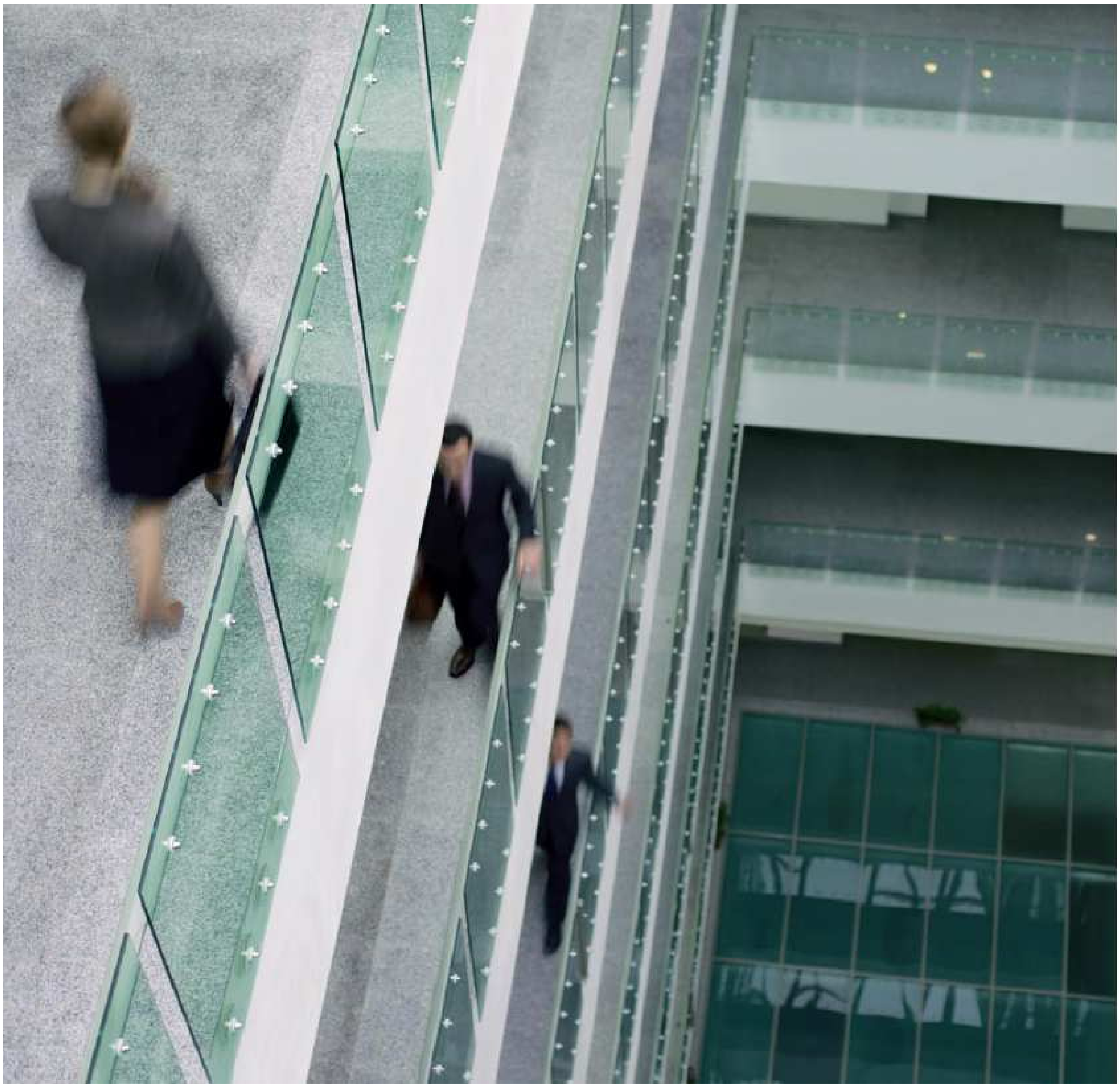
Response to Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

May 3, 2010



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May 3, 2010

FILED ELECTRONICALLY

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW.
Washington, DC 20210
Attention: Lifetime Income RFI

Re: RIN 1210–AB33: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

Milliman appreciates the opportunity to respond to the Request for Information (RFI) on lifetime income options in retirement plans issued by the Department of Labor (DOL) and the Department of the Treasury. We are pleased to hear of your interest in promoting income security in retirement. We agree that too many American workers do not have the option to cost-effectively convert their accumulated 401(k) savings into guaranteed retirement income.

