United States Government Accountability Office

Report to Congressional Requesters

November 2013

401(k) PLANS

Other Countries' Experiences Offer Lessons in Policies and Oversight of Spend-down Options

GAO-14-9

GAO Highlights

Highlights of GAO-14-9, a report to congressional requesters

November 2013

401(k) PLANS

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Why GAO Did This Study

American workers are primarily saving for retirement through their 401(k) plans and will likely need assistance making complicated decisions about how to spend their money throughout retirement. Other countries with defined contribution (DC) systems are also dealing with this spend-down challenge. To identify lessons for the U.S. from the experiences of other countries, GAO examined selected countries' (1) approaches to offering retirement spend-down options; (2) strategies to help participants make sound decisions; and (3) approaches to regulating and overseeing options. An initial review of countries with established DC systems indicated that some countries including the six GAO selected—Australia, Canada, Chile, Singapore, Switzerland, and the United Kingdom—have developed innovative spend-down policies that have the potential to yield useful lessons for the U.S. experience. GAO reviewed reports on DC plans; and interviewed experts and government officials in the U.S. and selected countries.

What GAO Recommends

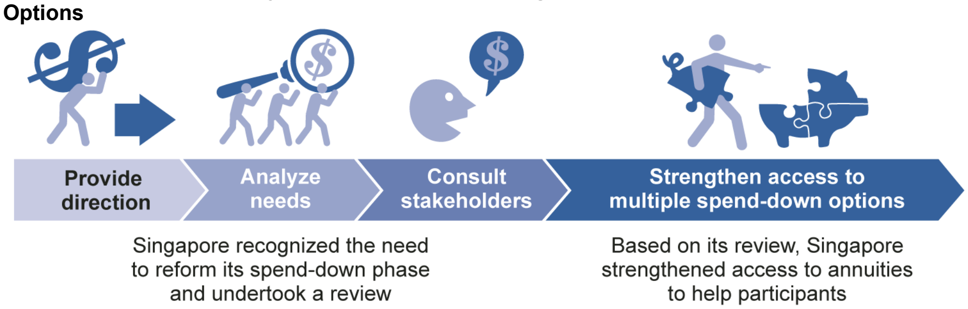
GAO recommends that DOL and Treasury, as part of their ongoing efforts, consider other countries' approaches in helping 401(k) plan sponsors expand access to a mix of spend-down options for participants. GAO also recommends that DOL consider other countries' approaches in providing information about options and regulating the selection of annuities within DC plans. In response, DOL generally agreed with GAO's recommendations and will evaluate approaches.

For GAO-14-9 and interactive retirement materials, go to www.gao.gov/products/GAO-14-9. For more information, contact Charles Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

What GAO Found

The six countries GAO reviewed can offer U.S. regulators lessons on how to expand access to a mix of spend-down options for 401(k) participants that meet various retirement needs. Five of the six countries generally ensure that participants can choose among three main plan options: a lump sum payment, a programmed withdrawal of participants' savings, or an annuity. In the last several decades, all the countries took steps to increase participant access to multiple spend-down options, with some first conducting reviews of participants' retirement needs that resulted in policy changes, as shown below. In the United States, 401(k) plans typically offer only lump sums, leaving some participants at risk of outliving their savings. The U.S. Departments of Labor (DOL) and the Treasury (Treasury) have begun to explore the possibility of expanding options for participants, but have not yet helped plan sponsors address key challenges to offering a mix of options through their plan.

Example of Steps Taken by Other Countries to Strengthen Access to Multiple Spend-down Options



Source: GAO analysis of documents from Singapore's National Longevity Insurance Committee and Central Provident Fund.

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this study.

Countries reviewed used various strategies to increase participants' knowledge and understanding of spend-down options, which may be useful to DOL in its ongoing efforts. Strategies used by other countries include (1) communicating spend-down options to participants in an understandable and timely manner, and (2) helping participants see how their savings would translate into a stream of income in retirement by providing them with projections of retirement income in their annual benefit statements. Currently, 401(k) participants have difficulty predicting how long their savings will last because most benefit statements do not focus on the stream of income it can generate. DOL is currently considering including income projections in statements, which may help participants better understand what their balance could provide on a monthly basis once they retire.

Regulators in the countries GAO reviewed employed several approaches to overseeing the spend-down phase aimed at helping participants sustain an income throughout retirement. For example, most of the countries used withdrawal rules and restrictions for lump sums and programmed withdrawals to help protect participants from outliving their savings. With respect to annuities, DOL continues to consider current regulatory barriers that may prevent 401(k) plan sponsors from offering annuities, which do not exist in other countries. Looking at what other countries require may help DOL in its efforts.

Contents

Abbreviations

ABI	Association of British Insurers
AFP	Administradoras de Fondos de Pensiones
APRA	Australian Prudential Regulatory Authority
CPF	Central Provident Fund
DB	defined benefit
DC	defined contribution
DOL	Department of Labor
EBSA	Employee Benefits Security Administration
ERISA	Employee Retirement Income Security Act of 1974
FIO	Federal Insurance Office
IRS	Internal Revenue Service
NAIC	National Association of Insurance Commissioners
OECD	Organisation of Economic Co-operation and Development
Treasury	Department of the Treasury
U.K.	United Kingdom

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

November 20, 2013

The Honorable George Miller
Ranking Member
Committee on Education and the Workforce
House of Representatives

The Honorable Robert E. Andrews
Ranking Member
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and the Workforce
House of Representatives

American workers are primarily saving for retirement through 401(k) plans, which have become the dominant type of plan private sector employers are offering in the United States.[1] Since the inception of 401(k) plans, regulators have focused their efforts on ensuring that plan participants accumulate savings for retirement.[2] With many participants who have had defined contribution (DC) plans throughout their career nearing retirement, regulators have begun to focus on the decumulation

[1] In 2012, the Advisory Council on Employee Welfare and Pension Benefit Plans, also known as the ERISA Advisory Council, reported that the percentage of private employers offering single-employer DB plans has decreased to less than 9 percent. In contrast, the percentage of private employers offering DC plans has increased to more than 88 percent. See ERISA Advisory Council, *Examining Income Replacement During Retirement Years In a Defined Contribution Plan System*, (Washington, D.C.: December 2012). Another study calculated that 68 percent of workers covered by employer retirement plans only had access to DC plans in 2010 based on U.S. Board of Governors of the Federal Reserve System, Survey of Consumer Finances (1983 and 2010). Alicia H. Munnell, Anthony Webb, and Francis M. Vitagliano, *The Economic Implications of the Department of Labor's 2010 Proposals for Broker-dealers*, Center for Retirement Research at Boston College Working Paper 2013-4 (February 2013).

[2] We have reported on numerous issues that have hampered participants' efforts to save for their retirement, such as fees, participant inertia, and limited financial literacy. For more on these issues, see GAO, *401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants*, GAO-13-30 (Washington, D.C.: Mar. 7, 2013); *401(k) Plans: Increased Educational Outreach and Broader Oversight May Help Reduce Plan Fees,* GAO-12-325 (Washington, D.C.: Apr. 24, 2012); *401(k) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest*, GAO-11-119 (Washington, D.C.: Jan. 28, 2011); and *Retirement Savings: Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges*, GAO-10-31 (Washington, D.C.: Oct. 23, 2009).

phase, or the spending down of retirement savings, because of the real possibility that some retirees may outlive their savings. Unlike participants in traditional defined benefit (DB) plans who are offered a specific periodic benefit for life at retirement, 401(k) plan participants must take responsibility for the complex decisions required in the spend-down phase. By 2015, participants whose retirement savings will be primarily made up of what they accumulated in their 401(k) plans, which were introduced in 1978, will be eligible to retire. Typically, 401(k) plan participants receive benefits as a lump sum payment and are thus primarily left on their own to manage their money in a way that ensures they do not outlive their retirement savings.[3] Current regulatory efforts by the Department of Labor (DOL) and the Department of the Treasury (Treasury) have begun to focus on the spend-down phase as it has become clearer that workers in the United States are increasingly subject to financial risks in retirement that can cause them to either outlive their savings or to lower their standard of living.

The United States is not alone in facing this growing concern for retirees. Other countries with retirement systems dominated by DC plans similar to 401(k) plans face the same problem of ensuring that plan participants effectively manage the spending of their retirement savings, whether under a mandatory or voluntary system. This is particularly important given the common challenges of low average balances of DC plan participants and the longer average life expectancies.[4] Some countries have developed innovative approaches and strategies that can help participants better manage their DC plan savings throughout their lives, while the United States has just begun to explore ways to help 401(k) plan participants. As DOL and Treasury move forward, you expressed interest in potential lessons learned from countries that have addressed these issues. This report addresses the following questions:

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[3] In addition, in the United States, although DB plan participants must be offered a life annuity option at retirement, there is a growing trend in traditional DB plans to offer participants lump sum payout options. While we note that the challenge of managing the spend-down phase is not solely an issue for DC plans, the spend-down phase in the context of DB plans is outside the scope of this report.

[4] According to the Organisation for Economic Co-operation and Development (OECD), between 1960 and 2010, the average life expectancy at age 65 increased by around 3.9 years for men (from about 12.7 to 16.6 years) and 5.4 years for women (from about 14.7 to 20.1 years), among OECD countries. Furthermore, the United Nations projects life expectancy at age 65 will increase to 20.3 years for men and 24.6 years for women in 2050.

1. What approaches have other countries with DC plans taken to offer participants certain retirement spend-down options?
2. What key strategies are used in other countries with DC plans to help participants make sound spend-down decisions to improve retirement outcomes?
3. What approaches have other countries used to regulate and oversee spend-down options?

To answer these questions, we selected six countries with extensive or growing DC systems in which to conduct in-depth reviews of retirement spend-down phase strategies: Australia, Canada, Chile, Singapore, Switzerland,[5] and the United Kingdom (U.K.). We selected these countries from an initial review of countries with well-developed account based retirement systems. In selecting these six countries, we considered if the country had (1) developed innovative spend-down phase policies or options; (2) a clearly defined and well-established oversight structure for the DC plan spend-down phase and providers, such as insurance companies, that offer spend-down products; and (3) an approach to the spend-down phase that was different from the other countries we selected. As part of our initial review, we interviewed and obtained comparative studies of DC systems published by academics, the Organisation for Economic Co-operation and Development, The World Bank, and other industry experts, such as international benefits consulting firms, as well as our prior work.[6] We then examined the characteristics of each country's DC system for policies, practices, and requirements related to retirement spend-down options. On the basis of this initial review, we determined that the six countries selected could potentially provide lessons for the United States given their experience and unique approach to the spend-down phase. For each of the six countries selected, we reviewed publicly available research and reports about each

[5] Most occupational retirement plans in Switzerland are hybrid plans that incorporate some DC features, such as individual accounts, within a DB plan structure. Switzerland mandates the rate of return credited to participants' contributions during the accumulation phase as well as the terms for pricing annuities that participants can purchase with these savings.

[6] GAO, *Defined Contribution Plans: Approaches in Other Countries Offer Beneficial Strategies in Several Areas*, GAO-12-328 (Washington, D.C.: Mar. 22, 2012); *Private Pensions: Changes Needed to Better Protect Multiemployer Pension Benefits*, GAO-11-79 (Washington, D.C.: Oct. 18, 2010); and *Private Pensions: Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs*, GAO-09-642 (Washington, D.C.: July 24, 2009).

country's spend-down options, oversight framework, and initiatives to educate participants about options. We also interviewed pension experts, service providers, regulatory agencies and other government officials from the countries selected. We did not conduct an independent legal analysis to verify the information provided about the laws, regulations, or policies of the foreign countries selected for this study. Instead, we relied on appropriate secondary sources, interviews with relevant officials, and other sources to support our work. We submitted key report excerpts to agency officials in each country for their review and verification, and we incorporated their technical corrections as necessary. To provide context for various spend-down options and illustrate some of the factors that can affect retirement income we designed a retirement model and hypothetical scenarios. To create this, we consulted with actuaries to develop a formula for pricing annuities based on benchmarks typically used by insurance companies in U.S. retail markets. We also reviewed data from the Federal Reserve Economic Database, including 10-year Treasury constant maturity rates, and Thrift Savings Plan to establish historical ranges for interest rates, inflation, and investment returns on 401(k) accounts. Appendix I provides additional information on our scope and methodology.

We conducted this performance audit from June 2012 through November 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

U.S. 401(k) Plans and Their Oversight Framework

Employers can sponsor two broad types of retirement plans, referred to in the Employee Retirement Income Security Act of 1974 (ERISA) as pension plans: (1) DB plans, which promise to provide benefits generally based on an employee's years of service and frequently are based on salary, regardless of the performance of the plans' investments, and (2) DC plans, in which benefits are based on contributions and the performance of the investments in participants' individual accounts. Since the inception of ERISA, employers have shifted away from sponsoring DB plans and moved toward sponsoring DC plans. The dominant type of DC plan is a 401(k) plan. In 2011, U.S. employers sponsored over 510,000

401(k) plans covering more than 61 million workers with more than $3.1 trillion in plan assets.[7] Unlike DB plans, in which plan participants are eligible for a specific payment for life, 401(k) plan participants typically must make their own, sometimes complex, choices about their account balance both before and during retirement. For example, participants need to decide how much to contribute, how to invest, and how to spend down savings in retirement.

