employee Benefits Security Administration

Washington, D.C. 20210

JUL 18 2016

Mr. Charles A. Jeszeck

Director, Education, Workforce, and Income Security

United States Government Accountability Office

Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review your draft report (GA0-16-433) entitled "401(k) Plans: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants." The draft report concerns challenges 401(k) plan participants encounter in making their retirement savings last for their entire lifetime and the legal risks and constraints that may deter many plan sponsors from offering lifetime income options in their 401(k) plans.

The draft report recommends that the Department of Labor (Department) amend its safe harbor regulation at 29 CFR §2550.404a-4 applicable to the selection of a distribution annuity in an individual account plan to provide more detailed criteria related to the requirement that the fiduciary assess the insurer's solvency and long-term ability to pay benefits promised under the annuity contract. Second, the draft report recommends that the Department provide additional fiduciary relief, similar to that available under ERISA section 404(c), when the plan offers an "appropriate mix" of annuity and lifetime income withdrawal options for employees to choose among. Third, the draft report recommends that the Department issue new guidance or amend EBSA's publication "Meeting

Your Fiduciary Responsibilities" to encourage employers to offer and employees to use lifetime income options in defined contribution plans.

We agree that workers today face greater responsibility for managing their assets for retirement, both while employed and during their retirement years. This greater responsibility is primarily a result of the trend away from defined benefit plans, where a worker's retirement benefit is typically a specified monthly payment for life, and toward defined contribution plans, where typically contribution, asset allocation, and drawdown decisions are assigned to the participant. Managing finances in order to provide income for life for oneself and one's spouse is a tremendously difficult but important task.

In view of the importance of this issue, the Department and the Department of the Treasury, jointly and separately have taken a variety of actions, noted in your draft report, in connection with 401(k) and other defined contribution plans to explore ways to facilitate access to, and use of, lifetime income or other arrangements designed to provide a lifetime stream of income after retirement. Thus, there can be no dispute that we are committed to continuing to explore steps to advance lifetime income options in individual account retirement plans. The Department, however, has reservations about your recommendations.

Under the annuity selection safe harbor, the selection of an annuity provider and contract for benefit distributions from an individual account plan satisfies the requirements of section 404(a)(I)(B) of ERISA if the fiduciary: (1) engages in an objective, thorough and analytical

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search for the purpose of identifying and selecting providers from which to purchase annuities; (2) appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract; (3) appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract; (4) appropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and (5) if necessary, consults with an appropriate expert or experts for purposes of meeting these conditions.

As to your first recommendation, we do not believe that the best approach to the issues identified in your draft report is to have the Department attempt to "help plan sponsors minimize their legal risks" by defining detailed criteria that would satisfy ERISA's prudence and loyalty requirements for selecting an insurer to guarantee lifetime payment of an employee's accrued benefits. Rather than strengthening consumer protections for plan participants and beneficiaries, we are concerned that your suggestion carries the risk of degrading the oversight required of a fiduciary responsible for protecting the rights and interests of plan participants and beneficiaries. Moreover, the approach in the annuity selection safe harbor regulation is consistent with the approach in the ERISA regulation at section 2550.404a-1 regarding fiduciary obligations in connection with investment duties in general.

With respect to your second recommendation, we are concerned that adopting your suggestion could in effect result in a transfer of the responsibilities associated with the selection of the annuity provider from a responsible fiduciary to an individual employee when he or she selects a lifetime income option. Moreover, it is unclear how conditioning the fiduciary relief on the plan offering an "appropriate mix" of annuity and lifetime income withdrawal options changes in any material way the issues for the fiduciary responsible for the selection of the annuity because the fiduciary would still need to make a prudent selection of the lifetime income providers and the products.