The SPARK Institute, Inc. and the Insured Retirement Institute have both filed excellent responses to this RFI that are broadly representative of the industry position on the questions raised in the RFI. We endorse the suggestions that these entities have made to the DOL. In our response here, we have focused on areas where we believe Milliman has a particularly valuable point of view to contribute.

Milliman is wholly owned and managed by approximately 300 Principals, who have been elected in recognition of their technical, professional and business achievements. Our sole business is providing independent consulting services. We are not affiliated with any public accounting or brokerage firms. The consultants of the firm are not permitted to own stock in any insurance or reinsurance company, nor are they allowed to own stock in client organizations. In these ways, Milliman is able to provide analyses and opinions that are totally independent and objective.

Milliman's Financial Risk Management (FRM) practice is a leading provider of risk management services to financial institutions who provide guaranteed lifetime income products, managing over $500 billion of retirement savings in 6 million customer accounts. Our practice is fundamentally changing the way people save for retirement.

As independent experts with many years of experience working with over 35 major life insurance companies on their guaranteed retirement income programs, we believe we have valuable insights to provide in the retirement savings debate. Specifically, we see there are three features that are needed for a successful guaranteed retirement income program for the 401(k) and IRA markets:

1. The guarantee should be backed by multiple insurance companies;
2. The fair value of the guarantee should be fully funded through a collateralized separate account; and
3. Market risk should be neutralized through industry standard hedging techniques.

We have been developing industry standards to achieve a solution with these multiple layers of protection. We do not represent any particular group or entity. We are simply using our expertise to try and bring together an appropriate solution. Our experience puts us in the optimal position to coordinate the activities of a multiple insurer backed guarantee program.

We hope that our responses prove valuable to you as you work towards bringing about fundamental improvement in retirement security for American workers. We would welcome the opportunity to speak with you about how to best create guaranteed retirement income programs for the 401(k) and IRA markets. These programs can benefit the tens of millions of workers approaching retirement. If you would like to speak with us, please let us know of a date and time you are available and we would be happy to call or come to Washington to meet with you.

Best regards,

Kenneth P Mungan

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QUESTIONS #3 & #4: *Discussion of types of lifetime income products that are being added (on an ever-growing scale) inside of defined contribution plans and directly to the IRA and retail markets*

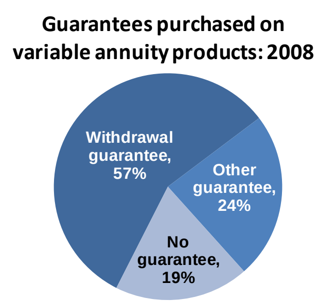
Today's lifetime income guarantee products are very different from those available even just 10 years ago. Understanding that the market is constantly evolving, we focus our discussion on the products most likely to be available to current and near term retirees. These products fit into two main categories: (1) Income Annuities, and (2) Guaranteed Withdrawal Products.

The main difference between these products is who maintains control over the assets. For Income Annuities, the insurance company controls the assets. The participant must exchange a lump sum, all or a portion of the retiree's savings, for a stream of future life-contingent payments. For Guaranteed Withdrawal Products, the participant maintains control of the assets. In exchange for an annual fee, the insurance company guarantees the participant a certain minimum withdrawal amount every year for life.

This issue of who controls the assets manifests itself in a number of ways. If the participant controls the assets, as with Guaranteed Withdrawal Products, there are significant advantages in terms of flexibility, liquidity and transparency:

- The investor can take extra retirement income in case of need without disproportionate penalty
- The investor is free to leave and re-enter the program, without surrender charges
- The investor's beneficiaries receive the remaining account value if the investor dies before it is depleted
- The fees are explicit, rather than embedded in a life-contingent payment amount
- The investor's guarantee can increase with positive stock market performance
- The investor receives both *market and longevity* protection
- The investor's risk is *individualized*… his money, his guarantee

Guaranteed Withdrawal Products, with benefits that apply for the life of the participant, are becoming the retirement vehicle of choice around the world.



The advantages to the investor of being able to maintain control of his assets have driven an explosion in the sales of guaranteed withdrawal products in the US[1].

- ***86%*** of 2008 variable annuity sales were in products that offered an optional withdrawal guarantee
- ***Over 50%*** of policyholders actually purchased a withdrawal guarantee[i]

Although income annuities can be the most cost effective type of retirement savings guarantee, these options are virtually never the right choice for a person's entire retirement portfolio, because of the loss of liquidity such products create. Experts say that on average, 60% of a person's retirement savings should go into income annuities[ii]. The positioning of an income annuity product in a retirement portfolio is often done in consultation with a financial planner. Guaranteed withdrawal products, with their greater flexibility and liquidity, are a potential one-size-fits-most solution.