In the United States, 401(k) plans are subject to provisions of ERISA, which are generally enforced by DOL's Employee Benefits Security Administration (EBSA) and Treasury's Internal Revenue Service (IRS).[8] To carry out its responsibilities under ERISA, EBSA issues regulations and other guidance. The IRS, under Title II of ERISA, and subsequent amendments to the Internal Revenue Code, generally is responsible for ensuring that plans meet certain requirements for tax qualification, among other things. Tax advantages are intended to encourage employers to establish and maintain pension plans and encourage employees to participate in the plans. For example, employer contributions to qualified plans are, within limits, tax deductible and, in general, contributions and investment earnings are not taxed as income until the employee withdraws them from the plan.

In recent years, EBSA and IRS have increased their focus on the decumulation phase of 401(k) plans, exploring ways to facilitate access to lifetime retirement income products, such as annuities. For example, in 2008, EBSA issued a new safe harbor regulation for selecting annuity providers as an optional way for sponsors and other plan fiduciaries of DC plans to satisfy their responsibilities under ERISA to act prudently and in the interest of the plan's participants and their beneficiaries.[9] Subsequently, in 2010, EBSA and IRS sought public comments to aid the agencies in thinking about how they might facilitate access to and the use

[7] U.S. Department of Labor, Employee Benefits Security Administration, Private Pension Plan Bulletin: Abstract of 2011 Form 5500 Annual Reports, Version 1.0 (Washington, D.C.: June 2013).

[8] Additionally, ERISA provides for the establishment of the ERISA Advisory Council to advise the Secretary of Labor and make recommendations on the Secretary's functions under ERISA.

[9] Selection of Annuity Providers—Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58,447 (Oct. 7, 2008)(codified at 29 C.F.R. § 2550.404a-4).

of lifetime income streams after retirement.[10] More recently, IRS proposed a new regulation in February 2012 to encourage retirement plans to offer a longevity annuity option, also referred to by some as deeply deferred annuities, in which payments initiate at an advanced age, such as age 80.[11] This regulation has not been finalized.

In addition, other entities play a role in overseeing and monitoring insurance companies that sell annuities—guaranteed income payments for life or a specified term—either through 401(k) plans or in the retail market to individual investors. For example, state insurance regulators are responsible for enforcing state insurance laws and regulations, including those covering the licensing of agents, reviewing insurance products (including annuities) and their rates, and examining insurers' financial solvency and market conduct. In addition to state insurance regulators, the National Association of Insurance Commissioners (NAIC)—a voluntary association of the heads of insurance departments from the 50 states, the District of Columbia, and five U.S. territories—plays a role in insurance regulation. Although NAIC is not a regulator, it provides guidance and services designed to more efficiently coordinate interactions between insurers and state regulators.[12] Additionally, although the Federal Insurance Office (FIO) is not directly involved in the supervision of private and public pension plans, it has a role in coordinating and developing insurance policies. FIO advises the Secretary of the Treasury on domestic and international insurance policy issues; and consults with states regarding insurance matters of national and international importance. FIO also coordinates federal efforts and develops federal policy on prudential aspects of international insurance matters. For example, FIO has been working with international regulators to develop a methodology and indicators for identifying global systemically important insurers, meaning that their failure might threaten global financial stability.

[10] Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans, 75 Fed. Reg. 5253 (Feb. 2, 2010).

[11] Longevity Annuity Contracts, 77 Fed. Reg. 5443 (Feb. 3, 2012)(to be codified at 26 C.F.R. pt. 1).

[12] NAIC services include providing detailed insurance data to help regulators understand insurance sales and practices; maintaining a range of databases useful to regulators; and coordinating regulatory efforts by providing guidance, model laws and regulations, and information-sharing tools.

Key Aspects of DC Systems in the United States and Selected Countries

In addition to the United States, the selected countries for this review—Australia, Canada, Chile, Singapore, Switzerland, and the United Kingdom—each have extensive or growing DC retirement systems. As shown in table 1, the key features of each country's predominant DC plan vary.[13]

Table 1: Key Features of DC Plans by Country

Country	Key features of DC system	Contributions	DC assets as a percentage of national gross domestic product, 2011
Australia	Mandatory plans are known as superannuation funds, which may be established by a single employer, groups of employers in an industry, financial service companies, or even by individuals themselves.	There is a mandatory employer contribution rate of 9.25 percent of an employee's earnings, which is scheduled to gradually increase to 12 percent by 2022.	91.6%
Canada	Employers can voluntarily sponsor plans, which may be administered by a single employer, groups of employers in an industry, or financial service companies.	Contribution rates by employer and employee vary by plan. DC plans typically require employee contributions of 5 percent of earnings and matching employer contribution.	2.8
Chile	Mandatory individual retirement plans are managed by for-profit entities called Administradoras de Fondos de Pensiones (AFP).	Employers are not required to contribute to a participant's account. Employees are required to contribute 10 percent of applicable earnings and pay monthly administrative fees to their AFP.	61.3

[13] Countries we reviewed, including the United States, have taken steps to address the challenges of the accumulation phase for their participants. For example, in order to increase the adequacy of workers' accumulations, Australia is increasing the level of mandatory employer contributions to DC plans, known as superannuation funds, from 9.25 percent in 2013 to 12 percent by 2020. To increase participation and savings in DC and other employer-sponsored retirement plans, in October 2012 the United Kingdom began implementing a mandate on employers to automatically enroll workers into retirement plans and make contributions on their behalf. In the United States, to increase participation in 401(k) plans, Congress, IRS, and DOL took steps to promote the adoption of automatic enrollment and appropriate default investment options for the accumulation phase.

Country	Key features of DC system	Contributions	DC assets as a percentage of national gross domestic product, 2011
Singapore	Mandatory plans are administered by the Central Provident Fund (CPF) Board.	For participants under age 50, employers are required to contribute 16 percent and employees 20 percent. From age 50 and older, rates gradually reduce to 6.5 percent and 5 percent for the employer and employee, respectively at age 65. Contributions are credited to accounts for retirement and for other things, such as housing and health care.	62.9
Switzerland	Mandatory occupational plans, which are administered by independent foundations and may be sponsored by a single employer industry associations, or insurance companies. These plans have minimum rates of returns on savings and a minimum conversion factor for annuities.[a]	Age-based contributions range from 7 percent of income for younger employees to 18 percent for employees approaching retirement. Employers are required to pay at least half of these contributions.	110.3
United Kingdom	Starting in October 2012, the United Kingdom began phasing in a requirement over 6 years that employers automatically enroll workers in a plan and make contributions to it. These plans can either be governed by a board of trustees or under a contract set up between participants and a financial service company.	In 2013, minimum contributions were 2 percent with at least 1 percent by the employer. These rates are scheduled to increase to 8 and 3 percent by October 2018, respectively.	25.2
United States	Employers can voluntarily sponsor several types of DC plans. The most popular type of DC plan is 401(k) plan. These plans are administered by employers, who may hire private companies to service the plan.	Employers, employees, or both may make contributions to the individual employee accounts. Employers may choose to make additional contributions (such as contributing a percentage of each eligible employee's salary), match the amount contributed by the employee, or both. Under IRS tax rules, contributions are limited.[b]	20.9

Source: GAO analysis of foreign documentation, interviews with industry experts, and data from the International Monetary Fund World Economic Outlook September 2011 database. GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

[a]Officials in Switzerland said the majority of plans in Switzerland are hybrid plans. These hybrid plans are similar to cash balance plans, which in the United States are legally classified as DB plans because participants' benefits are determined by a benefit formula. However, a cash balance plan has certain features, such as notional or hypothetical "individual accounts," that make it resemble a DC plan.

[b]In the United States, the maximum annual limit for employee individual contributions to a 401(k) plan was $17,500 for 2013. The catch-up contribution limit for employees aged 50 and over was $5,500.

Retirement Spend-Down Options

At retirement, participants in DC plans enter the distribution, or spend-down phase, during which they use their savings to meet their retirement needs.[14] DC participants are typically offered one or more of three main types of spend-down options at retirement, although the availability of these options and the rules related to their use vary by country:

- **Lump sum payments** are a single distribution of some or all of a participant's retirement savings. For example, in the United States, participants generally only have the option to withdraw all or part of their account balance, which can, at the participant's discretion, then be used to invest in retail financial markets, among other things.

- **Programmed withdrawals** are a series of fixed or variable payments from a participant's account and may be administered either within a plan or in retail financial markets.[15] Programmed withdrawals attempt to produce relatively stable annual income for the lifetime of the retiree. For example, a participant could set up their own programmed withdrawal strategy and decide to draw down a certain percentage of their assets each month or year to meet their retirement needs. Governments could also set minimum and maximum drawdown limits.

- **Annuities** are guaranteed payments that are normally secured through a contract with an insurance company for either a set period or for the participant's lifetime. Annuities come in a variety of forms.[16] For example, deferred annuities allow participants to delay the start date of payments to a later point in retirement. Variable annuity

[14] Participants in 401(k) plans may make withdraws on their retirement savings account before retirement under certain limited conditions, typically referred to as leakage. For additional information on the incidence, amount, and relative significance of different forms of 401(k) plan leakages, see GAO, *401(k) Plans: Policy Changes Could Reduce the Long-term Effects of Leakage on Workers' Retirement Savings*, GAO-09-715 (Washington, D.C.: Aug. 28, 2009).

[15] In the United States, programmed withdrawals may be referred to as "systematic withdrawals".

[16] This report provides examples of some annuities in the United States and countries we reviewed, and is not an exhaustive list of all types of annuities.

payments are not guaranteed and vary based on the performance of underlying investments selected by the participant.[17]

Factors that affect annuity payment calculations can vary by country

Annuity payment amounts may depend on a number of factors beyond simply the amount of retirement savings a participant can use to purchase the annuity less fees charged by insurers. These factors vary by country and may, depending on the country, include such factors as:

- Age: Participants can generally expect to receive higher payments the higher the age at which payments commence.
- Gender: Men typically receive higher payments compared to women of the same age, since studies have shown that women tend to live longer than men. This may not apply, however, in countries and market sectors that require annuities to be offered on a gender-neutral basis—such as for an annuity offered through a plan in the United States.
- Health: Participants with certain health conditions or lifestyle habits such as smoking can in some cases obtain higher payments.
- Interest rates: Participants who purchase annuities during periods of low interest rates may lock in lower payments than if they had purchased during a period of higher interest rates.

Participants face trade-offs in choosing among spend-down options because no single option protects against all the various risks participants may encounter in retirement, such as longevity[18] and inflation risk. To choose suitable options, participants approaching retirement must weigh the strengths and shortcomings of each against their own unique retirement needs. They also need to consider their other sources of retirement income, including government benefits and personal savings.[19] Table 2 illustrates some of the trade-offs participants face in choosing among spend-down options.

[17] Variable annuities may include riders, such as guaranteed lifetime withdrawal benefits, to provide various protections or additional features, subject to certain restrictions. In the United States, these newer products have raised some questions about their cost, complexity, vesting rules, and protections of state guaranty associations, among other issues. For additional information about the consumer benefits and risks of newer annuity products in the United States, see GAO, *Retirement Security: Annuities with Guaranteed Lifetime Withdrawals Have Both Benefits and Risks, but Regulation Varies across States,* GAO-13-75 (Washington, D.C.: Dec. 10, 2012).

[18] Longevity risk is the risk of living longer than anticipated at the time of retirement. In such cases, even large savings may be exhausted and prove inadequate.

[19] In addition to government benefits and personal savings, in the United States, other potential sources of retirement income include other financial assets, such as pension income from DB and DC plans and nonfinancial assets such as home equity.

Table 2: Examples of Trade-offs That Participants Face in Choosing among Spend-Down Options

Spend-down option	Protects you against some risks	But may expose you to others
Lump sum payments[a]	• Provide immediate access to retirement savings, some of which can be used to pay off debt and cover the costs of unforeseen events, such as unexpected high medical costs. • Unused savings can be left as an inheritance.	• Participant is responsible for ensuring that retirement savings last their lifetime.[b] • Lump sum payments do not protect against inflation.[c] • Participant assumes investment risk for any retirement savings they reinvest.[d]
Programmed withdrawals[e]	• Enable participants to keep retirement savings invested. • Offer flexibility to choose the level and timing of payments drawn from the plan, sometimes subject to any minimum or maximum requirements. • Provide access to retirement savings to cover the costs of unforeseen events. • Unused savings can be left as an inheritance.	• Payments from programmed withdrawals are not guaranteed to last for life. • Programmed withdrawals do not protect against inflation.[c] • Participant assumes investment risk for retirement savings invested.[f]
Annuities	• Provide regular payments that can be guaranteed to last the participant's lifetime. • Protect against investment risk, which the insurance company assumes.[g]	• The decision to purchase an annuity is often irreversible. When there is an option to discontinue an annuity, it may subject the participant to relatively high surrender charges. • Retirement savings used to purchase an annuity cannot be left as an inheritance. • The participant risks purchasing an annuity when interest rates are low, therefore receiving lower monthly payments than expected. • Participant is at some risk of inflation unless they purchase a fully inflation indexed annuity.[h]

Source: GAO analysis.

[a]A participant who takes a lump sum payment from a plan may later, at the participant's discretion, use these assets to purchase a retail annuity or invest in retail financial markets, among other things.

[b]Depending on the tax treatment of retirement income, participants may also pay higher taxes by taking their retirement savings as a single payment in one year rather than as a series of payments spread over multiple years.

[c]In taking a lump sum payment or a programmed withdrawal, the participant is responsible for identifying and developing strategies to protect against inflation, such as purchasing an inflation protected retail annuity or achieving the investment returns necessary, net of commissions and fees, to finance increasing withdrawals.

[d]Participants can in some cases maintain preferential tax treatment on their retirement savings by rolling such savings into an individual retirement account (IRA), but as we have previously reported, the rollover process can be confusing for participants. See GAO-13-30.

