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ERISA Advisory Council

De-Risking Notices Should Balance Simplicity, Sufficiency of Information, ERISA Council Told

Model notices on pension plan de-risking should inform participants of state protections of their benefits in cases in which group annuities are being purchased from insurance companies and of the risks of taking a lump sum if that option is offered, witnesses told the ERISA Advisory Council.

Notices should provide all the relevant information to individuals but still be simple enough for participants to understand, they said at a morning session May 28 during the second day of the council's three-day meeting.

The question participants ask is, "What does this mean for me?" said Edward Stone of Edward Stone Law. Stone is also special counsel to the Association of BellTel Retirees Inc. and ProtectSeniors.org.

Keeping disclosures short doesn't mean skimping on information, and should also include risk information regarding the viability of the employer sponsoring a plan as well as of the plan itself, said William Kadereit, president of the Washington-based National Retiree Legislative Network.

The plan sponsor should err on the side of giving too much information instead of too little, Kadereit said.

While financial education is important, it isn't enough to help individuals make prudent choices regarding their assets, Kadereit said.

"No matter how much you educate them, if you keep them in the dark, they'll make the wrong decision," or that'll increase the chance that they'll make the wrong decision, he said.

The ERISA Advisory Council is focusing on two topics in 2015: model notices on defined benefit plan risk shifting and model notices and plan sponsor education on lifetime plan participation.

The council took up the latter topic May 27 (see related articles in this issue on the morning and afternoon sessions).

Financial and Risk Illiteracy. Sponsors should also take into account that many plan participants aren't financially savvy and need good information presented in an understandable way, witnesses said.

Simply providing better information is unlikely to be helpful, because most people find it "cognitively challenging" to choose between lump sums and annuities, said Erzo F.P. Luttmer, an economics professor at Dartmouth College and research associate at the National Bureau of Economic Research.

Sponsors should also give participants supplementary information in a "choice architecture" framework to guide them in making the prudent choice, he said.

Luttmer defined choice architecture to refer to "how choices are structured, including whether there are defaults and what choices are available."

If the information in a lump-sum disclosure notice frames the choice in terms of the "consumption or income stream" the participant would have throughout retirement, rather than in terms of "investments," there is a greater likelihood that an individual will make the right decision, given their circumstances, Luttmer said.

A consumption model would provide information in terms of the income stream, on a per-month basis, that the individual would get under each choice, rather than in the actuarial value of each choice.

Annamaria Lusardi, an economics and accountancy professor at the George Washington University School of Business and founder and academic director of the Global Financial Literacy Excellence Center, agreed, and added that not only are most people financially illiterate, they are also "risk illiterate."

Risk illiteracy, she said, means not understanding probabilities, being able to calculate expected values, the relationship between risk and return, or how to diversify risk—all of which magnifies the challenge in choosing between lump sums and annuities, and the decisions involved in managing a lump sum.

The Government Accountability Office made recommendations on what participants need to know when they are offered lump sums (42 BPR 414, 3/3/15), but that report pays only scant attention to the fact that among the general population, financial literacy is "very low," Lusardi said.

The GAO report includes two graphics to illustrate the potential effects of a lump-sum decision, which experts may find useful, but probably wouldn't be useful for the average person, Lusardi said.

Lusardi made three recommendations: that disclosures be made readily available and easily accessible; that they be provided in very simple ways and in plain English; and that help be provided to conceptualize the information, such as by including tools that make it easy to make calculations or comparisons between possible choices.

In her research, brief videos and interactive visual tools have both been shown to be effective in increasing financial literacy, Lusardi said.

Annuity Transfers. In addition to informing participants of state law regarding their insured annuities, notices of annuity transfers also should tell participants that the protections and fiduciary responsibilities under

the Employee Retirement Income Security Act no longer apply, Stone said.

Stone agreed with other witnesses who said that annuity notices should be kept short, and offered two brief sample notices in his written testimony, one dealing with disclosures prior to a risk transfer and the other after the transfer.

Matt McDaniel, a partner at Mercer LLC and leader of the consulting firm's U.S. defined benefit risk transfer sector, said that when a plan sponsor decides to settle its pension obligations through an annuity buy-out, the annuity notice is only informational, because the participant doesn't have to make a choice.

McDaniel said the notices should include:

- a description of what is occurring and what will remain unchanged through the annuity purchase process, such as the participant's benefit amounts and survivor benefits;

- a disclosure that the sponsor is no longer responsible for funding the benefits and that the Pension Benefit Guaranty Corporation is no longer responsible for backstopping them;

- information on the selected insurer; and

- information that describes the coverage provided by the state guaranty association of the state in which the individual resides.

In addition to the recommendations that McDaniel, Stone and others made, disclosures should address the "known unknowns" and individual circumstances that

could influence a participant's decision whether to accept a lump-sum offer, said Ellen L. Kleinstuber, vice chairperson for the American Academy of Actuaries' pension committee.

A model notice should be offered only if it is supported by a fiduciary-protected safe harbor notice, such as provided under tax code Section 402(f), and issued by the Department of Labor or the Internal Revenue Service or the PBGC, Kleinstuber said.

In the afternoon session on model notices for derisking, witnesses said model notices aren't the proper method to ensure that plan participants receive the essential information they need to decide whether to select a lump-sum distribution or a plan-purchased annuity (see related article in this issue).

BY SEAN FORBES

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Copies of written testimony by Thursday morning's witnesses are at: Erzo F.P. Luttmer, <http://op.bna.com/pen.nsf/r?Open=pkun-9wxsea>; Annamaria Lusardi, <http://op.bna.com/pen.nsf/r?Open=pkun-9wxsb9>; William Kadereit, <http://op.bna.com/pen.nsf/r?Open=pkun-9wxshk>; Stephen Silverberg, <http://op.bna.com/pen.nsf/r?Open=pkun-9wxs5z>; Edward Stone, <http://op.bna.com/pen.nsf/r?Open=pkun-9wxs8p>; Matt McDaniel, <http://op.bna.com/pen.nsf/r?Open=pkun-9wxrrl>; and Ellen L. Kleinstuber, <http://op.bna.com/pen.nsf/r?Open=pkun-9wxrjx>.