We believe a better approach to the issues identified in your draft report is to explore efficient and cost effective ways to put the evaluation of the annuity provider in the hands of fiduciaries with financial expertise who are capable of satisfying ERISA's requirements without the need of a regulation that would reduce the obligations fiduciaries have to protect the interests of plan participants and beneficiaries. As noted in your draft report, such an approach is reflected in the EBSA October 23, 2014, information letter from Phyllis C. Borzi to J. Mark Iwry. In that case, the Department concluded that a series of target date funds with investments in unallocated deferred annuity contracts could serve as "qualified default investment alternatives" within the meaning of 29 CFR §2550.404c-5 (QDIA regulation). The investment product incorporated a financial institution acting as an ERISA fiduciary responsible for conducting a prudent evaluation of the unallocated deferred annuity contracts in the TDFs. We understand similar product innovations are already being developed for the retirement plan marketplace. In fact, your report states that "[i]ndustry stakeholders also told us that they expect adoption of deferred annuities, such as QLACs, embedded in target date funds, to increase in the future as more providers introduce their products to the in-plan market and more plans adopt them as a default solution." That approach would also be consistent with the suggestion in your report that federal

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agencies give particular consideration to the selection and setting of default options when individuals are presented with choices.

Furthermore, we understand that financial institutions are innovating in other ways in this area, such as by developing fiduciary services where they will conduct a reasonable, independent investigation and evaluation of the risks and other characteristics of a proposed annuity provider for the employer who is interested in offering lifetime income solutions to employees. Your report states that representatives of one annuity provider told GAO that there were only a few big consulting firms that would be able to help plan sponsors meet the requirements under the safe harbor regulation, and that it would be expensive to contract with them. It was not clear from your report, however, whether you also spoke with financial institutions that have recently announced that they are adding this kind of fiduciary service to their business models. We also note that the 2014 ERISA Advisory Council recently conducted a study and issued a report on "outsourcing" employee benefit plan services with a particular focus on functions that historically have been handled by employers, such as "named fiduciary" responsibilities.[1] We believe that having a financial institution assume ERISA fiduciary responsibility as an investment manager for these decisions under Section 3(38) of ERISA better preserves ERISA's prudence and loyalty duties in annuity selection decisions while also addressing plan sponsors' concerns about not having the requisite education, experience or skill to prudently select and monitor an annuity provider.

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Sincerely,

Phyllis C. Borzi

Assistant Secretary

Data Tables

Accessible Text for Figure 1: Plan Administration of Required Minimum Distributions (RMD)

1. Plan sponsor contracts with a service provider
2. Record keeper calculates required minimum distribution (RMD) amounts and distributes those payments for participants over age 70½
3. RMDs made to participants from their 401(k) savings based on each participant's age and account balance divided by a life expectancy factor published by the IRS.

Source: GAO analysis of agency and industry documents and stakeholder interviews. | GAO-16-433

Accessible Text for Figure 2: Making 401(k) Savings Last for Life May Involve More Risks than Accumulating Savings

Concern	Duration
Investment: “Did I choose the right investments?”	Working years through retirement
Market: “How will my savings be affected by the ups and downs in the market?”	Working years through retirement
Inflation “Will I have enough savings to afford higher prices in the future?”	Working years through retirement
Interest rate “When should I buy an annuity?”	As retirement draws near through retirement
Sequence of returns “What if markets drop right before or after I retire?”	As retirement draws near through retirement
Longevity “Will my savings last?”	During retirement
Cognitive “Can I handle complex decisions?”	During retirement

Source: GAO analysis of relevant research. | GAO-16-433

Data Table for Figure 3: Aging Americans’ Income Relative to the Poverty Threshold

Percentage of US population living near or below the poverty threshold

Percentage of poverty threshold	Age 65 to 74	Age 75 and older
Under 100 percent	8.7	11.7
Under 150 percent	17.6	25.9
Under 200 percent	27.1	40.1

Source: U.S. Census Bureau, Current Population Survey, 2015 Annual Social and Economic Supplement. | GAO-16-433

Accessible Text for Figure 4: Service Provider Arrangements for Lifetime Income Options in 401(k) Plans

Plan participants work Plan Sponsor and Record Keeper

- **Plan sponsor:** Establishes 401(k) plan, selects investments and distribution options, which may include lifetime income options.
    - **Investment advisers:** Some help plan sponsor select investment and distribution options for the plan, including those that provide lifetime income; others assist participants with retirement planning.
    - **Legal counsel:** Advises plan sponsor on legal compliance and mitigating fiduciary risk.

- **Record keeper:** Builds a platform on which investment and distribution options are offered to participants, tracks information about participants, and facilitates withdrawal options.
    - **Insurance company:** Issues annuity contracts.
    - **Managed account provider:** Provides recommendations on investments, and sometimes on lifetime income options in the plan.