[e]In the United States, there is some limited indication that plan sponsors may allow participants to set up a programmed withdrawal within a 401(k) plan. We previously found that 401(k) plans generally have lower fees and better comparative information, as well as fiduciary requirements for selecting and managing investment options relative to IRAs, see GAO-13-30.

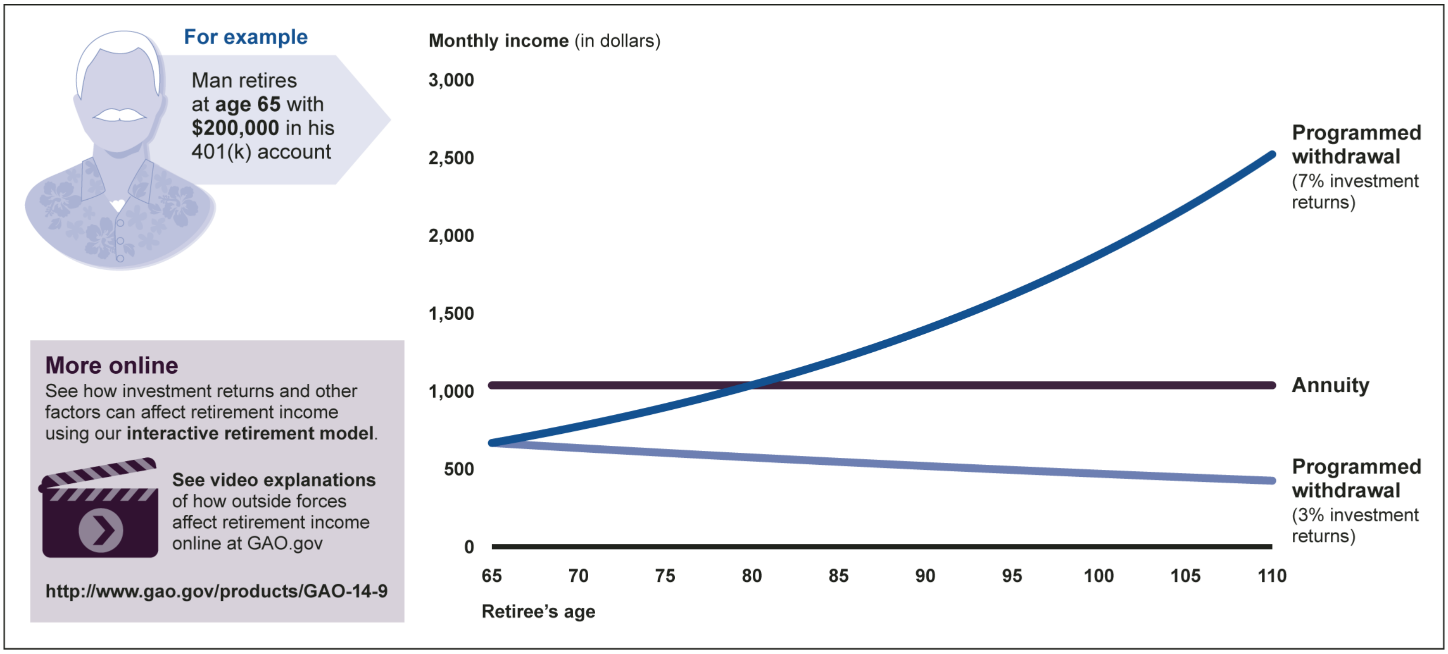
[f]Another factor affecting the sustainability of programmed withdrawals is the sequence of investment returns—in other words, the order in which years of positive and negative investment returns occur—during the drawdown period. See GAO, Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices, GAO-11-400 (Washington, D.C.: June 7, 2011).

[g]This is not the case for variable annuities. Payments for variable annuities vary based on the performance of investments. The insurance company continues to assume the longevity risk, but the investment risk is transferred to the annuitant.

[h]Increasing payment annuities generally provide some protection against rising prices, but may not fully protect against inflation. For example, according to the Insured Retirement Institute, very few life insurance companies offer true inflation-protected annuities in the United States.

To effectively weigh the trade-offs between spend-down options, participants have to understand how interest rates, investment returns, and inflation, among other key factors, can affect their retirement income. Figure 1 below illustrates how investment returns can affect the retirement income a programmed withdrawal provides. In contrast, an annuity, once purchased, protects against investment risk over the course of retirement. Purchasing an annuity, however, may be irreversible, thereby potentially limiting the ability to leave an inheritance or cover unforeseen costs in retirement. And interest rates at the date of purchase can affect the size of payments from an annuity. In all cases, even modest inflation can erode the purchasing power of retirement income over the course of an extended retirement.

Figure 1: Hypothetical Projection of Monthly Retirement Income for a 65-Year-Old 401(k) Plan Participant



Source: GAO analysis, actuarial data on life expectancy.

Note: Annuities in this example convert 401(k) savings of $200,000—the average 401(k) plan balance for individuals in their 60s with 30 years of contributions, according to an Employee Benefit Research Institute analysis of 401(k) balances at the end of 2011—into monthly retirement income for a 65-year old male assuming interest rates of 2 percent. We selected this interest rate based on federal Thrift Savings Plan annuity rates as of May 2013. The programmed withdrawals in the figure provide monthly income totaling 4 percent of the participant's account balance each year assuming annual investment returns of either three or seven percent. These returns are in line with average 10-year historical returns on Thrift Savings Plan funds that track major U.S. stock, corporate bond, and government securities indices. There is no assurance that future investment returns will match historical returns. This example does not account for inflation, which reduces the purchasing power of retirement income. Projected monthly income does not reflect any federal income taxes on distributions from tax-deferred accounts. This example also does not account for changes in behavior in response to investment returns, such as increasing the rate of withdrawals in order to maintain a standard of living or reducing the rate of withdrawals when faced with the prospect of running out of savings.

To see the effect these factors can have on retirement income from the three main spend-down options, see the interactive retirement model available at http://www.gao.gov/products/GAO-14-9.

Strategies to Improve Retirement Outcomes Have Relied on Behavioral Economics

In the last decade, some experts have emphasized an aspect of behavioral economics to help improve retirement outcomes for participants in 401(k) plans. In these plans, individuals face greater responsibility and risks in managing their retirement income needs both during the accumulation and spend-down phases, such as having insufficient savings to support a comfortable retirement and not having the right tools to make sound financial decisions about how to use what they have accumulated.[20] Our prior work found literature arguing that information or financial education, including improving financial literacy, is not necessarily the best or only approach to ensuring good retirement outcomes. They have proposed alternative strategies, sometimes in combination with information and financial education, that aim to help participants reach financial goals by making use of insights from behavioral economics—which blends economics and psychology—that indicate people are often prone to inertia and procrastination, and have difficulty processing complex information. For example, participants in 401(k) plans do not always receive timely, clear information to help them understand their options, as well as the risks and trade-offs of managing income throughout retirement. Even when such information is available, participants do not always make choices that are in their best interest. Insights from behavioral economics have led to strategies that use inertia to bolster or facilitate positive policy outcomes, such as default enrollment in 401(k) plans to increase retirement savings. Researchers and practitioners have proposed similar interventions for the spend-down phase, such as encouraging or “nudging” some participants toward annuitizing a portion of their retirement wealth.

[20] Possible explanations for low savings rates—even in countries where participation in retirement plans is mandatory—include low incomes, which constrain an individual’s ability to save for retirement in light of more short-term competing demands, and discontinuous or interrupted work histories, where unemployment or exiting the labor market may be due to childbearing or care giving needs and can interrupt retirement plan contributions. Where participation is voluntary, plan coverage may be low, because employers may not be offering a pension plan, or even if they do, employees may not join, or may choose to opt out if they are automatically enrolled.

Countries Used Multiple Approaches to Broaden Participants' Retirement Options for the Spend-down Phase

Instituting Multiple Spend-down Options Helped Participants Address Varied and Changing Risks

Although DC systems in countries we reviewed often varied in their features, structure, and regulatory oversight,[21] all six countries ensured that participants have institutionally-facilitated access to a mix of spend-down options through their plans to help them manage retirement risks.[22] Five of the six countries make the three main spend-down options—lump sum payments that offer participants flexibility to access and use their retirement savings, programmed withdrawals that allow participants to keep their account balances invested and draw on savings as needed, and annuities that offer guaranteed retirement income and protection against investment risk—explicitly available to DC participants. The countries we reviewed also allow participants to combine spend-down options to meet changing needs over the course of an extended retirement. For example, within certain conditions, participants in Singapore can take a partial lump sum after age 55 and purchase an annuity that guarantees them some amount of retirement income for life.

Other sources of retirement income, such as those from national pension systems, can address some retirement risks, but all the countries we reviewed recognize the importance of their DC system in improving retirement outcomes and have taken steps to increase participant access to multiple spend-down options. For example, Switzerland has a national

[21] Each country's retirement system reflects that country's unique historical and political experience, making generalizations difficult. For example, widespread choice by participants of lump sum payments in Australia may in part reflect the country's long-standing tradition of providing retirement benefits in a single payment, a practice that predates Australia's current mandated DC system.

[22] GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this study.

pension system that provides some level of guaranteed retirement income, similar to the annuity option available to participants through their plan. Even with this system in place, in 2005 Switzerland required plans to offer participants at least 25 percent of their account balance as a lump sum payment, an option that had previously only been made at the discretion of the plan. One financial advisor we spoke with told us this policy change benefits participants who decide they already have sufficient retirement income and would accept lower annuity payments through their plan in exchange for more access to their savings at retirement.

National pension system in Switzerland

Switzerland's national pension system has two components: an earnings-related public pension funded mainly by payroll contributions and an income-tested supplementary benefit funded by general revenues. Payment amounts for the earnings-related benefit are based on lifetime earnings. Payments in retirement are indexed to prices and earnings.

For information about the national pension systems in the other countries we reviewed, see appendix II.

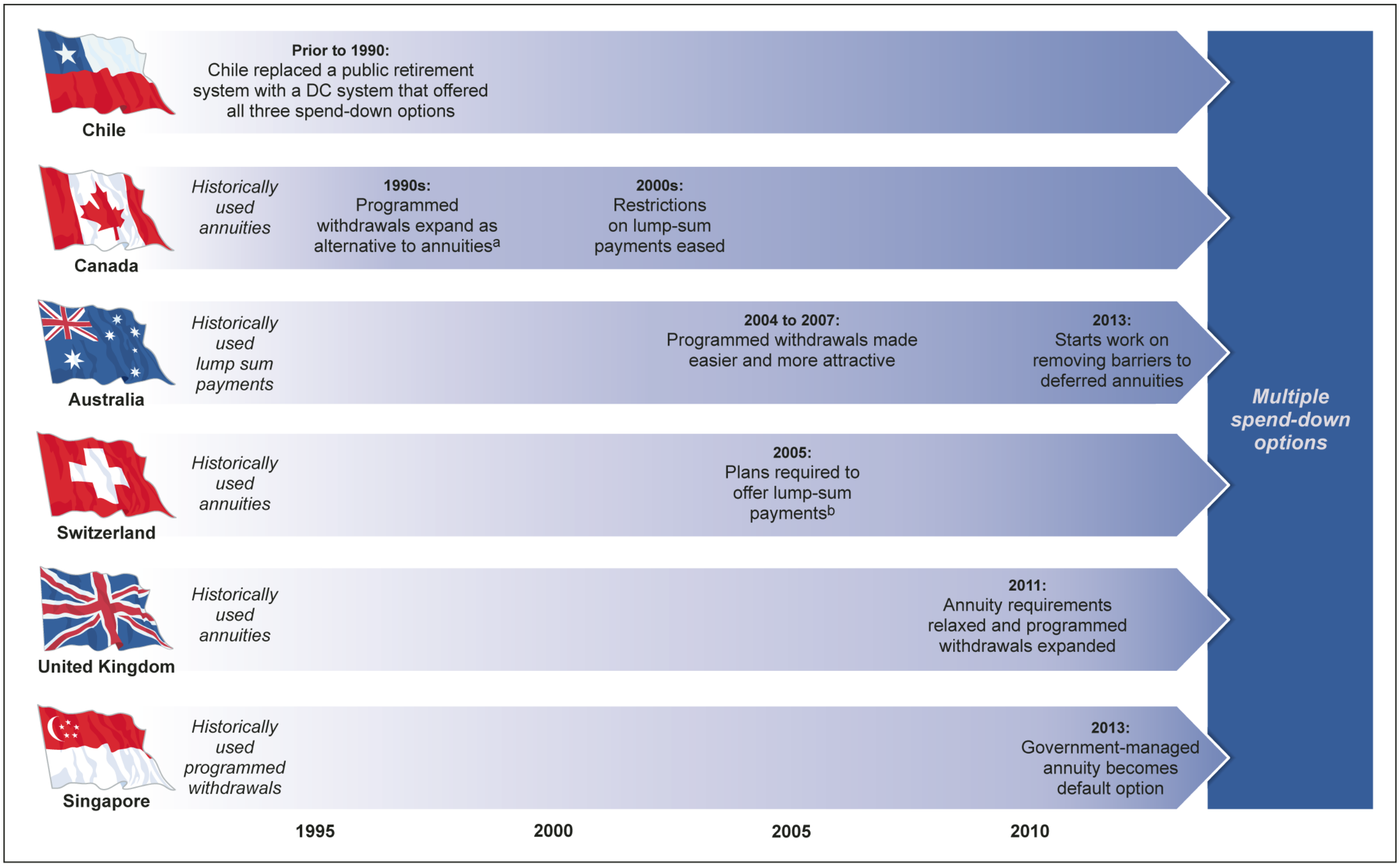
Source: The World Bank and OECD.

