

**Background on the Lifetime Income Disclosure Act (S. 267)
as introduced by Senators Bingaman (D-NM); Isakson (R-GA); and Kohl (D-WI)
on February 3, 2011**

Background

With the continuing decline of the defined benefit plan system and the growth of the defined contribution plan system, increasing numbers of employees will be retiring with just an account balance under a 401(k) plan and/or an IRA. Aside from Social Security benefits, such employees will not have any source of guaranteed income for life.

If retirees draw down their retirement savings over their expected life expectancy, half of them will outlive their private retirement savings. With life expectancies continuing to increase, the risk of retirees outliving their retirement savings is one of the critical public policy challenges of the next decade in the retirement policy. The key issue is how to make employees aware of this risk and how to educate employees about lifetime income issues.

The Lifetime Income Disclosure Act would require benefit statements to include the annuity equivalent of an employee's benefit — a small step, but one that can make a significant difference in beginning to tackle the public policy challenge.

Present Law

Under present law, employees participating in defined contribution plans, such as a 401(k) plan, are entitled to receive a benefit statement showing the balance in their account. With respect to plans that permit the employees to direct the investments in their account, these statements must be provided quarterly; where the employer directs the investments, the benefit statements can be provided annually.

Today, with respect to a defined contribution plan, benefit statements are generally required to provide participants with certain information, including the participant's total benefit and the participant's vested benefit. Additionally, in the case of quarterly benefit statements, the statement is generally required to inform participants of how the benefit is invested; explain any restrictions on the participant's right to control such investments; explain the importance of investment diversification; and direct the participants to a Department of Labor website providing information with respect to investing.

Proposal

Under the proposal, defined contribution plans subject to ERISA (such as 401(k) plans) would be required to include "annuity equivalents" on benefit statements provided to employees. An annuity equivalent would be the monthly annuity payment that would be made if the employee's total account balance were used to buy a life annuity that commenced payments at the plan's normal retirement age (generally 65). The statement would be required to show the monthly annuity payments under both a single life annuity and a qualified joint and survivor

annuity (*i.e.*, an annuity with survivor benefits payable for life to the employee's spouse). The annuity equivalents would only be required to be provided once a year, even where quarterly statements are otherwise required. Thus, where quarterly statements are otherwise required, annuity equivalent need only be indexed on one such statement each year.

Rationale

Currently, plan statements do not provide employees with critical information that they need. Employees have monthly and annual budgets, which are generally based on their salaries. Employees thus are accustomed to making financial plans based on their monthly and annual incomes. But many employees who receive a benefit statement are not prepared to convert a lump sum account balance into a monthly income amount for life beginning in the future. Thus, employees are not well-prepared to evaluate whether they will have enough retirement income to cover the cost of their current standard of living. Knowing the amount of monthly income they can expect will help employees evaluate whether they are on the path to retirement security.

In this regard, benefit statements that provide annuity equivalents would be much better coordinated with Social Security benefit statements, which only express benefits in the form of a life annuity. Individuals would be able to determine the total retirement income available to them during their retirement. Thus, the proposal would build on the success of Social Security benefit statements, providing additional information regarding retirement income.

Moreover, the proposal could help individuals consider how best to draw down their 401(k) benefits. When individuals receive their benefit statements today, they see their benefit expressed as a single lump sum amount. That naturally leads them to think of their 401(k) plan benefit as a lump sum amount, not as a source of guaranteed income for life. This can have a subtle but powerful effect on their decision regarding how to receive their 401(k) plan benefit. It is critical that employees be made more aware of the possibility of receiving at least a portion of their benefit in an annuity form that protects them against outliving their savings.

Implementation

This proposal addresses a critical public policy issue. But it is equally important that the proposal be structured not to impose any material burden or potential liability on employers that voluntarily maintain a plan. Thus, under this proposal, the Department of Labor ("DOL") would be directed to issue, within a year, assumptions that employers may use in converting a lump sum amount into an annuity equivalent. Accordingly, employers will be able to base their annuity equivalents entirely on clear mechanical assumptions prescribed by the DOL. Of course, to the extent that a participant's benefit is or may be invested in an annuity contract that guarantees a specified annuity benefit, the DOL shall, to the extent appropriate, permit such specified benefit to be treated as an annuity equivalent.

The DOL would further be directed to issue, within a year, a model disclosure that explains (1) the assumptions used to determine the annuity equivalents and (2) the fact that the

annuity equivalents provided are only estimates. This model disclosure would include a clear explanation that actual annuity benefits may be materially different from such estimates.

The proposal also provides employers with a clear path to avoid liability: under the proposal, employers and service providers using the model disclosure and following the prescribed assumptions and DOL rules would not have any liability with regard to the provision of annuity equivalents. This exemption from liability would apply to any disclosure of an annuity equivalent that incorporates the explanation from the model disclosure and that is prepared in accordance with the prescribed assumptions and DOL rules. For example, subject to such conditions, the exemption would apply to annuity equivalents available on a website or provided quarterly.

Finally, the proposal does not go into effect until a year after the DOL has issued the guidance needed by employers to implement the new rules.