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[1] For more details on the growth of guaranteed withdrawal products , refer to Appendix I

QUESTIONS #2 & #14: *What explains the low usage rate of lifetime income arrangements, and what are the impediments to plan sponsors' including lifetime income options in their plans*

For the 401(k) participant who was planning to retire at the end of 2008, a guaranteed retirement income product would have been wonderful. Say at the beginning of 2008, a participant had $1 million in his retirement account, which would support a lifetime of income at $60,000 a year. At the end of 2008, his retirement account had fallen to $600,000. Suddenly, the income that money would support was only $36,000 a year. If he had a guarantee on his account, the guarantee would have allowed him to withdraw the $60,000 a year he was planning on, and if he ran out of money before he and his spouse died – no problem, the insurance company would just pick up the $60,000 a year payments.

Retirement income guarantees are terrific, but every dollar that a participant doesn't lose has to come from somewhere.

Retirement income guarantees are terrific, but every dollar that a participant doesn't lose has to come from somewhere. In practice, they come from the insurance company that provides the guarantee, but the insurance companies themselves get the money from the marketplace. They do this by investing in derivatives – not the complex, illiquid kind that helped cause the financial crisis, but rather the simplest, most liquid and transparent hedge assets available. This emphasis on simplicity has helped the life insurance industry to avoid the pitfalls found in the banking industry. In general, life insurers have avoided the complex financial instruments favored by banks, and they have emphasized redundancy and reliability in their operational processes.

To pay the guarantees, insurance companies purchase derivatives via their hedging programs. These derivatives earn money in the marketplace when equity markets or interest rates fall.

In fact, in 2009, Milliman completed a study of insurance companies offering guaranteed retirement income products and determined that the hedging programs had been about 94% effective in achieving their designed goals during the period from September 2008 through March 2009[iii]. In September and October alone, these hedging programs saved the life insurance industry an estimated $40 billion[iv].

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To understand just what might have happened to the industry *without* these hedging programs to support the guarantees they had sold, the table below takes seven large companies and shows the value of the guarantees at the beginning and end of 2008, as reported in their annual filings with the Securities and Exchange Commission (SEC). It isn't simply the sheer size of the guarantee value at the end of 2008 that is remarkable, but also the relative increase in the value. What started out as a small liability at the beginning of the year exploded – ending up as much as *eighteen times* higher at the end of the year. Without hedging programs, these initially small liabilities could have brought down the biggest company.

INCREASE IN VALUE OF GUARANTEES

Company	2007 Reserve (millions)	2008 Reserve (millions)	relative increase
Prudential	168	3,229	18x
Nationwide	92	1,700	17x
Pacific Life	222	2,775	12x
Met Life	284	3,134	10x
John Hancock	500	4,715	8x
Sun Life	378	2,374	5x
TOTAL	**1.6 billion**	**17.9 billion**	**9x**

Source: 10K filings with SEC

Hedging programs were 94% effective during the financial crisis, saving the life insurance industry an estimated $40 billion.

It is industry standard practice to hedge liabilities. Rating agencies ask for information on the hedge programs being managed by companies and evaluate them for their effectiveness. US reserve and capital requirements for insurance companies have recently been revamped to specifically address retirement income guarantees and hedging programs that back them. However, take this highly leveraged exposure to market movements and add to this the reality of AIG and Lehman Brothers failing, and it becomes obvious just why many large plan sponsors are concerned about the credit risk inherent in any guarantee program backed by a single insurance company.

Extending the safe harbor clause is a protection of last-resort for plan sponsors. What sponsors really want is assurance that the guarantees will be paid.

One approach that has been proposed is to extend the safe harbor under 29 CFR 2550.404a-4 to cover other lifetime income products, a recommendation we agree with. However, it is important to realize that this is a last-resort protection for the plan sponsor. The first thing the plan sponsor cares about is that even if the company gets into financial trouble, the guarantees can continue to be provided.

Now consider the size of the annuity market, which is almost exclusively where retirement income guarantees are being sold now, and compare this to the defined contribution ("DC") and IRA market. These markets, *five times* the size of the annuity market, are where the DOL is looking to expand the uptake of guaranteed retirement income products.