Historically, five of the six countries tended toward one spend-down option,[23] but all have more recently expanded access to additional options, in some cases substantially altering the retirement decisions of participants, as shown in figure 2. For example, Canada had traditionally "locked in" participants' assets for the purpose of securing a stream of retirement income, which participants could previously only do by purchasing an annuity. In the 1990s, however, Canada expanded the spend-down options that would meet this locking-in requirement to include programmed withdrawals.[24] Government officials and a financial professional in Canada told us this was done in response to participants' reluctance to lose access to their assets and their desire to leave an inheritance. Programmed withdrawals have since become the most widely used spend-down option in Canada.

[23] Chile instituted pathways to all three main spend-down options at the inception of their DC system in 1981.

[24] Retirement plans in Canada are generally regulated at the provincial level, so policies such as locking-in provisions requiring participants to purchase an annuity vary by province.

Figure 2: Timeline of Key Retirement Spend-down Policy Changes in Six Countries Leading to Facilitated Access to Multiple Options for DC Plan Participants



Source: GAO analysis of retirement systems in those countries; Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this study.

[a]The introduction in some jurisdictions of programmed withdrawal arrangements with maximum limits on withdrawals gave participants an alternative to purchasing an annuity at retirement to meet Canada's restrictions on drawing down DC plan assets. Previously, participants could only meet these restrictions by purchasing an annuity.

[b]Switzerland does not offer programmed withdrawals as a spend-down option for participants.

While each of the six countries we reviewed has multiple spend-down options to help DC plan participants tailor a retirement income strategy to fit their unique circumstances, in the United States, 401(k) plans generally only offer participants one option—a lump sum payment—leaving participants on their own to identify and develop strategies to manage retirement risks.[25] Although some 401(k) plan sponsors may offer all three of these options to participants, most do not offer annuities or programmed withdrawals similar to the systematic or formalized options[26] offered in other countries.[27] As a result, U.S. plan participants typically take a lump sum payment, and then have to make difficult choices in order for their financial assets to last throughout retirement.

Countries Undertook Reviews of the Spend-down Phase to Help Address Participants' Retirement Needs

We also found that three of the six countries conducted reviews of participants' retirement needs and concerns in the spend-down phase, which resulted in governments taking actions that led to additional spend-down options to meet those specific needs. For example, in 2007 and 2008, Singapore conducted a review of its retirement phase and determined a programmed withdrawal option designed to last approximately 20 years was not adequate to meet the needs of many participants based on their increasing longevity (see fig. 3 for the key steps taken.)[28] Singapore consulted with a broad spectrum of

[25] In the United States, participants who do not have access to annuities or programmed withdrawals through their plan may roll over their account balance into an IRA, where they can develop their own systematic withdrawal strategy, or purchase an annuity in the retail market.

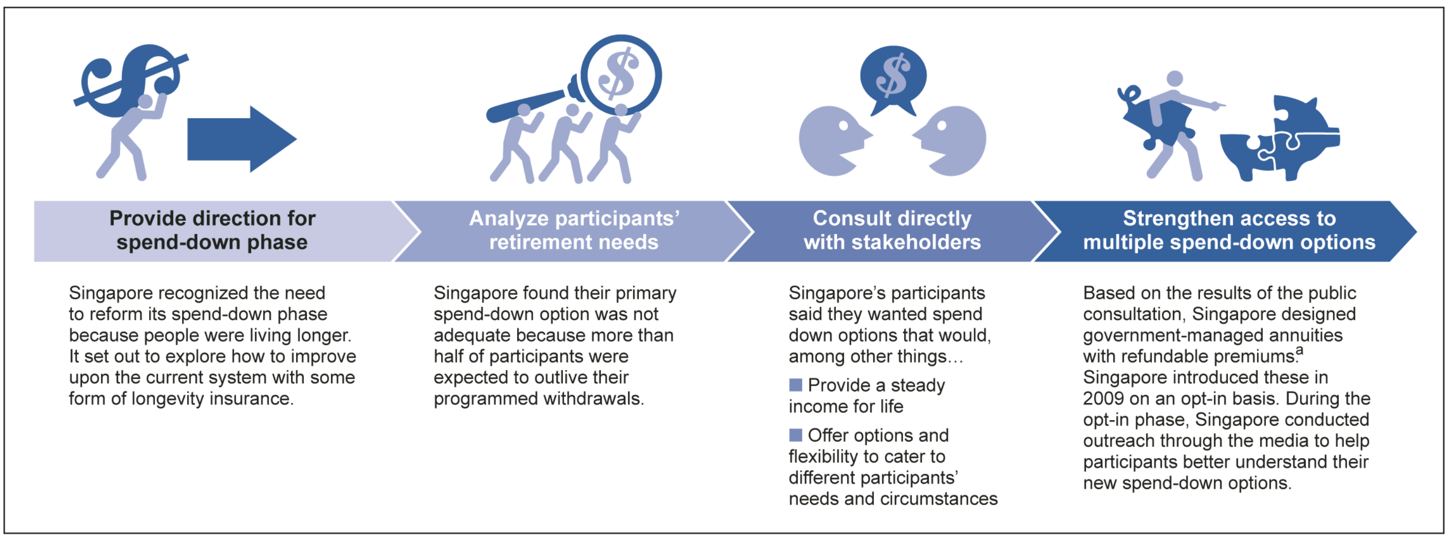
[26] U.S. participants that remain invested in their 401(k) plan past age 70 ½ are required to comply with certain provisions of the Internal Revenue Code that set required minimum distributions from tax-deferred accounts, such as 401(k) plans, generally by April 1 in the year following the year in which the participant reaches age 70 ½. Although considered a minimum distribution, this is different than the formalized programmed withdrawals that other countries offer to participants when retiring prior to age 70.

[27] According to an IRS survey of 1,200 randomly selected plan sponsors, for plan years 2006 through 2008 only 38 percent of 401(k) plans in the United States offered programmed withdrawals, only 19 percent offered qualified joint and survivor annuities, and only 11 percent offered single life annuities. The total percent of plans offering some kind of annuity may be less than 30 percent because the percentages may include plans that reported offering both qualified joint and survivor annuities and single life annuities. Department of the Treasury, IRS Tax Exempt and Government Entities Division, *Section 401(k) Compliance Check Questionnaire*: *Final Report*, (Washington, D.C.: March 2013).

[28] Singapore appointed a committee in 2007 to study the needs of participants and design government-managed annuities. The committee examined mortality data in Singapore and found that more than half of participants were at risk of outliving their programmed withdrawals if they retired at age 65. The committee created retirement simulations comparing retirement provided by the existing programmed withdrawal option against that of the proposed annuities under varying conditions.

stakeholders, including working adults, community and social sector leaders, and insurance companies and industry associations, in designing a new spend-down option to better meet participants' needs. Singapore concluded from this consultation that Singaporeans wanted an annuity scheme that provided an income for life and that would replace the programmed withdrawal option, where payouts stop completely after about 20 years. As a result, in 2009 Singapore began offering government-managed annuities, known as the Central Provident Fund Lifelong Income Scheme for the Elderly (CPF LIFE), on an opt-in basis. In 2013, Singapore set one of these CPF LIFE annuities as the default option for certain participants.

Figure 3: Steps Singapore Took to Strengthen Pathways to Multiple Spend-down Options



Source: GAO analysis of documents from Singapore's National Longevity Insurance Committee and Central Provident Fund.

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this study.

[a]Participants can discontinue their annuity and get a refund of their premium less any monthly payments already made and a fee.

Similarly, the United Kingdom undertook a review to address concerns with the spend-down phase, which resulted in policy changes that provided increased flexibility for participants to choose how to spend down their account assets. Specifically, the United Kingdom determined that its long-standing rules that effectively required individuals to purchase an annuity by the age of 75 were too restrictive for an increasing number of participants—who were both living longer and working longer—and for some was acting as a barrier to saving in DC plans. As part of the review, the United Kingdom consulted with a range of stakeholders, including individuals, service providers, and industry and consumer representatives, on how to ensure that participants make appropriate spend-down choices in the absence of the annuity requirement. Based on this review, the United Kingdom removed its annuitization requirement in 2011, making this option voluntary, and expanded access to programmed withdrawals in order to give participants more flexibility to choose spend-down options that best suit them.[29] As a result, participants can remain invested in their plans and manage the timing and amount of withdrawals from their plans, within certain limitations, or delay the purchase of an annuity until interest rates are more favorable. Government officials and experts we spoke to agreed that most participants at present have not accumulated sufficient retirement savings to be eligible for and make full use of programmed withdrawals as a spend-down option.[30] According to government officials and one financial service provider, annuities remain the most widespread form of distribution from DC plans in the United Kingdom.[31] Despite current low rates of saving, the structure is in place to give workers more flexibility in planning for retirement as the DC system in the United Kingdom matures and workers accumulate larger account balances.

[29] The government also cited participants' negative perceptions of annuities as a reason for this change. The government attributed these perceptions in part to a decline in the size of payments from annuities in response to falling interest rates and increases in longevity. The government also attributed negative perceptions to a lack of understanding about how annuities work. Regulators, policymakers, and the pension industry in the United Kingdom have taken steps to raise awareness among participants about strategies for getting more income from annuities, for example, by shopping for annuities that provide larger payments to individuals with certain health conditions or lifestyles that may reduce their longevity. Sales of enhanced annuities, which are annuities that provide larger payments because the annuitant has a shorter life expectancy, have grown rapidly since their introduction in 1995. According to Towers Watson, sales of enhanced annuities increased from £419.6 million ($635.8 million) in 2001 to nearly £4.5 billion ($6.8 billion) in 2012.

[30] In order to take programmed withdrawals without restriction, known as flexible drawdown, participants must document that they have a secure pension—for example, from an annuity—of at least £20,000 (about $30,300) per year. Participants that do not meet this requirement may take capped drawdowns, generally limited to 120 percent of the value of an equivalent single-life level annuity.

[31] According to the financial service provider, in 2011, programmed withdrawals accounted for about £2 billion ($3 billion) in DC plan distributions, whereas annuities account for about £12 billion ($18.1 billion). See Mark J. Warshawsky, *DC Plan Payout Practices and Policies in Canada, Switzerland, U.K., Australia, and Singapore, Towers Watson Insider* (Arlington, VA: January 2013).

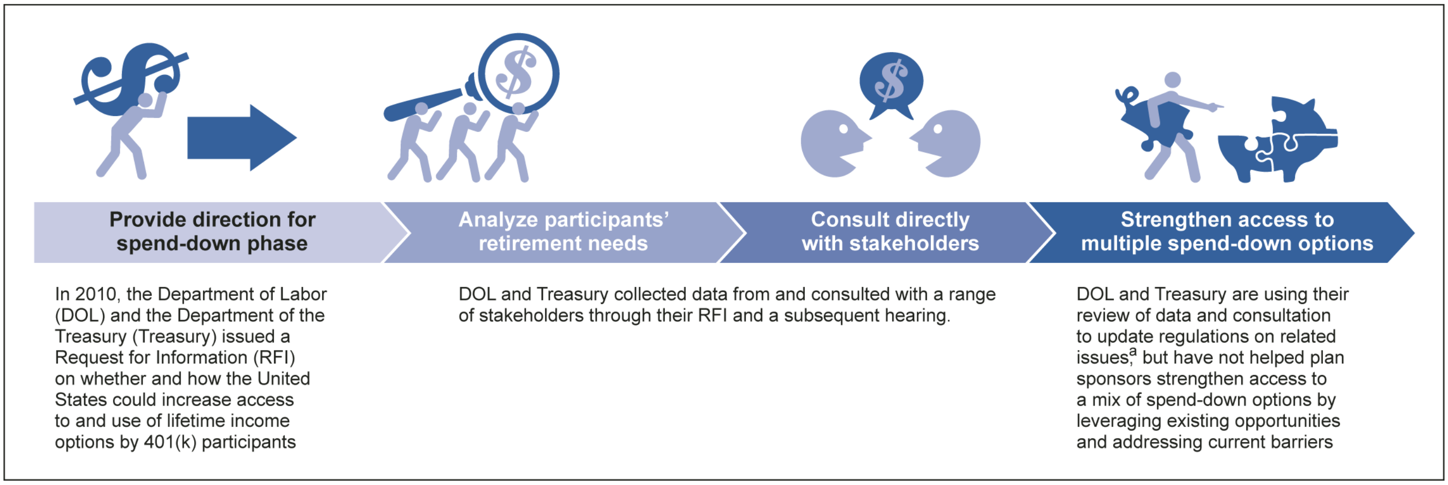
U.S. Regulators Have Begun to Explore the Spend-down Phase, but Have Not Yet Strengthened Access to a Mix of Spend-down Options

In the United States, as shown in figure 4, similar to the steps taken by some of the other countries, DOL and Treasury have recently begun to explore the possibility of expanding 401(k) participants' access to spend-down options through their plans that offer lifetime income, but they have not yet made a concerted effort to help plan sponsors offer a mix of options to their participants. Most 401(k) plans typically only offer participants the option to take their benefits as lump sum payments, which leaves participants on their own, or to the retail market, to ensure their savings last throughout retirement. In recognition of the potential risk workers face under current conditions, DOL and Treasury undertook efforts in 2010 to collect detailed information from the public to determine what, if any, steps they could take to enhance the retirement security of 401(k) plan participants by facilitating access to, and use of, options designed to provide a stream of lifetime income after retirement.[32] Through this process, DOL and Treasury received feedback from financial service providers and other stakeholders on the challenges plan sponsors face in offering a mix of spend-down options to participants through their respective plans.[33] But the feedback also highlighted some existing flexibilities 401(k) plan sponsors have to offer multiple spend-down options. One large service provider described a range of spend-down options it offers participants, including programmed withdrawals and investment strategies that generate retirement income, such as mutual funds designed with built-in payment streams. Another service provider discussed how technology enables sponsors to offer participants access to competitive online annuity markets that can provide the benefit of competition and improved pricing at a reasonable cost.

