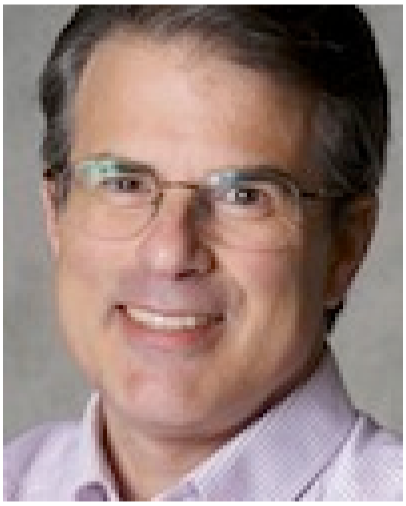
Two Cheers for DOL's Lifetime Income Disclosure

By Kerry Pechter *Thu, Aug 20, 2020*

The Department of Labor's 'interim final rule' on disclosure of estimated lifetime income from 401(k) balances is welcome, but it lacks a critical feature. Public comments might improve it.



The Department of Labor has issued a 112-page "**interim final rule**"—still subject to amendment in response to public comment, but final if not amended—that implements legislation requiring defined contribution plans to include "lifetime income illustrations" in an annual plan benefit statement.

These illustrations are intended to give plan participants an idea of how much monthly income their DC savings could generate, based on certain assumptions specified in the rule.

The idea—a logical idea, because policymakers have decided that participants should think of their DC savings as income, not only as lump sums—was to show participants where they stand at the moment in terms of preparing financially for retirement.

But this rule isn't particularly helpful, and even though it might be amended after the upcoming public comment period, it might not be.

The rule merely tells participants (or a participant and spouse)—no matter if they're 25 years old today or 65 years old or any age in between–how much income their *current* savings would buy if they were reaching retirement age *today*, and bought an annuity at today's interest rates and annuity prices.

"Income illustrations are potentially important for our quest to expand lifetime income in the DC system," former senior Treasury official and current Brookings Institution nonresident senior fellow Mark Iwry told *RIJ* this week. But he urges that Labor's final rule also encourage plans to include income illustrations based on the projected size of account balances at retirement age, which he advocated when he served in the Obama administration.

"Labor can find authority under the SECURE Act to protect plan sponsors from liability for providing these much more helpful projections. The Act did not explicitly limit liability protection for plan sponsors to illustrations based on current account balances as opposed to both current and projected future balances.

"The language should have explicitly protected and encouraged such projections, but it was not explicit in either direction. Yes, Congress also had other fish to fry—though it wouldn't have taken much extra effort to fry this guppy," he said.

In any event, Iwry believes Labor has implicit statutory authority, as it did before the legislation, but "might have hesitated, at the interim rule stage, to include liability protections for appropriate projections because it first wanted to see whether the upcoming public comment process would lay a sufficient foundation in the public record regarding need, demand, and rationale."

In its interim final rule, the DOL provides the example of a 40-year-old woman with current savings of $125,000. Then it shows that if she were 67 today (her intended retirement age), and paid $125,000 to a life insurer for an annuity today, she would receive $645 per month for life (or $533 per month if she bought a joint-life annuity for two people).

That's a fairly useless number. It won't help participants *project* the amount of savings they might accumulate by the time they retire if they keep saving at the current rate, or how much they might be able to generate from those savings.

Rough projections, though admittedly impossible to make precise because the future is unpredictable, would at least give the participant a target number to aim for, and an idea of the savings rate necessary to reach their goals.

In fact, some DC plans already do that. The Social Security Administration has done that. And the DOL even has a calculator on its website that helps people do that. But, as Iwry speculates, some of DOL's regulation writers may feel that if Congress wanted them to include projections in the regulations, it would have been more helpful to have spelled this out explicitly and therefore DOL's decision on this is being put off to the final rule.

There's a back story to all this. The idea of requiring DC plans to disclosure turns out to be more controversial than it might look, for these reasons:

- Plan sponsors' attorneys worry that plan participants might interpret an *estimate* of future income as a *promise* of future income, and sue their employers for fooling them. [In accordance with the SECURE Act, the DOL rule assures plan sponsors that they won't be liable for misleading participants as long as they follow the examples, instructions and model language in the rule.]

