NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

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May 3, 2010

Via e-mail to: www.regulations.gov

Department of Labor
Employee Benefits Security Administration
29 CFR Parts 2509, 2520 and 2550
RIN 1210-AB33

Department of the Treasury
Internal Revenue Service
26 CFR Part 1
RIN 1545-BJ04

Re: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

The NCCMP is a non-partisan, non-profit organization that works to assure an environment in which multiemployer plans can continue their vital role in providing benefits to millions of working Americans. Although some multiemployer plans are defined contribution plans, these tend to be supplemental plans, while the majority of multiemployer pension plans are defined benefit plans that, with few exceptions, only pay benefits as annuities. As such, the topic of this Request for Information (RFI) is directly applicable to a minority of the plans in the multiemployer community. We are responding to this RFI both to represent the interests of these plans, and because we recognize that multiemployer plans are part of a larger universe of retirement plans, and policies that benefit the wider retirement plan community indirectly help to ensure that our constituent plans are able to survive and flourish.

Background

In recent decades, two trends have materialized among single-employer pension plans:

- Defined contribution plans have gradually replaced defined benefit plans as the primary vehicle for providing retirement income at many companies

- Defined benefit plans have increasingly offered participants the option to receive their benefits as lump sums, often in conjunction with a transition to 'cash balance' style pension plans.

As a result of these trends, a far greater number of participants retiring today are able to receive their retirement benefits as lump sums than were able to do so in the early days of ERISA. This ability, combined with a very strong participant preference for lump sum payments, means that as time goes on, fewer and fewer participants are relying on annuities in their retirement.

It is very difficult to structure a financially sound retirement using a single sum distribution. Perhaps the most significant problems are the amount of retirement savings most working Americans can afford to save throughout their careers, and the opportunities for even those modest amounts to be depleted through "leakage", which refers to loans, early distributions, and excessive fees. Beyond these issues, individuals who spend the distribution too quickly and experience a long life after retirement are likely to exhaust their money, forcing them to rely on family support or public assistance during their final years. Other individuals may be reluctant to draw on the money for fear of exhausting it, and are therefore not able to enjoy their retirement in the manner they should. Lump sum retirement distributions force retirees to make difficult investment decisions that they may not be equipped to handle, and they also expose retirees to the dangers of unscrupulous financial advisors. Lastly, all of these concerns are further complicated when an individual's retirement benefit is expected to provide not only for his or her own financial security, but that of his or her spouse as well.

Suggested Objectives

For the reasons listed above, the financial security of millions of retiring Americans will be enhanced by reversing the trend away from annuity benefits. We have identified three objectives that Congress and the regulatory agencies should pursue to support the ultimate goal of having more workers retire with annuity benefits.

- Encourage Use of Defined Benefit Plans
- Discourage Payment of Lump Sums from Defined Benefit and Defined Contribution Plans (Other than Supplemental Plans)
- Facilitate Defined Contribution Plans that Required Annuity Distributions

The following sections provide details on the rationales behind each of these objectives, as well as potential courses of action that would support each.

Encourage Use of Defined Benefit Plans

Defined benefit pension plans currently provide reliable financial security to millions of retired Americans. Despite their great success in this area, there has been a substantial decline in their use in recent years. The primary factors that have driven many companies to abandon defined benefit plans in favor of defined contribution plans are the administrative complexities imposed on sponsors of defined benefit plans, and the financial risk that defined benefit plans create for the employer. The administrative complexities are well known and we will not dwell on them in this submission, other than to acknowledge what is widely documented. With respect to the financial risk assumed by such sponsors, under current law, when a single-employer defined benefit plan incurs a loss on its investments, the employer is obligated to make-up the loss to the plan over a 7-year period. In addition, the interest rate used to value the defined benefit liabilities is tied to the bond markets, and when interest rate movement causes the liabilities to increase, the same 7-year funding period applies. These factors result in cash flow volatility that is potentially crippling for many companies.

Pension plan funding needs to strike a balance between ensuring that companies are not able to allow plans to remain dangerously underfunded, and providing sufficient flexibility to make it financially viable for companies to sponsor plans in the first place. The interests of participants are harmed both by underfunded defined benefit plans, and by companies choosing not to offer defined benefit plans. Congress and the regulatory agencies should consider if the current funding requirements are so restrictive that they actually harm participants by making it impractical for companies to sponsor plans.

In addition, many plan sponsors do not understand how significantly they can reduce the volatility of their defined benefit plans by investing less in equities and more in fixed income securities. Although this approach is likely to lower the investment returns over the long term, movement in interest rates will cause the assets and liabilities to move in tandem, which greatly dampens the cash flow volatility. This does not imply that investing in fixed income securities is the necessarily the correct way to fund a pension plan, only that it is an effective technique for reducing the financial risk associated with sponsoring a plan.