[32] See 75 Fed. Reg. 5253 (Feb. 2, 2010). The agencies asked for information on issues such as advantages and disadvantages of receiving benefits in the form of lifetime payments, types of lifetime income products currently available to participants through their plan, and regulatory barriers to offering lifetime income, among other issues. In September 2010, DOL and Treasury held a joint hearing to discuss their request for information and further consider specific issues relating to spend-down options intended to produce retirement income for participants.

[33] For example, one respondent said that IRS rules requiring minimum distributions from 401(k) plans beginning at age 70 ½ can act as a barrier to some lifetime income options such as "deeply" deferred annuities that begin payments at an advanced age, such as 80 or 85. Respondents also described challenges for participants in comparing annuity prices and features. Respondents also cited participants' reluctance to choose lifetime income options even when they are made available, which some attributed to a lack of understanding of these options.

Figure 4: Steps DOL and Treasury Have Taken to Explore Spend-down Options for DC Plan Participants



Source: GAO analysis of documents from the Department of Labor.

[a]For example, DOL is considering developing a rule that would require a participant's account balance to be expressed on his or her benefit statement as an estimated lifetime stream of payments. Pension Benefit Statements, 78 Fed. Reg. 26,727 (May 8, 2013).

Since 2010, DOL and Treasury have begun taking steps to improve the information participants receive about the spend-down phase and expand access to spend-down options. For example, in May 2013, DOL proposed rules that would require 401(k) participants' benefits statements to show how their account balances would translate into a stream of lifetime income payments.[34] And in February 2012, Treasury proposed rules that would make it easier to purchase deeply deferred annuities.[35] However, in contrast to the steps taken by other countries, DOL and Treasury have

[34] These lifetime payment projections would be based on both the current value of their account and the projected value of their account balance at the normal retirement age. As part of this advance notice of proposed rulemaking, DOL requested comments from the public on whether and how this could be done. Pension Benefit Statements, 78 Fed. Reg. 26,727 (May 8, 2013).

[35] Longevity Annuity Contracts, 77 Fed. Reg. 5443 (Feb. 3, 2012)(to be codified at 26 C.F.R. pt. 1). At present, 401(k) participants who use a portion of their account balance to purchase a deeply deferred annuity may risk violating IRS rules requiring minimum distributions from IRAs beginning at age 70 ½. In April 2013, the Australian government announced that it would encourage the take-up of deferred annuities by providing these products with the same concessional tax treatment that superannuation assets in programmed withdrawal products receive. This reform, which was to apply starting on July 1, 2014, has not yet been implemented.

not yet used the information they collected to develop and implement a strategy that would help 401(k) plan sponsors leverage existing flexibilities and address challenges in offering their participants a mix of spend-down options that meet varying retirement needs. Without additional steps by U.S. regulators to help ensure sponsors are providing participants with access to a mix of options, most 401(k) plan participants are likely to continue taking a lump sum payment at retirement, regardless of whether this option is the most appropriate to meet their particular needs. By doing so, participants are at risk of either spending their assets too quickly and outliving their savings, or being too conservative with their assets, forcing them to accept a lower standard of living than necessary. Low rates of saving for retirement in the United States highlight the need to make the most of participants' 401(k) account balances. Simulations conducted by the Employee Benefit Research Institute in 2010 indicate that nearly half of workers in the United States above the age of 35 may be at risk of not having enough retirement income to meet their needs. Moreover, this problem may be more acute for those with lower incomes. When ranked by pre-retirement income, households in the lowest one-third may be at risk more than 70 percent of the time. Although all of the countries we reviewed are similarly coping with the challenge of small account balances, we found that offering a mix of options allows participants to select options that can best meet their unique circumstances.

Strategies Used by the Countries We Studied Helped Participants Make More Informed Decisions

Several Approaches Used by Other Countries to Increase Participants' Knowledge and Understanding of Spend-down Options Could Help DOL's Efforts to Provide Information

Most of the countries we reviewed used various mechanisms such as communicating simple and consistent information in a timely manner to help participants make more informed spend-down decisions.[36] For example, in Australia, the government developed a booklet for participants that lays out the various spend-down options as they approach retirement with simple illustrative examples, together with the benefits and drawbacks of each, as shown in figure 5.[37] As a result, participants have access to information to plan for retirement by weighing the pros and cons of different ways to manage and make the most of their retirement savings.

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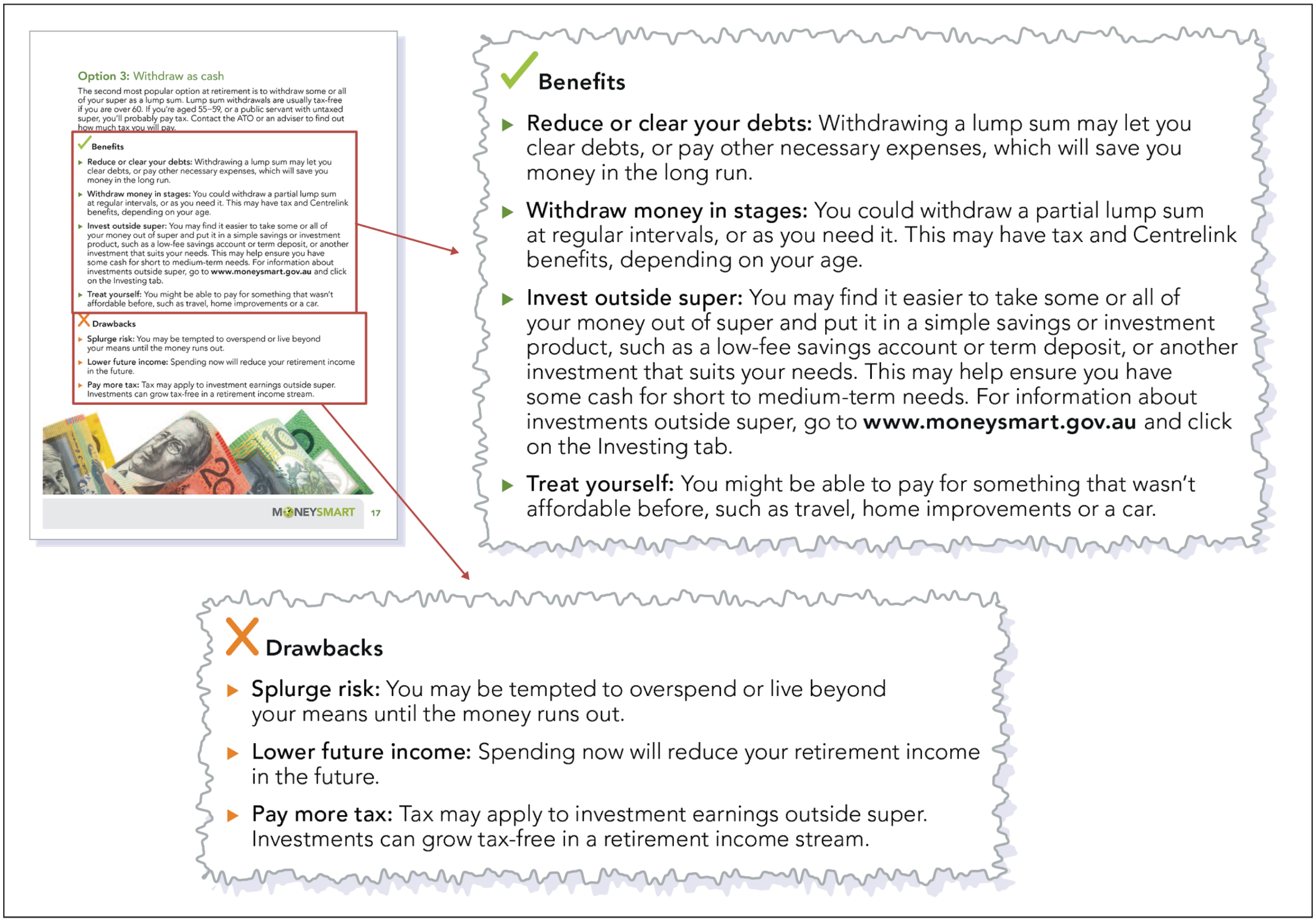
[36] GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this study.

[37] Australian Securities and Investments Commission, "*Financial Decisions at Retirement: How to make the most of your money and avoid costly mistakes*," accessed July 26, 2013, www.MoneySmart.gov.au.

Figure 5: Example of Information on Spend-down Options Developed for Participants Approaching Retirement in Australia



Source: GAO presentation of Australian Securities & Investments Commission information.

Additionally, in the United Kingdom, plans are required to send a "wake up" information pack to participants 4 to 6 months before their retirement date that explains the key spend-down options, which has helped participants better understand their options.[38] The pack is also used to

[38] In particular, the pack highlights the various annuity options, including the enhanced annuities that potentially offer a much higher income for individuals with health or lifestyle conditions that may result in a shorter life expectancy.

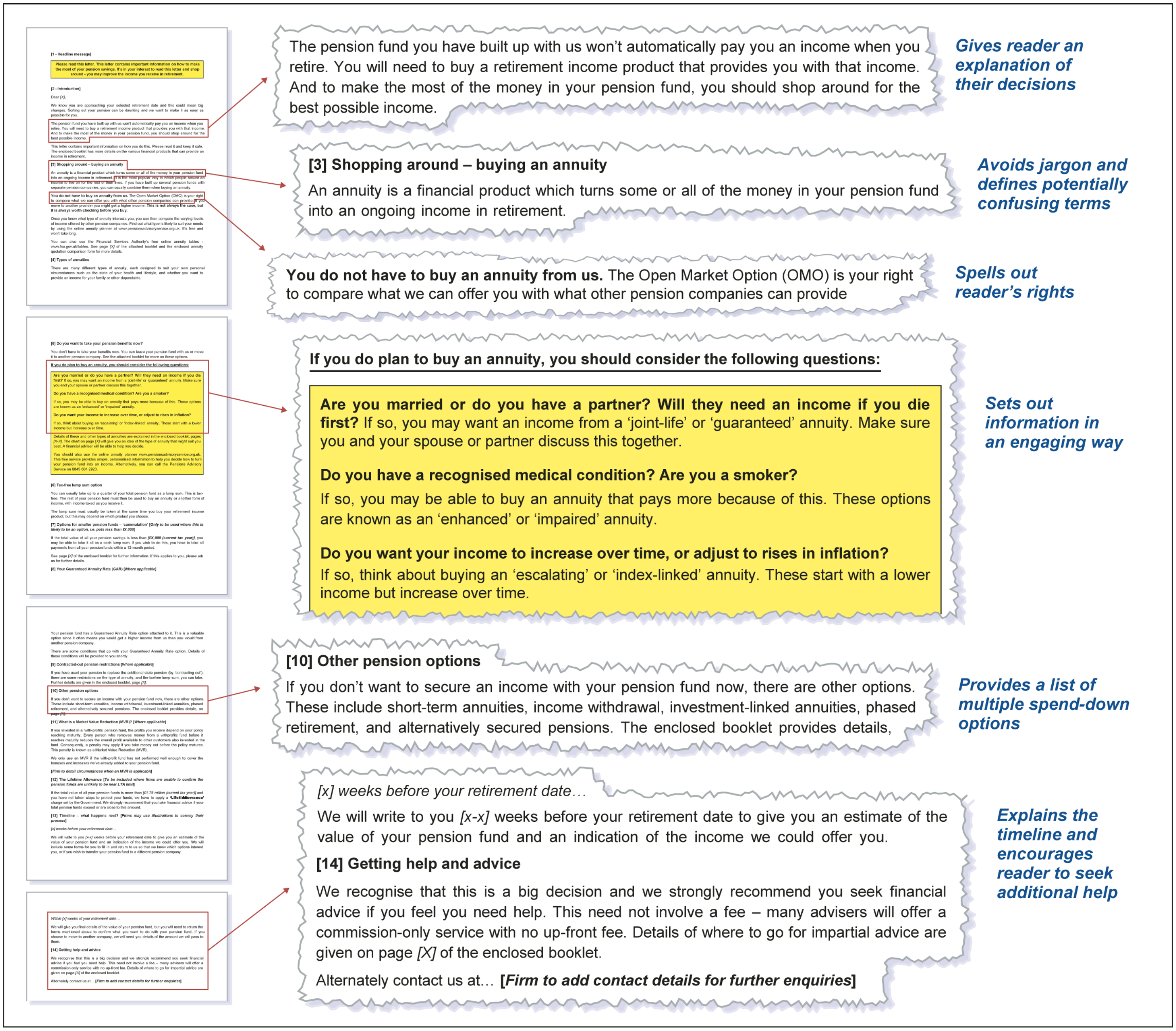
help plans meet the requirement to inform participants of their right to buy an annuity from a provider other than the one that holds their pension savings. In consultation with the government, the Association of British Insurers (ABI) developed a code of conduct, which requires its members—insurance companies—to communicate certain information to participants.[39] According to ABI's code of conduct, as shown in figure 6, the information in the pack should be in plain, clear language and include a cover letter detailing the participant's options and additional literature, such as a brochure on retirement facts by the U.K. government. It points participants to sources of advice and support, such as regulated advisers and independent advice organizations. In addition, the U.K. financial regulator requires that plans send participants a follow-up pack 6 to 10 weeks prior to retirement, which emphasizes the need to make a decision, among other things. ABI expects its members, who are service plan providers, to send participants communications that are in line with these practices. U.K. pension regulators told us that they also expects trust-based plan communications to meet the standards developed by the ABI, so participants in plans administered by trusts and insurance companies receive comparable information. According to a 2009 ABI study, the wake up pack increased the proportion of participants feeling quite or very comfortable about understanding their retirement options from 70 to 80 percent.[40] Their study also found that participants generally thought the information in the pack was relevant to their situations. In addition, a 2013 ABI study found that 85 percent of people who read pre-retirement information agreed that information from their provider made them more aware of their options at retirement.[41]

[39] ABI is a trade association made up of insurance companies in the United Kingdom. It has over 300 member companies, accounting for 90 percent of the U.K. insurance market. The associations speaks on behalf of U.K. insurers and works work with government, regulators and policymakers—both in the United Kingdom and internationally—to ensure the insurance industry meets the highest standards. ABI, *Consumers in the Retirement Income Market: Code of Conduct on Retirement Choices* (London, U.K.: March 2012).