- Fund companies don't necessarily want participants to think about turning their savings into annuities; that would involve a transfer of money from fund companies to insurance companies.
- Broker-dealers have the same fear; they would prefer that participants roll over their 401(k) savings to a brokerage IRA when they retire.
- It's hard to get a consensus on the assumptions that go into a projection. For instance, policymakers had difficulty deciding whether the hypothetical future annuity should be fixed or inflation-adjusted. Even people who buy life annuities rarely buy inflation-adjusted ones, because they cost a lot more.
- Some people were afraid that, if rank-and-file participants saw how little income their 401(k) savings would produce, they would become discouraged and stop saving (which, as noted, is a reason to illustrate estimated income based on projected savings at retirement age).

There's also the small problem that, for several reasons, very few Americans ever actually buy the kind of annuities that the DOL wants DC plans to illustrate. Those are fixed life annuities, either immediate (income starts soon after purchase) or deferred (income starting more than 13 months after purchase).

Someone might also mention that participants rarely read their 401(k) disclosures. The people who do probably don't need any nudge toward saving more for retirement.

All of these issues help explain why the government has kicked this idea down the road for 11 years. It was first proposed in 2009 after Barack Obama was elected. Phyllis Borzi, then a DOL assistant secretary, and Mark Iwry, then senior advisor to the Treasury secretary, both thought it was a great idea. But in 2010 the Democrats lost control of the House of Representatives for eight years. Battles over the Affordable Care Act sidelined most retirement legislation.

Projections of future income were always envisioned. In 2013, retirement consultant, researcher and former senior Treasury official Mark Warshawsky **wrote** in *Institutional Investor* magazine:

"If a married participant aged 45 has $125,000 in her 401(k) account and the plan has a normal retirement age of 65, the projected balance would be $557,534 at retirement. Two monthly lifetime non-inflation-indexed annuity streams of payments would be shown, as if the participant were now 65 — $564, based on the current balance and estimated current annuity rates, and $2,514, based on the projected balance."

More recently, Iwry and two Brookings Institution colleagues evaluated the income disclosure recommended by the RESA Act in 2019 (a predecessor of the SECURE Act), and warned in a **whitepaper** that:

“an illustration based only on the current account balance is less useful than the combination of that illustration and another that converts a projected future account balance to its income equivalent (while emphasizing the speculative nature of the assumptions and hence the merely illustrative nature of the projections).”

The new rule only indirectly addresses the idea that projections would make the required disclosure more useful in terms of helping a participant get ready for retirement. On page 60, the DOL writes:

“The ability to incorporate social security projections and IRAs; customize assumptions to see the impacts of those changes on the projected lifetime income streams; show the integrated effects of in-plan annuity investment options combined with other plan investments; estimate the gaps between projected monthly incomes at retirement and the desired monthly incomes; provide education about how to close those gaps, and personalize future draw-down strategies that incorporate social security and other retirement assets. *Although these flexible and customizable features are likely to better engage participants, and thus, better prepare them for retirement, a recordkeeper can satisfy the conditions set forth in the [interim final rule] without these flexible and elaborate features.* [Emphasis added.]

Still, government officials like to avoid “sacrificing the good for the perfect.” Former Labor assistant secretary Borzi told *RIJ* this week that the rule might encourage more savings:

“I surely hope this may provide the nudge that some folks need. The most impressive bit of research we had when I was at the DOL was a study of TSP [Thrift Savings Plan] participants. Once the TSP put a simple illustration of what the participant’s current account balance would produce as a monthly income stream on each quarterly account statement, there was a very noticeable spike in contributions.

“[The numbers] they were sufficient to overcome my concern that a lifetime income stream illustration might in fact be discouraging to some participants, particularly those who were younger and/or with shorter work histories,” she added. “I was afraid that they would feel that their monthly benefit was so small that it was almost meaningless and that they would be more likely to put their money to other uses, other than making a contribution to the

TSP. But that didn’t seem to be the case.”