

This is the last Bulletin from Reish & Reicher. We say that with mixed emotions. It is always difficult to leave a long and successful arrangement. But we are excited about going to the Drinker Biddle law firm, effective Wednesday, March 16—where we will continue to write bulletins under the new banner. We have attached a contact sheet with our new email addresses and telephone numbers.

401(k) Account Balances as Monthly Retirement Income

By Fred Reish and Bruce Ashton

401(k) participants receive quarterly statements of their account balances. Surveys by providers and others generally report on 401(k) account balances in terms of averages, averages by age group, and so on. In other words, it is common in almost all reporting and any conversation about 401(k) plans to refer to “account balances.”

But, the 401(k) industry—plan sponsors, participants, providers and advisers—are beginning to realize that the real purpose of 401(k) plans is—or at any rate should be—to provide monthly income in retirement. As a result, the government, and particularly the U.S. Departments of Labor and Treasury, are increasingly interested in retirement income. Providers and advisers are also focusing on the issue. This is due to the simple truth that, in retirement, 401(k) participants need to withdraw their money on a monthly basis to pay their mortgages, phone bills, rent, utilities, and so on. In other words, 401(k) accounts need to generate a monthly “paycheck.”

In turn, that raises obvious issues about the appropriate way to invest and withdraw money in retirement. For example, a couple—both age 65—can reasonably expect that at least one of them will be alive—and need income—at age 95. (We are working on another article about on the probabilities of living to various ages. That article will be distributed in the next few months.) How can enough money be accumulated over 40 years, say, between the ages of 25 and 65, to provide a 30-year, prepaid retirement? It is difficult to do that. It is also difficult to properly withdraw money in a way that it lasts for 30 years. The sustainable withdrawal rates are surprisingly small, for example, 4% or 5% per year.

About a year ago, the Departments of Labor and Treasury issued a request for information (RFI) about sustainable retirement income. The RFI asked about both insured and uninsured solutions. An organization that we support, the Institutional Retirement Income Council (IRIC), provided detailed and thoughtful responses to the questions. (As a disclosure, Fred Reish was part of the IRIC team that drafted the answers.)

This bulletin quotes four of the questions asked by those agencies and provides the answers given by IRIC. The purpose of this bulletin is not to persuade you to agree with those conclusions,

Fred Reish Provides Comments to Government Accountability Office

On February 28th, the Government Accountability Office (GAO) issued its report “401(k) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest.”

In doing its analysis, and preparing its reports, the GAO typically interviews people who are experienced and knowledgeable about the particular issue. In this case, the GAO interviewed, among others, Fred Reish of our firm.

The study focuses on:

“The sponsors of 401(k) plans face conflicts of interest from service providers assisting in the selection of investment options because of third-party payments and other business arrangements.

The payments, sometimes called revenue sharing, create a conflict of interest because the provider may receive greater compensation from certain funds. Moreover, providers are reported to commonly structure their relationships with sponsors in a manner that avoids being subject to fiduciary standards under the Employee Retirement Income Security Act (ERISA). According to several industry experts, many sponsors, particularly of smaller plans, do not understand whether or not providers to the plan are fiduciaries, nor are they aware that the provider’s compensation may vary based on the investment options selected. Such conflicts could lead to higher costs for the plan, which are typically borne by participants.”

You may obtain a copy at www.gao.gov/products/GAO-11-119.

but rather to encourage you to think about the questions and answers. We believe that everyone in the retirement community—plan sponsors, fiduciaries, participants, providers and advisers—needs to have an answer, or perhaps multiple answers, to these questions. In other words, our purpose is to stimulate thought and encourage debate.

Here are the questions and IRIC’s answers:

21. Should an individual benefit statement present the participant’s accrued benefits as a lifetime income stream

“Legends” of the Retirement Plan Industry

PLANADVISER magazine has recognized Fred Reish as one of the 5 Legends of the Retirement Plan Industry. According to *PLANADVISER*, these legends have made a significant personal impact on the retirement plan industry and the advisers who support it. The *PLANADVISER* “legends” will be featured in the fifth anniversary issue of *PLANADVISER* and will be honored at its annual Awards for Excellence celebration in New York City. For more information, please visit: <http://tinyurl.com/PLANADVISERS-Legends>

of payments in addition to presenting the benefits as an account balance?

Individual benefit statements should, at least annually, present the participant’s account balance as a projected lifetime income stream of payments beginning at the participant’s Social Security retirement age.