[40] Kevin Crouch, Ian Sparham, and Richard Fincham, *Pre-retirement Wake-up Pack: Results of Customer Research,* ABI Research Paper No 18 (London, U.K.: ABI, 2009).

[41] Kevin Crouch, Gemma Allen, Fiona Whitehead, Anthony Carter and Rachel Levy, *Retirement Choices: Baseline to Measure Effectiveness of the code of Conduct*, ABI, (London, U.K., May 2013).

Figure 6: United Kingdom Cover Letter Example of Best Practices for Communicating Spend-down Decisions and Options to Participants



Source: GAO analysis of an Association of British Insurers (ABI) template for service providers.

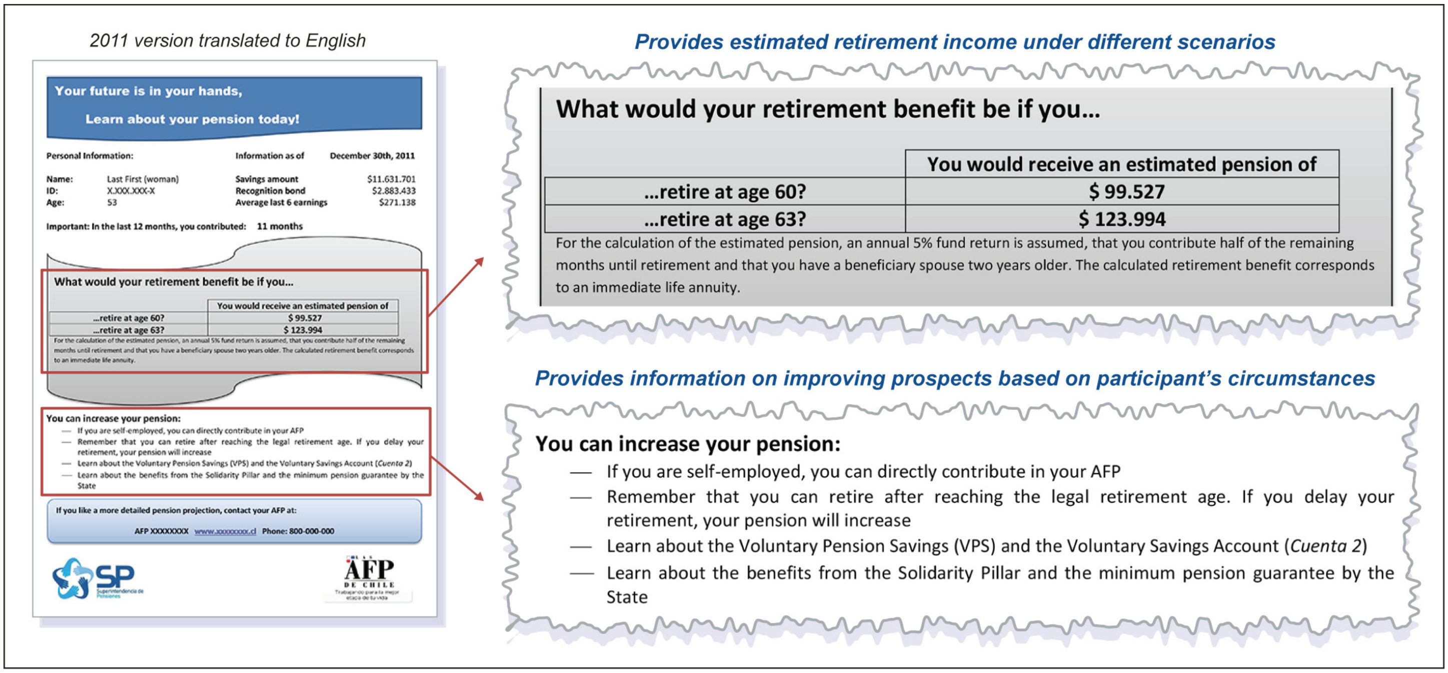
Countries we reviewed did not rely solely on the disclosure of information but also found ways to show how the information provided to participants applied to their particular circumstances. In particular, two of the six countries—Chile and the United Kingdom—help participants see how their savings would translate into a stream of retirement income by requiring plans to provide participants with monthly or yearly projections in their benefit statements, a comparison which can be useful for making retirement decisions.[42] Since 2005, Chile has required pension plans to estimate retirement income in the annual statements using multiple assumptions about the participant's expected retirement date, as shown in figure 7. For older participants about 10 years from retirement, one estimate assumes the participant stops working at the normal retirement age, while a second estimate assumes that the participant postpones retirement and continues to make contributions for 3 more years.[43] According to Chilean pension officials, the aim of these scenarios is to help participants compare their current income to expected future retirement income and to encourage them to make additional voluntary contributions in case their retirement income looks low. In fact, a 2011 study of the impact of providing these personalized pension projections to Chilean participants suggests that the receipt of this information resulted in participants making additional contributions to improve their retirement prospects.[44]

[42] Similarly, the Australian Securities and Insurance Commission issued new guidelines in 2011 for DC plans that choose to include retirement estimates in participants' annual benefit statements. These estimates supply the projected retirement savings in a lump sum format at age 65 and the annual stream of income that this lump sum balance is expected to provide from age 65 to 90.

[43] For younger workers, their statements will include estimates of expected pension income under two scenarios where the participant (1) makes no additional contributions and (2) continues contributing until the normal retirement age.

[44] Eduardo Fajnzylber and Gonzalo Reyes, *Knowledge, Information and retirement saving decisions: Evidence from a large scale intervention in Chile*, Working Papers from Adolfo Ibáñez University, School of Government (May 2011).

Figure 7: Example of Chile's Benefit Statement Illustrating Projected Income



Source: Superintendence of Pensions, Chile.

Finally, enabling participants to compare across various spend-down options and products within an option also helps them to plan for retirement. For example, we found that two of the six countries—Chile and the United Kingdom—provide electronic quotations to help near-retirees make informed decisions.

- The Chilean government introduced its central electronic quotation system (SCOMP)[45] in 2004, which lowers participant search costs and gives them easy access to transparent, reliable information by showing different spend-down options in a comparable format. The SCOMP offers individuals who are ready to retire comparable quotations for the programmed withdrawals and annuity options in a single document replacing the traditional way people looked for and bought retirement products through brokers. The SCOMP has

[45] SCOMP is the Spanish acronym for Electronic Consultation and Offer System for Annuities and Phased Withdrawals.

enabled participants to more easily receive a larger amount of quality information by making all possible offers available to them without the need to hire financial intermediaries such as sales agents and brokers.[46]

- A similar benefit is available in the United Kingdom through the Money Advice Service[47] set up by the government, which allows participants to compare a range of illustrative annuity quotes on a voluntary basis. This service offers free and unbiased advice on financial matters. Specifically, Money Advice Service's website provides comparable annuity quotes from participating insurance companies, once an individual answers a set of standard questions. The individual is then presented with a table listing insurance companies and his or her annuity quotes, both in monthly, quarterly, and yearly amounts. The U.K. developed the service to provide those who do not know how to or cannot afford to get advice about annuities from other sources, particularly those with relatively small account balances. U.K. regulators told us that although participants may benefit from seeing quotes, most participants' plan balances are too small for the service to be useful for them. However, this service may become more important as more workers are automatically enrolled in plans and assets grow.[48]

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[46] Although all quotes appear in one document, many participants seem to have difficulty making a decision about the spend-down option by themselves and often use a financial intermediary to help, according to focus groups conducted by the Chilean government. As a result, the government is taking steps to simplify and shorten the document. SCOMP was introduced to increase transparency but also competition among annuity providers.

[47] The Money Advice Service was set up as an independent body in April 2010 as the Consumer Financial Education Body, which was established under the Financial Services Act in 2010 with statutory functions to enhance people's understanding and knowledge of financial matters, and their ability to manage their own financial affairs. The Money Advice Service was launched in April 2011 with online, telephone, and United Kingdom-wide face-to-face services.

[48] Since 2012, most U.K. employers were required to automatically enroll some or all of their workers into a qualifying plan that meets certain minimum standards and pay contributions on their behalf. The U.K. government established the National Employment Savings Trust (NEST) to help employers meet this new requirement. According to a report by the U.K. Department for Work and Pensions, NEST is a low-cost, trust-based, occupational pension scheme focused on people with low to moderate earnings and employers that the existing pensions industry does not serve well.

In the United States, plans must provide participants certain disclosures related to their benefits and options under the plan. For example, benefit statements with the individual's account balance are required to be provided to 401(k) plan participants at least quarterly.[49] However, the disclosures do not require that participants receive information about their spend-down options before they make a decision. As a result, 401(k) plan participants may lack key information, such as the benefits and drawbacks of various spend-down options, needed to make an informed decision, and which could affect their retirement outcomes. In addition, although plan sponsors are permitted to provide information and education to participants, there is no specific guidance for sponsors to provide participants approaching retirement with information on spend-down options. Consequently, some plan sponsors may not provide participants with sufficient information, which may result in participants potentially making decisions that fail to sustain their incomes throughout retirement.

DOL has begun to consider including lifetime income projections in benefit statements, which may yield positive outcomes for participants. Currently, 401(k) plan benefit statements generally only show a participant's account balance, and according to DOL officials participants may have difficulty predicting how long their savings will last. An April 2013 study funded by DOL found that more than half of a sample of plan statements did not include projections of the participant's balance at retirement, estimates of the retirement income they might be able to expect at retirement, or the "relationship between future outcomes and current savings or investment behavior."[50] In May 2013, DOL announced that it was considering developing proposed regulations regarding DC plan benefit statements, and solicited public comments to inform its

[49] The administrator of an individual account plan shall provide a pension benefit statement at least quarterly to a participant or beneficiary in a participant-directed 401(k) plan and annually to participants or beneficiaries who have accounts in which they do not have the right to direct the investments of assets in those accounts. 29 U.S.C § 1025(a)(1)(A)(i) and (ii).

[50] Jack Clift, Lauren A. Fleishman-Mayer, Angela Hung, Caroline Tassot, and Joanne Yoong, *Designing Better Pension Benefit Statements: Current Status, Best Practices and Insights from the Field of Judgment and Decisionmaking* (RAND Corporation, April 19, 2013).

thinking as it considers possible regulatory proposals.[51] One idea is to show a participant's current account balance and an estimated lifetime stream of payments based on such balance, assuming the participant is at normal retirement age as of the date of the statement, even if he or she is younger. The second idea is aimed at participants who have not yet reached normal retirement age, which shows a projected account balance at normal retirement age and then converts to an estimated lifetime stream of payments. As shown in Chile, including lifetime income projections on plan statements, similar to those being considered by DOL, can help participants envision and understand the lifetime monthly income that can be generated from an account balance.

Most of the Countries We Reviewed Use Incentives to Encourage Certain Kinds of Participant Behavior

Recognizing that disclosure of information alone is not always sufficient to ensure good retirement outcomes, several countries also use subtle incentives or nudges to promote particular kinds of behavior. In particular, two countries we reviewed—Singapore and Switzerland—use defaults to exploit inertia and promote a specific option.[52] In Switzerland, for example, some plans use annuities as the default spend-down option allowing for the possibility of opting out. One study suggests the take-up rate of annuities is higher in such plans relative to those where the lump sum option is the default.[53] In contrast, the United Kingdom is attempting to address participants' inertia in shopping for annuities. Until recently, most participants purchased an annuity from their existing service

[51] Pension Benefit Statements, 78 Fed. Reg. 26,727 (May 8, 2013). As of August 2013, DOL was reviewing comments submitted in response to this advance notice of proposed rulemaking.

[52] Singapore has made annuity payments from CPF LIFE the default option for participants with account balances above a threshold, following recent pension reforms, recognizing that the previous standard practice of programmed withdrawals over 20 years was no longer adequate to ensure lifelong retirement income in light of increasing longevity. Participants with account balances below the threshold, on the other hand, are defaulted into the programmed withdrawal option.