Source: GAO analysis of agency and industry documents and stakeholder interviews. | GAO-16-433

Data Table for Figure 5: Selected 401(k) Plan Adoption Rates for Withdrawal Options by Plan Size

Percentage of plans covered by GAO's review offering select withdrawal options

	Small plans (Assets under $10 million)	**Mid-size plans** (Assets between $10 and $200 million)	**Large plans** (Assets greater than $200 million)	**All plans**
Installment payments	15	28	20	16
Systematic withdrawals	7	14	20	8
Managed payout funds	<1	<1	<1	<1

Source: GAO analysis of 401(k) plan record keeper questionnaire data. | GAO-16-433

Data Table for Figure 6: Selected 401(k) Plan Adoption Rates of Annuity Options by Plan Size

	Small plans (Assets under $10 million)	**Mid-size plans** (Assets between $10 and $200 million)	**Large plans** (Assets greater than $200 million)	**All plans**
Fixed immediate annuity	14	18	9	14
Guaranteed minimum withdrawal benefit	8	36	4	10
Deferred annuity	<1	<1	<1	<1
Annuity shopping platform	<1	<1	<1	<1

Source: GAO analysis of 401(k) plan record keeper questionnaire data. | GAO-16-433

Data Table for Figure 7: Selected 401(k) Plans Funded Using a Group Annuity Contract by Plan Size

	Small plans (Assets under $10 million)	**Mid-size plans** (Assets between $10 and $200 million)	**Large plans** (Assets greater than $200 million)	**All plans**
Percentage of plans covered by GAO's review funded by a group annuity contract	88	38	14	84

Source: GAO analysis of 401(k) plan record keeper questionnaire data. | GAO-16-433

Data Table for Figure 8: Potential Effects on a 401(k) Account Balance of Paying a 1 Percent Guarantee Fee Over 10 Years

	Initial investment at age 48	**By age 57**
Without additional 1 percent fee	10,000	158,489
With additional 1 percent fee	10,000	145,440

Source: GAO analysis of agency documentation and stakeholder interviews. | GAO-16-433

Accessible Text for Figure 9: Three Ways Industry Can Preserve Participant Benefits through Service Provider Changes

- **Option A:** Refund the value of the guarantee to the participant, who could then purchase a similar product from a new 401(k) plan insurer
- **Option B:** Record-keepers utilize middleware software to allow participants to keep their annuity provider
- **Option C:** Keep the lifetime income by transferring the participant's contract from an old insurer to a new insurer

Source: GAO analysis of interviews with agency stakeholders. | GAO-16-433

Data Table for Figure 12: Some Separation Packets We Reviewed Provided More Information than Others on Lifetime Income Options

Component	**Number of plans**
Steps for selecting an option	15 of 16
Description of each available lifetime income option	14 of 16
Pros and cons of each option	4 of 16
Text readable at 8th grade level	4 of 14
Implications of not making any choices	3 of 16

Component	Number of plans
Important deadlines for making decisions	2 of 16
Mechanism for comparing options (such as a retirement planning tool)	2 of 16
Description of common retirement risks	1 of 16
Description of the risks associated with each option	0 of 16

Source: GAO analysis of a non-generalizable sample of 16 401(k) separation packets. | GAO-16-433

Data Table for Figure 13: Taxes and Easy Access to Funds Are Top Priorities for Surveyed Participants

Category	Percentage of respondents
Amount of taxes paid	54.69
Easy access to funds	53.89
Not outliving savings	41.32
Financial market volatility	33.3
Account fees	29.41

Source: GAO survey of defined contribution plan participants in coordination with Boston Research Technologies. | GAO-16-433

Accessible Text for Figure 14: A Deferred Annuity Can Provide Longevity Protection

With a portion of a target date fund invested in an annuity, a participant's retirement income can feature both flexibility and security.