Unfortunately, many plan sponsors and participants continue to see 401(k) plans as “savings” plans, rather than as “retirement” plans. In other words, they focus on the amount that they have saved, or accumulated, without realizing that it should be viewed as a stream of income payments during retirement. The projections would help both plan sponsors and participants understand the retirement income issues and the adequacy of the account balances for that purpose. In turn, that would likely lead to improvements in plan design and operation, as well as increases in participant deferrals (or other compensating participant behavior).

IRIC strongly encourages the DOL to issue not only clarifying guidance on this issue but a clear safe harbor. We strongly believe that safe harbors are the most effective way to encourage plan sponsors to adopt these changes to their plans.

22. If the answer to question 21 is yes, how should a lifetime stream of income payments be expressed on the benefit statement? For example, should payments be expressed as if they are to begin immediately or at specified retirement ages? Should benefit amounts be projected to a future retirement age based on the assumption of continued contributions? Should lifetime income payments be expressed in the form of monthly or annual payments? Should lifetime income payments of a married participant be expressed as a single-life annuity payable to the participant or a joint and survivor-type annuity, or both?

IRIC recommends the projections on the statement should:

- Project what the current account value would buy in monthly income at Social Security retirement age assuming the participant made no further additions to principal, received an appropriate real rate of return, and:

- Project a second balance that assumes the participant keeps contributing at the current level, the employer continues to make the company match at its present rate, with an appropriate assumed real rate of growth on the participant’s investments, through Social Security retirement age.
- Projections should be in today’s dollars.
- Projections, with the caveat noted below, should be done as a single life annuity.

In addition, the Department of Labor should provide a website which has a calculator for these purposes. The Department of Labor could work with various industry groups, as it did with the initial fee disclosure forms, to develop such a calculator using well-considered practices and research. If the Department provided that calculator, it would provide a strong influence in establishing accepted standards for projecting and communicating retirement income needs, similar to the impact the Social Security Administration had when it introduced annual benefit statements with projections. Further, there would be substantial savings to 401(k) plans and participants.

So as not to cause confusion at the participant level, plan sponsors should also be allowed to use the income projection methodology of the in-plan retirement income product if one is offered. The Agencies may wish to encourage a footnote to the straight life annuity projections mentioned above to indicate that providing a similar benefit to a spouse for life (*i.e.* 100% joint and survivor annuity) would reduce the guaranteed income amount by approximately 16%. Further, plan sponsors should be encouraged to provide additional information and projections using reasonable assumptions and disclosures. It would be helpful for the Department of Labor to provide a regulatory safe harbor for the range of assumptions that plan sponsors may use for projecting these future income amounts. See answer to Question 23.

We emphasize that the payments should be expressed in the form of monthly amounts, since the typical participant is used to being compensated on a monthly basis and to paying his bills on a monthly basis. In other words, the normal financial cycle for most workers, and most retirees, is monthly.

Also, the monthly income should be projected as current dollars because, if the information is provided in future inflated dollars, participants will have an inaccurate sense of wealth.

Since plan sponsors in most instances do not have access to employees’ complete wage history, the Social Security Retirement Estimator calculators are more accurate in projecting future Social Security benefits. The Agencies should encourage plan sponsors to provide links on their websites to these calculators.

IRIC strongly encourages the DOL to issue not only clarifying guidance on this issue but clear safe harbors. We

strongly believe that safe harbors are the most effective way to enable plan sponsors to adopt these changes to their plans. See answer to Question 23.

23. If the answer to question 21 is yes, what actuarial or other assumptions (e.g., mortality, interest, etc.) would be needed in order to state accrued benefits as a lifetime stream of payments? If benefit payments are to commence at some date in the future, what interest rates (e.g., deferred insurance annuity rates) and other assumptions should be applied? Should an expense load be reflected? Are there any authoritative tools or sources (online or otherwise) that plans should or could use for conversion purposes, or would the plan need to hire an actuary? Should caveats be required so that participants understand that lifetime income payments are merely estimates for illustrative purposes? Should the assumptions underlying the presentation of accrued benefits as a lifetime income stream of payments be disclosed to participants? Should the assumptions used to convert accounts into a lifetime stream of income payments be dictated by regulation, or should the Department issue assumptions that plan sponsors could rely upon as safe harbors?