[53] The researchers analyzed the spend-down selections of participants from 10 Swiss companies in the public and private sector between 1996 and 2006. Nine of the 10 companies offered an annuity as the default spend-down option, while the tenth company offered a partial lump sum payment as the standard option. Overall the default option was preferred by more than two-thirds of the sample. Participants at the company that offered a partial lump sum as the standard option, however, only chose an annuity about 10 percent of the time. See Monika Butler and Federica Tappa. "The Choice Between an Annuity and a Lump Sum: Results from Swiss Pension Funds," *Journal of Public Economics*, 91 (2007): 1944-66.

provider, partly because the wake up pack they received shortly before retiring included an application for an annuity with that provider, although it might not have offered the best rate. Working together, the U.K. government and ABI agreed that to promote the search for better annuity rates providers should not include an annuity application in the pack.[54]

In addition, tax incentives are also used to encourage or deter the use of certain spend-down options. For example, in 2007, the Australian government removed the favorable tax treatment enjoyed by annuities, which caused the relatively small market for life annuities to virtually disappear, and negatively affected the market for term annuities as well, according to researchers. In addition, researchers found that a series of reforms between 2005 and 2007 contributed to the rapid increase in the demand for programmed withdrawals.[55] For example, the reforms exempted from taxes all earnings or investment returns on assets kept in superannuation funds to support programmed withdrawals, provided that minimum age-based annual drawdowns are satisfied. A report by the Australian pension regulators showed an increase in the proportion of retirement income taken as programmed withdrawals from one third in 2005 to one half by 2012.[56] Over the same period, the proportion of superannuation funds offering programmed withdrawals increased from 35 percent to 80 percent.

[54] Although people have had the right to shop around for annuities, referred to as "Open Market Option," since 1978, and pension providers have been recommended to include a letter reiterating that right in the wake up pack since 2004 most people were still using their current pension provider to supply their annuity at retirement.

[55] Around the same time, reforms eliminated taxes on all retirement spend-down options taken on or after age 60. The introduction of key legislation was a significant factor leading to the expansion of the market for programmed withdrawals, according to researchers Bateman, Hazel and John Piggott. "Too Much Risk to Insure: the Australian (non-) Market for Life Annuities," in Olivia Mitchell, John Piggott and Noriyuki Takayama (eds.), *Revisiting Retirement Payouts* (Oxford University Press, 2011), 81-105. In more recent years, sales of annuities in Australia appear to have recovered somewhat. In June 2013, Challenger Limited, Australia's largest provider of annuities projected sales of lifetime annuities for the year of over $220 million (AUD 240 million), approaching the roughly $260 million (AUD 280 million) in annuities sold by all insurers in Australia in 2004, prior to the reforms.

[56] Australian Prudential Regulation Authority, Annual Superannuation Bulletin June 2012 (Sydney, Australia: Jan. 9, 2013).

Countries Also Assist Participants Who Rely on Financial Advisors

Three of the countries we reviewed implemented policies to strengthen safeguards regarding financial advisors, so that DC plan participants seeking professional advice have the opportunity to receive fair and objective information that enables them to better manage their retirement income. These countries recognized that spend-down decisions can be complex for participants, who may choose to rely on the assistance of a financial advisor to help make appropriate choices. As a result, countries such as the United Kingdom have taken steps to protect DC participants against inappropriate fees and unscrupulous advice in making spend-down decisions. For example, since January 1, 2013, financial advisors in the United Kingdom are prohibited from receiving commissions on products they sell in order to reduce the sale of costly and unfit products and minimize conflicts of interest. Instead, they now have to explain to participants how much advice will cost and reach agreement with the participant on a price and method of payment, such as an upfront fee or installments. Since 2008, Chile requires that those who previously worked as annuity brokers broaden their knowledge to all aspects of pensions before being registered as advisors. This knowledge enables them to provide participants and their beneficiaries with comprehensive information needed to make informed decisions about their benefits based on their needs and interests.

Countries' Regulation and Oversight of Spend-down Options Offer Lessons for U.S. Regulators

Most of the Countries We Reviewed Used Withdrawal Rules to Help Protect Participants from Outliving Their Savings

Most of the countries we reviewed imposed income requirements or withdrawal limits on lump sum payments to help those who take this option mitigate retirement risks.[57] For example, in three of the six countries, participants must meet retirement income requirements if they wish to withdraw all or part of their DC plan assets as a lump sum. Specifically, in order for participants in Chile to be eligible to access part of their account, they would need to accumulate enough income to finance 100 percent of the maximum pension with a government supplement and a 70 percent or higher replacement rate based on the last 10 years of their salaries.[58] According to the Chilean pensions regulator, participants who meet these conditions can withdraw any amount in excess of the amount needed to meet the minimum.[59] Under these rules, relatively few participants have taken partial lump sum payments and, of those who did, the amounts were generally quite small. In contrast, Australia does not place an upper limit on the amount participants can withdraw as a lump sum. According to researchers and

[57] GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this study.

[58] According to Chilean pensions regulators, both eligibility conditions should be met jointly so if the equivalent amount of 70 percent of income is lower than the maximum pension with a supplement, known as the Pension Solidarity Complement, the participant will not be allowed to take a partial lump sum. For additional information about Chile's pension system, see appendix II.

[59] The rules for accessing a partial lump sum distribution were initially designed as part of early retirement rules. Subsequently, the Chilean government became concerned that the earlier workers retired, the more likely it was that over time it would have to supplement a retiree's benefit with government pension benefits. As a result, the accumulation conditions were revised in 2004 and 2008 from 50 percent of the minimum to 150 percent. In accordance with the introduction of the new solidarity pillar in the 2008 reform, the requirement of financing a pension equal or higher than 150 percent of the minimum pension guarantee was amended to financing a pension equal or higher than 100 percent of the maximum pension with the Pension Solidarity Complement.

government officials, participants in Australia who choose this option may run the risk of outliving their savings and becoming solely reliant on government benefits for retirement income. However, some researchers and government officials we spoke with said retirees in Australia may actually be overly cautious in spending down their assets and face the opposite risk of accepting a lower standard of living than is necessary to meet their retirement needs. In the United States, lump sum distributions from 401(k) plans are subject to few restrictions. During our 2011 review of the choices retirees make in managing their assets, we found that some U.S. plan participants prefer to have access to their full 401(k) plan retirement savings, such as by rolling their assets over into an individual retirement account (IRA) or withdrawing them when they retire. At retirement, 401(k) plan participants may withdraw their full account balance as a lump sum and may be required to pay federal and state income taxes on that amount.[60]

Of the five countries that offer programmed withdrawals, four countries regulate them to help prevent participants from spending their savings too quickly. For example, Chile's 2008 pension reforms introduced an additional actuarial factor in the government calculation of the maximum withdrawal amount to account for longevity risks. The maximum withdrawal amount is calculated so payments do not drop below a certain floor, 30 percent of the first payment, by the time participants reaches the age of 98. As a result of these reforms, a retiree's benefits can vary year to year based on life expectancy estimates and projected returns on investments, but will not fall below a certain amount.[61] Canada also limits the annual amount a participant can withdraw from programmed withdrawal products. Regulators in some Canadian jurisdictions impose

[60] When 401(k) plan participants separate from their employers, leaving their plan savings in the plan, rolling or moving the money into a new qualified employer plan, or rolling the money into an IRA, would preserve the tax-deferred status of their plan savings. Lump sum distributions are subject to ordinary income tax. Participants who take an early distribution, those taken before age 59 ½, generally pay a 10 percent additional income tax and incomes taxes on the lump sum distribution amount, in order to discourage the use of plan funds for the purposes other than retirement and ensure that the favorable tax treatment for plan funds is limited to those that are, in fact, used to provide retirement income. See GAO-13-30 for more information.

[61] In Chile, retirees who chose the programmed withdrawal option and exhaust their funds by outliving their actuarial life expectancy could also be eligible for government-guaranteed benefits.

an annual maximum withdrawal, which helps to ensure participants have a regular income up to age 90.

Most 401(k) plan participants in the United States do not have access to programmed withdrawal products through their plans similar to the ones we found in other countries. The primary programmed withdrawal option that U.S. plan participants may be aware of is the required minimum distributions in tax-deferred plans, such as 401(k) plans, when a participant reaches 70 ½.[62] If a plan offers a systematic withdrawal and the participant designs and manages their programmed withdrawal, the extent to which their strategy is successful at providing income throughout retirement depends on a number of factors, such as the rate of drawdown, future investment returns, inflation, and longevity. For an illustration about how some of these factors may affect retirement income, see the additional materials at http://www.gao.gov/products/GAO-14-9.

DOL Continues to Look at Barriers Plan Sponsors Face in Offering Annuities to 401(k) Plan Participants, Which Do Not Exist in the Countries We Reviewed

DOL is in the process of reviewing regulatory barriers that may prevent or discourage 401(k) plan sponsors from offering annuities to participants. In the United States, 401(k) plan sponsors who offer an annuity to their participants through their plan are subject to fiduciary standards in their selection of an annuity provider, which require them to act solely in the interest of the plan's participants and their beneficiaries. In 2008, DOL issued new final regulations, in the form of a safe harbor, for the selection of annuity providers to help plans prudently choose them and to some extent encourage plans to offer annuities.[63] In proposing the safe harbor DOL speculated that an annuity option would give more participants the opportunity to annuitize their savings, while not impeding them from choosing other options.[64] Even with this safe harbor, according to some U.S. retirement experts and plan service providers, sponsors of 401(k) plans may be hesitant to offer an annuity to their participants because of

[62] Participants that remain invested in their 401(k) plan past age 70 ½ are required to comply with certain provisions of the Internal Revenue Code that set required minimum distributions from tax-deferred accounts, such as 401(k) plans, generally by April 1 in the year following the year in which the participant reaches age 70 ½.

[63] Selection of Annuity Providers—Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58,447 (Oct. 7, 2008) (codified at 29 C.F.R. § 2550.404a-4).

[64] Selection of Annuity Providers for Individual Account Plans, 72 Fed. Reg. 52,021, 52,023 (Sept. 12, 2007)(to be codified at 29 C.F.R. § 2550.404a-4).

the additional burden and the potential liability sponsors may incur. In 2010, some respondents to DOL's request for information on lifetime income options, which included some questions related to the existing safe harbor provision, suggested that DOL revise one condition of the safe harbor that requires sponsors to assess the ability of an insurance company to make all future payments under an annuity contract. Respondents in favor of DOL revising the condition noted that it could help ease some DC plan sponsors' concerns about offering an annuity as a spend-down option. Additionally, this could help participants who would otherwise purchase an annuity in the retail market gain access to group prices, which are typically lower than individual prices.[65] In December 2012, the ERISA Advisory Council reported on the importance to the retirement community that DOL develop guidance designed to provide meaningful assistance to plan sponsors and participants by modifying the existing safe harbor provision that governs the selection of an annuity provider. In its report, the ERISA Advisory Council also encouraged DOL to partner with NAIC to help with its effort to develop a more workable safe harbor for the selection of annuities and other lifetime income products.[66] In 2012, DOL began working with the NAIC ERISA Retirement Income Working Group as they consider possible options for easing plan sponsor concerns with the financial soundness of annuity providers as related to the DOL safe harbor for the selection of an annuity provider and fiduciary responsibilities.

In the countries we reviewed, employers are not expected to assess an annuity provider's ability to make future payments before contracting with them to offer an annuity through their plans. According to regulators in each of the countries we reviewed, there are no requirements for employers to assess the financial stability of an insurer and countries generally rely on insurance regulations and industry standards to oversee and monitor insurance companies, including those that sell annuities.[67]

[65] In the United States, annuities offered in pension plans must be offered on a gender-neutral basis. *Arizona Governing Committee v. Norris,* 463 U.S. 1073 (1983). By contrast, annuities offered in the retail market, including IRAs that are not employer-sponsored, are not subject to the same rule, and these annuities may vary based on gender. Women may find more favorable single-life annuity rates through pension plans, but men may find more favorable rates through the retail market.

[66] See ERISA Advisory Council (December 2012).

[67] It should be noted that, with the exception of Canada, the other countries we reviewed have national regulatory frameworks for insurance. In the United States, insurance regulations are governed at the state level.

For example, in Canada, regulators told us that insurers must meet solvency requirements[68] and financial market conduct standards, and all insurers are members of an association that promotes consistent insurance practices and standards by issuing guidelines to its members. Moreover, in four of the six countries regulators and industry practitioners told us that the main responsibility of employers is to contribute to the plan during accumulation, and their obligations typically cease at retirement.[69] In the United Kingdom, where plans are required to inform participants of their right to shop around for an annuity, there are no requirements to assess the potential annuity provider the participant may select through the plan. According to U.K. government officials, plan trustees and participants do not have the expertise to assess the solvency of an annuity provider and are not expected to do so. Furthermore, they noted that this responsibility lies with the bank and insurance company regulators, so plans offering and participants purchasing an annuity are assured of the provider's solvency. Additionally, because plans do not need to take steps to assess annuity providers, there are no additional administrative costs associated with offering an annuity through the plan. As some of the countries we reviewed illustrate, the absence of a requirement for plan sponsors to assess annuity providers allows plans to more easily provide participants a way to annuitize their retirement savings, if they so choose.

Conclusions

The DC systems in the countries we reviewed differ from the United States in a number of ways, and not all the lessons they have to offer would apply here, but their experiences illustrate additional steps DOL and Treasury could consider to help 401(k) plan sponsors make the most of existing flexibilities to offer multiple spend-down options through their plan and broaden participants' retirement options. By 2015, participants whose retirement savings will be primarily made up of what they

[68] We did not assess the adequacy of solvency requirements in the countries we reviewed because this was beyond the scope of this study. Our recent work found that the effects of the financial crisis on insurers and policyholders were generally limited, with a few exceptions. For more information, see GAO, *Insurance Markets: Impacts of and Regulatory Response to the 2007-2009 Financial Crisis*, GAO-13-583 (Washington: D.C.: June 27, 2013).