- Income from selling stocks and bonds can vary from year to year to pay for such expenses as vacations or health care until those funds are depleted
- Annuity income remains when other funds are depleted

Source: GAO analysis of industry and federal agency documents and stakeholder interviews. | GAO-16-433

Accessible Text for Figure 15: Accumulation, Withdrawal, and Insured Phases of a Guaranteed Minimum Withdrawal Benefit

- During the accumulation phase, Step-up locks in highest value of benefit base
- During the withdrawal phase, Downside protection guards against decline in investment account value due to lifetime withdrawals, investment losses, and expenses
- During the insured phase, guaranteed annual lifetime income continues

Source: GAO analysis of product information provided by insurers for GAO-13-75. | GAO-16-433

Accessible Text for Figure 16: Comparison of 401(k) Plans Funded with and without a Group Annuity Contract

In a 401(k) plan with a group annuity contract offered through an insurance company, participants indirectly pay fees for investment management, plus a wrap fee they may not be aware they are paying • Participants select funds • Mutual funds contract with insurance company • Insurance company collects fees from participants and pays fund managers • Fund managers select and manage funds in a separate account • Insurance company provides a death benefit and an annuity	In a 401(k) plan without an annuity contract participants indirectly pay fund managers for investment management, as a percentage of plan assets through fees Participants select funds Fund managers select and manage fund portfolio

Source: GAO analysis of information from industry practitioners for GAO-12-325. | GAO-16-433

Accessible Text for Figure 18: Purchasing an Annuity at One Time or in Small Pieces

Option A	Option B
Annuity purchased at retirement in a single premium Hesitation over the large purchase can cause participants to miss the chance to purchase an annuity with discounts negotiated by their plan sponsor If participant buys the annuity, they face risk of low interest rates and/or poor returns that diminish the amount of income protection that can be purchased at that time	Annuity purchased in small pieces over time as participant nears retirement Participants can adjust to changes in need for guaranteed income, which can reduce hesitation to buy Buying in smaller pieces over time mitigates the risk of changing investment returns and interest rates

Source: GAO analysis of stakeholder documents and interviews, past GAO work, and our record keeper questionnaire. | GAO-16-433

Accessible Text for Figure 19: Participants Surveyed Value the Ability to Consolidate 401(k) Accounts

Most participants would appreciate help from their current plan sponsor in consolidating their accounts

63 percent of participants would be likely to pay for a service to help them consolidate accounts from past employers in their current DC plan.

81 percent of participants would be likely to pay for a service to help them consolidate an Individual Retirement Account (IRA) in their current DC plan.

93 percent of participants would view such a service as a good or excellent benefit relative to other benefits their employer might provide.

Source: Boston Research Technologies 2015 Study of Defined Contribution (DC) Participants' Portability Behaviors, Experiences, Needs, and Attitudes. | GAO-16-433

Related GAO Products

GAO, *401(k) Plans: Clearer Regulations Could Help Plan Sponsors Choose Investments for Participants,* GAO-15-578 (Washington, D.C.: Aug. 25, 2015).

GAO, *Retirement Security: Most Households Approaching Retirement Have Low Savings,* GAO-15-419 (Washington, D.C.: May 12, 2015).

GAO, *401(k) Plans: Improvements Can Be Made to Better Protect Participants in Managed Accounts,* GAO-14-310 (Washington, D.C.: June 25, 2014).

GAO, *401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants,* GAO-13-30 (Washington, D.C.: Mar. 7, 2013).

GAO, *Retirement Security: Annuities with Guaranteed Lifetime Withdrawals Have Both Benefits and Risks, but Regulation Varies across States,* GAO-13-75 (Washington, D.C.: Dec. 10, 2012).

GAO, *Thrift Savings Plan: Adding a Socially Responsible Index Fund Presents Challenges,* GAO-12-664 (Washington, D.C.: June 26, 2012).

GAO, *401(k) Plans: Increased Educational Outreach and Broader Oversight May Help to Reduce Plan Fees,* GAO-12-325 (Washington, D.C.: Apr. 24, 2012).

GAO, *401(k) Plans: Other Countries' Experiences Offer Lessons in Policies and Oversight of Spend-down Options,* GAO-14-9 (Washington, D.C.: Nov. 20, 2013).

GAO, *Financial Literacy: A Federal Certification Process for Providers Would Pose Challenges,* GAO-11-614 (Washington, D.C.: June 28, 2011).

GAO, *Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices,* GAO-11-400 (Washington, D.C.: June 7, 2011).

GAO, *Defined Contribution Plans: Key Information on Target Date Funds as Default Investments Should be Provided to Plan Sponsors and Participants,* GAO-11-118 (Washington, D.C.: Jan. 31, 2011).

GAO, Retirement Savings: Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges, GAO-10-31 (Washington, D.C.: Oct. 23, 2009).

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