The regulatory agencies could provide a valuable service by taking steps to ensure that companies fully understand that the financial risk of a defined benefit plan can be significantly reduced through asset allocation decisions. Since a shift away from equities would almost certainly result in reduced investment earnings, this shift would need to be accompanied by either increased contributions, or a modest reduction in the benefit level provided by the plan. In many cases, both the interests of the company and the interests of the employees would be better served by such an approach instead of a transition to a defined contribution structure.

Discourage Payment of Lump Sums from Defined Benefit Plans

Under current law, there is little reason for pension plans sponsors to favor either lump sum distributions or annuity distributions. Since the actuarial factors that are used to convert between these options typically use assumptions very similar to those used in plan funding calculations, benefit costs are effectively cost neutral to the plan. However, it should be noted that there are some modest administrative costs and some residual fiduciary responsibilities associated with of retaining the participant as an annuitant.

Congress and the regulatory agencies could serve the interests of plan participants by encouraging defined benefit plan sponsors to reduce or eliminate the availability of lump sum distributions and other sources of leakage. One option would be to place less onerous funding requirements on plans that pay the majority of their benefits as annuities. This approach is financially reasonable, due to the fact that the long time horizon associated with annuity payments allows the plan assets more time to absorb any adverse investment experience. In contrast, the short time horizon associated with lump sum payments means that the plan sponsor needs to replace investment losses in the plan much more quickly.

Another approach is to provide plan participants with a greater incentive to elect annuities instead of lump sums. This could be achieved by exempting either all or a portion of the annuity payments from defined benefit and defined contribution plans from the retiree's taxable income, which would also help level the playing field between the types of plans. In order to minimize the revenue impact and focus the tax incentive on the participants most in need of financial security in retirement, the tax exemption could be tied to the income level of the retiree, with lower income individuals receiving a greater tax savings. Alternatively, a change in the tax treatment of lump sums (except from supplemental plans) and other forms of early distributions that contribute to plan leakage could help further mitigate the revenue impact of this provision, while simultaneously further encouraging annuity distributions.

Facilitate Defined Contribution Plans that Require Annuity Distributions

There are several factors that contribute to the low utilization of annuities among participants with defined contribution benefits. One of the most significant issues is the fact that defined contribution participants generally need to purchase annuities on the private market, and these annuities are often very expensive to purchase. The high cost of annuities is due in large part to the fact that insurance companies deliberately price them very conservatively, due to their experience that individuals who buy annuities tend to have longer lifetimes than the general population.

Short of direct government intervention in the annuity market, the most effective way to encourage insurance companies to price annuities more competitively is to greatly increase the number of plan sponsors and individuals who participate in the market. While there are many potential approaches that both regulators and plan trustees can use to encourage participants to voluntarily annuitize their benefits from defined contribution plans, we believe that these steps will ultimately produce only minor improvements in participant behavior. The attraction of a large lump sum is simply so great to most participants that no amount of education or market enhancement will convince them to forgo this payment in favor of an annuity.

We suggest that regulators look for ways to encourage plan sponsors to adopt defined contribution plans that require that participants receive at least a portion of their retirement benefits through annuities. It would be impractical for this goal to apply to either participants' current balances or their future elective deferrals. However, it is practical for future employer contributions to be used to purchase deferred annuities that would be payable to participants when they retire. In effect, all future employer contributions could be invested in deferred annuities, while participants would maintain their discretion over the investment of both their entire current account balances and their future elective deferrals.

Although we believe that under current law it is permissible for plan sponsors to allocate all future employer contributions to deferred annuities, we are not aware of any companies that have adopted this approach. There are three possible reasons why plan sponsors have not chosen this plan design approach:

1. Lack of awareness of this design option
2. Concern over the permissibility of this approach
3. Belief that the design is not in the best interest of the company or the employees

While there is little that the regulatory agencies can do to address item (3), items (1) and (2) could be addressed by formal guidance and publications that discuss the framework within which these plans would operate. This material would discuss the relevant code and regulatory sections that would apply to these plans, provide guidance on ensuring compliance with these sections, and where necessary, establish safe harbors or other thresholds for plan sponsors to use.

Conclusion

The migration away from defined benefit plans in general, and away from annuity benefits and towards lump sum retirement benefits, poses a serious challenge to the ability of the American workforce to plan for and remain financially independent in retirement. We encourage the Department of Labor and the Department of Treasury to champion the implementation of new defined benefit plans and to increase its support of existing defined benefit plans. We also encourage the departments to promote the use of defined contribution plans that provide mandatory annuity benefits. We believe that companies will be interested in implementing these designs once they become both aware of them and comfortable with their permissibility and viability.

Respectfully submitted,

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