2008 U.S. RETIREMENT ASSETS BY PRODUCT

Retirement Savings Vehicle	Assets in trillions	% of total retirement assets
Annuities	1.4	10%
Federal Pension Plans	1.2	9%
State and Local Pension Plans	2.3	16%
Private DB plans	2.0	14%
DC Plans	3.5	25%
IRAs	3.6	26%
TOTAL	**14.0 trillion**	**100%**

Source: Investment Company Institute[v]

The defined contribution and IRA markets are *5 times* the size of the current guaranteed retirement income market.

The potential impact of an insurer failing to fulfill their obligations is enormous, particularly given the potential scale of this business, when these liabilities are part of the general account obligations of the insurance company. Even though the insurance companies have significant regulation controlling the reserves and capital that must be held to support each of their lines of business, including these products, the failure of an insurance company means that in some area of their business, these reserves and capital proved to be insufficient. Once an insurance company is in receivership, the participants in such a plan just end up in a line of creditors. To make matters worse, the circumstances that would lead to a failure of a large, highly-rated insurance company would be just the circumstances that create huge guarantee liabilities. And these are the same times when participants need most to be able to rely on those guarantees. We saw exactly this perfect storm of events in the recent financial crisis.

The potential impact of an insurer failure is enormous when the guarantees are just another part of the general account obligation of the insurance company.

So what is the solution? It is simple, obvious, and easily implemented. Put the assets backing these guarantees (including the hedge instruments) in a separate collateralized trust account.

Segregating the assets is no hardship to insurers, who all manage hedging programs to fund their guarantee liabilities anyway. Companies are already holding those reserves. They are already holding those hedge assets. This simply draws the line in the sand clarifying that the assets are specifically earmarked for the guarantee and thereby clarifies the place where the participants sit in the creditor chain in the event of a default. Make this trust account an asset of the plan, and plan sponsors have a viable option for replacing defaulting insurers, or simply continuing to manage the risk on their own (which at least provides market protection, even if it doesn't provide longevity insurance).

As an extra layer of protection, the trust account should be jointly backed by a consortium of insurers with joint and several liability. This provides the greatest protection to the plan, because all of the insurers would have to fail before the guarantee was in jeopardy. The reason that insurers would enter into such an agreement is because of the existence of the trust account. They would not need to set up any extra reserves in the case of an insurer failure, as that collateral would already be in the trust account. In the event of a failure of a pension plan guarantee provider, the Pension Benefit Guarantee Corporation ("PBGC") would backstop the plan. A fully collateralized trust account would be a particularly valuable structure were the PBGC brought in to unwind a failed pension plan, as the existence of the trust account would mean no large cash inflows to the pension plan would be required.

The Department of Labor should promote and encourage structures that reduce credit exposure to any single life insurance company. This should be done by application of the following three-pronged approach:

- The guarantee is backed by multiple, highly-rated insurance companies;
- The insurers collateralize the guarantee on a monthly basis in a separate account; and
- Market risk is neutralized through industry standard hedging techniques.

Only in this way can participants and plan sponsors begin to enjoy true retirement security.

The solution?

Simple, obvious, easily implemented.

1. **Neutralize market risk through industry-standard hedging techniques.**
2. **Collateralize the guarantee on a monthly basis in a separate account.**
3. **Use a pool of highly-rated insurance companies to back the guarantee.**

GENERAL COMMENT: *Onerous reporting requirements under the securities laws with respect to certain types of annuities create restrictions on what companies can provide guarantees on retirement plans*

Some types of annuity contracts are considered securities and must be registered with the Securities and Exchange Commission (SEC) under the Securities Act of 1933 (the "Securities Act"). Generally, in registering under the Securities Act, the entity becomes subject to all of the reporting requirements of the Securities and Exchange Act of 1934 (the "Exchange Act") as well as liability under Sarbanes-Oxley. For insurance companies that are already SEC reporting companies, this is a moot point. However, an insurance company that is not already a reporting company would not want to take on this increased obligation and are thus effectively prohibited from participating in the offering of certain annuities. In many cases, the insurers that fall into this category are highly rated, highly capitalized mutual companies that would otherwise be ideal to provide retirement income guarantees.

A new SEC rule (Rule 12h-7) which took effect last year provides an exemption for an issuer of certain annuities (such as index annuities, market value adjusted annuities, and synthetic annuities) from the Exchange Act reporting requirements. However, if the insurer breaches any of the conditions to the Rule, the whole exemption is rescinded and the company must meet all reporting requirements. Thus relying on the Rule as written today may prove very risky for an insurer, and in practice the Rule may not prove an effective form of relief for non-reporting companies. We recommend the DOL consult with insurance companies and with the SEC regarding this issue, with the goal of making the lifetime income guarantee market more accessible for industry participants.