The DOL should establish several safe harbors plan sponsors may use for projecting retirement income:

- The assumptions used by the DOL calculator (recommended in response to question 22); or
- The assumptions used by the retirement income option included in the plan (if one is offered); or
- The assumptions used by the defined benefit plan (if the plan sponsor also offers); or
- A set of assumptions which, in the aggregate, produce reasonable results and follow the principals established under FASB and GAAP as applied to defined benefit pension plans under ERISA.

Participants should be given disclosures about the material assumptions and any potential weaknesses related to the assumptions. Thus, participants should be told that the projections of lifetime income payments are estimates and can vary based on a number of factors, such as date of retirement, interest rates in the future, earnings on the underlying investments, form of payment, and so on.

In developing the safe harbor, the Department should make it flexible to allow for evolving products and circumstances. The benefit of the safe harbor is (and should be explained in the preamble to the regulation) that the Department of Labor clearly intends that there be a fiduciary safe harbor (and protection for service providers) so long as assumptions are used that are reasonable under the circumstances. Further, either the preamble or the regulation, or both, should specify that there is a broad range of reasonableness and that the standard is to be applied at the time that the assumptions were made, regardless of future developments. The safe

AV Preeminent Rated Lawyer by LexisNexis Martindale-Hubbell

The firm was just notified that Bruce Ashton, Fred Reish, Mike Vanic and Lee Reicher were rated an AV Preeminent Rated Lawyer by LexisNexis Martindale-Hubbell. As defined by the publication, the AV Preeminent Rated Lawyer designation identifies lawyers with the highest rating in legal ability and ethical standards, and is a reflection of expertise, experience, integrity and overall professional excellence.

harbor would also protect employers from liability in the event the amounts that are illustrated exceed the amount of benefit that actually accrues at the point of retirement.

The point of the safe harbors should clearly be to encourage plan sponsors to provide these future projections. The Agencies should encourage the practice that any ancillary projections provided to participants via calculators or other means should be consistent across the plan to avoid participant confusion and frustration.

24. Should an individual benefit statement include an income replacement ratio (e.g., the percentage of working income an individual would need to maintain his or her pre-retirement standard of living)? If so, what methodology should be used to establish such a ratio, such as pre-retirement and post-retirement inflation assumptions, and what are the impediments for plans to present the ratio in a meaningful way to participants on an individualized basis?

Plan sponsors, fiduciaries and providers should be encouraged to provide participants with information concerning replacement ratios and income needed in retirement. However, IRIC believes that this information should not be required to be provided on the benefit statement, but allowed to be made available through other means where the participant initiates the discussion and is able to provide inputs as needed. The Agencies should consider that recordkeepers do not always have full salary information in their data systems to provide accurate projections. Further, spousal information is unlikely to be available for any plan so replacement ratios should clearly be disclosed as representing one life.

Just as the Social Security Administration has created a standard for projecting Social Security benefits when they began providing annual statements, the DOL calculator mentioned in response to Questions 22 and 23 could provide a strong influence in establishing a standard for a general replacement ratio threshold. The team developing the application should be tasked with researching what the appropriate replacement ratio should be, along with establishing other assumptions used in the calculations.

IRIC strongly encourages the DOL to issue a clear safe harbor that covers employers putting projected income replacement ratio information on either the benefit statement or in an

advice tool. We strongly believe that safe harbors are the most effective way to enable plan sponsors to adopt these changes to their plans. In effect, a regulatory safe harbor should be created for any replacement ratios that are based on reputable academic and/or industry research. Further, the safe harbor should explicitly apply to a standardized threshold for all participants in a plan, without regard to their individual circumstances (such as their earning levels).

The primary concern is the need to balance the value of providing participants with an initial expectation for a replacement ratio, while recognizing plan sponsors do not have access to the information needed to provide a meaningful estimate for a participant based on their unique facts and circumstances. There is a concern among fiduciaries and providers that providing a generalized replacement ratio exposes them to additional risk and fiduciary challenges

because it may not be appropriate for a specific participant based on their specific situation. Establishment of a safe harbor would address this concern.

Conclusion

We hope this information is helpful and informative to you. If you are interested in knowing more about the IRIC, go to www.ircouncil.org/.

If you are interested in the responses to the RFI that were filed with Treasury and Labor, you can find them on the Department of Labor website at <http://tinyurl.com/DOL-RFI>.

We plan to continue this dialogue in the future by providing you with additional questions from the Agencies, together with IRIC answers.

Any tax advice contained in this communication (including any attachments) is neither intended nor written to be used, and cannot be used, to avoid penalties under the Internal Revenue Code or to promote, market or recommend to anyone a transaction or matter addressed herein.

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