APPENDIX 1: Overview of Guaranteed Retirement Income Products

Current Guaranteed Withdrawal Products are sold as optional benefits on variable annuity (VA) policies. The VA market in the United States has experienced rapid growth in recent years. According to the Insured Retirement Institute (IRI), the total VA industry net assets were $1.1 trillion as of year end 2008, as compared to the 2008 U.S. GDP of $14.3 trillion (see Figure 1). As illustrated in Figure 2, variable annuities have surpassed fixed annuities (which include Income Annuities) as the dominant savings vehicle for Baby Boomers to save for their retirement.

FIGURE 1: VARIABLE AND FIXED ANNUITIES TOTAL ASSETS

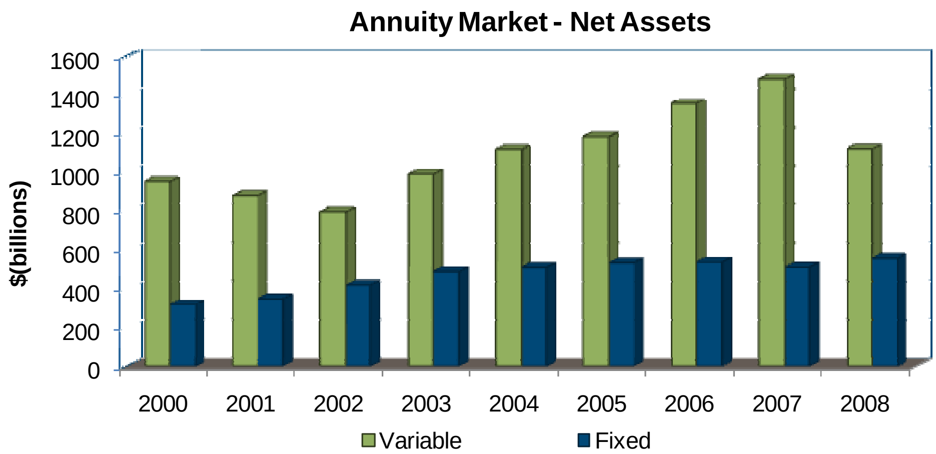
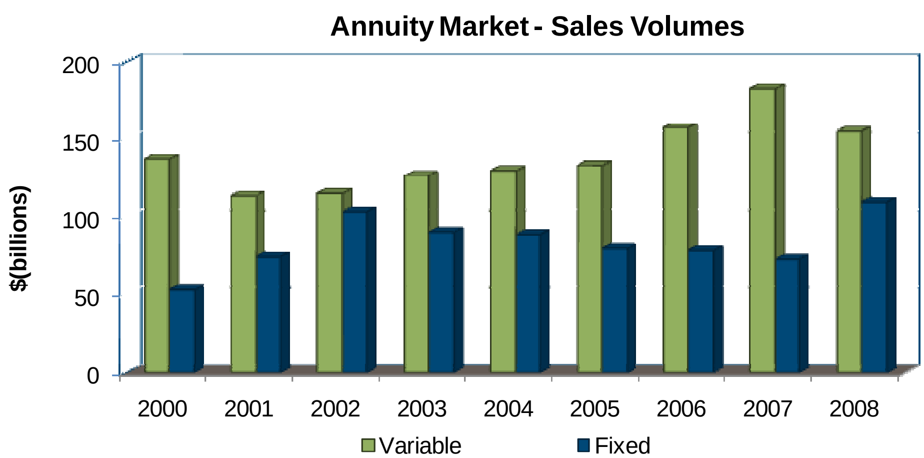


FIGURE 2: VARIABLE AND FIXED ANNUITIES TOTAL SALES VOLUMES

As illustrated in Figure 2, variable annuities have surpassed fixed annuities as the dominant savings vehicle for Baby Boomers to save for their retirement.



VA sales were particularly robust with the introduction of guarantees on the VA assets. The embedded guarantees in VAs are attractive to consumers because they provide a minimal floor of benefits when VA assets perform poorly, and yet leave upside potential for good VA asset performance. This feature makes VAs compare favorably to alternatives such as fixed annuities, bank certificates of deposit (CDs), or mutual funds. While fixed annuities and bank CDs are guaranteed, they do not offer participation in the capital markets. Conversely, mutual funds offer participation in the capital markets, but the investor could suffer significant losses.

REFERENCES

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