[69] In Switzerland, where plans are legally required to provide a minimum benefit, plan sponsors have some financial responsibility for annuity payments, according to Swiss regulators.

accumulated in their 401(k) plans will either be eligible to retire or approaching retirement and many will be faced with the challenge of ensuring they do not outlive their retirement savings. Yet, most of these participants' 401(k) plans will offer lump sum payments as the primary spend-down option for participants, leaving them to their own devices to figure out how to make their savings meet their needs and last throughout their retirement. Some participants may prefer having complete access to their retirement savings upon retirement. Others, however, could benefit from knowing that there are options offered through the plan—other than a lump sum payment—that might be optimal for them. The experiences of other countries have shown that participants benefit from being able to select among multiple, competitively priced and easily accessible options to address their diverse and changing retirement needs. Although DOL and Treasury have taken some initial steps to explore how the United States might expand the options available to 401(k) participants at retirement, they could do more to ensure that plan sponsors offer flexible options to participants, enabling them to choose the spend-down option that best fits their particular circumstances.

Our work also shows that information provided in an easy to understand format at appropriate times before a participant retires can help participants think about and plan for the amount they will need on a monthly basis during retirement. Receiving information on projected income with their account statements helps workers develop and focus on retirement income targets, which in turn can lead to positive changes in participant behavior, such as working longer to improve their prospects for a successful retirement. Comparing available spend-down options and longevity risk can also help participants understand the advantages and disadvantages of each option available to them. In addition, as illustrated in our interactive retirement model, learning to understand the effects of interest rates, inflation, and returns on each type of spend-down option can help participants begin to interpret financial information that can impact their retirement income. Given that DOL is considering various approaches to improve 401(k) plan participants' understanding of retirement income, it is clear that including information about spend-down options and estimated income can further help participants make more sound decisions about their retirement income.

Finally, unlike within 401(k) plans in the United States, in the countries we reviewed annuities were generally an option available to participants through their plans. Because few 401(k) plans in the United States choose to offer annuities to participants, they may be missing a beneficial spend-down option that can provide lifetime income at discounted group prices. As DOL continues to look at the barriers to 401(k) plans offering annuities, the lack of requirements for plan sponsors in other countries to assess an annuity provider's ability to make future payments—relying instead on the adequacy of insurance regulation—may be something to explore. Our work shows that offering annuities to participants can be done in an easy cost-effective manner enabling participants, if they prefer to consider this spend-down option and not dismiss it as being too expensive to obtain.

Recommendations for Executive Action

As DOL and Treasury continue their efforts to determine the actions needed to enhance the retirement security of 401(k) plan participants, we recommend they consider the approaches taken by other countries to formalize access to multiple spend-down options for U.S. plan participants that address varying retirement risks and needs. To the extent possible, lessons from other countries should be used to help DOL and Treasury ensure plan sponsors have information about their flexibilities and the ability to facilitate access to a mix of appropriate options for 401(k) plan participants.

In addition, as DOL considers changes to participant benefit statements and other disclosures, we recommend that the Secretary of DOL consider strategies other countries have employed to help participants make sound decisions, such as providing timely information at or before retirement about available spend-down options and projections of future retirement income.

We also recommend that as DOL continues to review regulatory barriers to lifetime income options for 401(k) plan participants it consider other countries' approaches to plans offering annuities, such as their reliance on existing solvency requirements and insurance industry standards to provide assurances rather than place responsibility on plan sponsors to make an assessment of an annuity provider's financial stability. As DOL considers the approaches of other countries and continues to work with NAIC, which facilitates interactions between insurance companies and state insurance regulators, DOL may wish to consult with the Federal Insurance Office, which coordinates federal efforts on prudential aspects of international insurance matters.

Agency Comments and Our Evaluation

We provided a draft of this report to DOL and Treasury for comment. Both agencies provided technical comments that were incorporated, as appropriate. DOL also provided written comments, which are reproduced in appendix III. In its written response, DOL generally agreed with our recommendations and stated that it will take steps to address these recommendations in its ongoing efforts. Moreover, DOL will be focusing on two areas for further consideration that we highlighted in our report, participant education and providing regulatory assistance to plan sponsors considering an annuity option in defined contribution plans.

Regarding our recommendation that DOL and Treasury consider the approaches of other countries to formalize access to multiple spend-down options for 401(k) plan participants, DOL commented that expanding access to additional options involves plan design features, which historically have not been subject to DOL's regulatory authority under Title I of ERISA. DOL noted that it will evaluate whether there are available regulatory approaches to address this recommendation. As we addressed in the report, participants can benefit from having access to a mix of options allows participants to select options that can best meet their unique circumstances. Therefore, we support DOL's efforts to look into available regulatory approaches to address our recommendation and would encourage the agency to fully consider the steps it could take within the scope of its current authority.

With respect to our recommendation to consider the strategies of other countries to help participants make sound retirement decisions, DOL agreed that participants should have timely information at or before retirement about available spend-down options and projections of future retirement income and stated that they will explore their options for actions. As we illustrated in our report, having timely information and projections of future income can help plan participants make more informed retirement saving decisions. We would again encourage DOL to fully consider what steps it could take within the scope of its current authority.

Finally, with respect to our third recommendation that DOL consider other countries' approaches as it reviews regulatory barriers to lifetime income options to 401(k) plan participants, DOL stated that it will evaluate the available regulatory approaches to address our recommendation. We also suggested that DOL consult with NAIC and FIO in its efforts. DOL commented that it began working with a NAIC Working Group to consider possible options for easing plan sponsor concerns with the financial soundness of annuity providers in connection with DOL's safe harbor for the selection of annuity providers and fiduciary responsibilities. DOL noted that the NAIC Working Group plans on providing EBSA with a list of “best practices” for fiduciaries when asking states for information about insurers, and that it will continue to work with NAIC, Treasury, FIO, and others as it evaluates regulatory approaches to address our recommendation. In response to DOL’s comment, we revised our draft to reflect the status of DOL’s efforts to collaborate with NAIC on the safe harbor for the selection of annuity providers. We commend DOL for its initiative to develop a more workable safe harbor, but continue to encourage DOL to review alternative approaches taken by other countries, such as their reliance on existing solvency requirements and insurance standards. As shown in our report, these approaches can ease the burden on plan sponsors. As a result of DOL’s review and potential action, 401(k) plans could more easily offer annuities to plan participants, which allow them greater flexibility to choose spend-down options that meet their needs and preferences.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretary of Labor, the Secretary of the Treasury, and other interested parties. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or jeszeckc@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

Charles A. Jeszeck, Director
Education, Workforce,
and Income Security Issues

Appendix I: Objectives, Scope, and Methodology

Our objectives for this review were to examine selected countries' (1) approaches to offering retirement spend-down options; (2) key strategies to help participants make sound decisions; and (3) approaches to regulating and overseeing options.

To address these objectives, we conducted in-depth reviews of retirement spend-down phase strategies in countries with extensive or growing defined contribution (DC) systems to determine lessons for the United States based on best practices used in other countries. We selected the following countries for this review: Australia, Canada, Chile, Singapore, Switzerland, and the United Kingdom (U.K.). In selecting the six countries, we considered if the country had (1) developed innovative spend-down phase policies or options; (2) a clearly defined and well-established oversight structure for the DC plan spend-down phase and providers, such as insurance companies; and (3) if the country's approach to the spend-down phase was uniquely different from the other countries in our scope. To determine which countries to include, we conducted an initial review of the universe of countries with well-developed account based retirement systems. We reviewed comparative studies of DC systems published by GAO, academics, the Organisation for Economic Co-operation and Development (OECD), The World Bank, and other industry experts, such as international benefits consulting firms, to determine which countries have extensive or growing DC systems and if those countries had developed innovative spend-down policies or options. We solicited recommendations on countries with innovative spend-down phase approaches or options from representatives of the OECD, The World Bank, U.S. government officials, academics, and industry practitioners who work with multi-national companies that operate in other countries with DC plans. We then examined the characteristics of each country's DC system for policies, practices, and requirements related to retirement spend-down options. Based on our initial review, we excluded countries in which the DC plan is structured in a substantially different manner from that of U.S. 401(k) plans or not well-developed relative to other pension options, or in which the spend-down phase was not well-defined. We also determined that the six countries selected could potentially provide lessons for the United States given their experience and unique approach to the spend-down phase.

For each of the six countries we selected, we reviewed publicly available research and reports about each country's pension systems—particularly information on spend-down options, oversight framework, and initiatives to educate participants about options. We also interviewed pension experts, service providers, regulatory agencies and other government officials from the countries selected. We did not conduct an independent legal analysis to verify the information provided about the laws, regulations, or policies of the countries selected for this study. Instead, we relied on appropriate secondary sources, interviews with relevant officials, and other sources to support our work. We submitted key report excerpts to agency officials in each country for their review and verification, and we incorporated their technical corrections as necessary.

In addition to addressing these objectives, we also developed a retirement model to help provide contextual information on spend-down options and certain factors that may affect retirement income from these options. The retirement model to allow users to view retirement income under a range of circumstances provided by three main spend-down options: (1) a lump sum payment of their account balance; (2) a programmed withdrawal with payments that are either fixed or set as a proportion of the remaining account balance; and (3) an immediate annuity that makes level payments with no joint or survivor benefit. We developed, in consultation with GAO's Chief Actuary and an external actuary with expertise in annuity pricing, a formula that was calibrated to approximate annuity payments similar to those found in U.S. retail annuity markets in July, 2013.[1] We simulated retail annuity prices because participants in most 401(k) plans do not have access to institutionally priced annuities within plans. For instance, to purchase an annuity, these participants would instead have to roll over a lump sum payment of their account balance into an IRA and purchase an annuity as an individual investor in U.S. retail markets. To set the ranges within which users can adjust assumptions about interest rates, investment returns and inflation, we analyzed historical data on economic indicators from the Federal Reserve Economic Database, including 10-year Treasury constant maturity rates, and investment returns from Thrift Savings Plan funds that track broad stock, fixed income, and government securities indices. To ensure the annuity rates generated from our model reflected U.S. retail market rates as of July 31, 2013, we calibrated rates using quotes from ImmediateAnnuities.com. We did not assess the reliability of data used to set ranges or calibrate rates, mainly because the information generated from the interactive tool provides illustrative context for the report and is

[1] In the United States, annuities offered in pension plans must be offered on a gender-neutral basis. *Arizona Governing Committee v. Norris,* 463 U.S. 1073 (1983). By contrast, annuities offered in the retail market are not subject to the same rule, and these annuities may vary based on gender.

not material to findings, conclusions, or recommendations. In addition, retirement income depicted in the interactive tool does not reflect any federal income taxes on distributions from tax-deferred 401(k) accounts.[2] Dollar amounts in the interactive tool are for illustrative purposes only and should not be considered as quotes for spend-down products or taken as financial advice.

We conducted this performance audit from June 2012 to November 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[2] In general, 401(k) contributions and investment earnings on those contributions are not taxed as income until the employee withdraws them from the plan.

Appendix II: Key Features of DC Pension Systems in Australia, Canada, Chile, Singapore, Switzerland, and the United Kingdom

Appendix II

Australia

At a glance

Since 1992, Australia has had a mandatory defined contribution (DC) pension system, known as the superannuation guarantee.[1] Employees generally designate a plan, known as a superannuation fund, to which the employer is required to direct contributions. Employees who do not designate a fund are placed in a default accumulation option, known from 2013 as MySuper. In 2010, Australia announced plans to gradually increase mandatory contributions from 9 to 12 percent of workers' wages by 2022. The average account balance at normal retirement age is about AUD 119,000 (approximately *$110,000*) as of 2012.

- **Total system assets:** AUD 1.4 trillion (*$1.3 trillion*) as of 2012
- **Percentage of workers with DC accounts:** not available during our review

Types of plans

Industry funds are generally non-profit entities[2] established by a single employer or group of employers. Industry funds generally offer 5 to 15 investment options designed to meet most participants' needs and in recent years many have become available to the public rather than being restricted to the employees of particular employers.

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

DC Spend-down options

- **Lump sums:** Participants may take some or all of their account balance as a lump sum payment.
- **Programmed withdrawals:** Participants have the flexibility to structure the timing and amount of withdrawals subject only to annual required minimum withdrawals. These options are known as account-based income streams or account-based pensions.
- **Annuities:** Only a small number of annuities are purchased annually, and most are term annuities that provide payments over a fixed period rather than lifetime annuities that guarantee payments for the participant's life.

Providers

Spend-down options may be provided by employers or a group of employers, banks, insurance companies, or financial service providers.

Regulators

- **The Australian Prudential Regulatory Authority** (APRA) is responsible for prudential regulation of all superannuation funds except for self-managed superannuation funds and some public sector schemes. Reforms implemented in July 2013 will enhance APRA's ability to set and enforce prudential standards. According to officials, APRA's authority prior to this had largely been limited to issuing, setting conditions on, and revoking licenses to operate superannuation funds. APRA is also responsible for the prudential regulation of other financial services entities, such as banks and insurance companies.
- **The Australian Securities and Investments Commission** licenses and monitors financial services businesses to ensure they operate efficiently, honestly, and fairly. This includes superannuation trustees who hold a license with the commission. It also operates a website that provides consumers information to help them make smart choices about their personal finances, including spend-down decisions, www.moneysmart.gov.au.

  The Australian Taxation Office is responsible for regulating self-managed superannuation funds, which it does by providing information to trustees on how to set up and manage their fund, checking that the fund complies with standards and laws, and taking enforcement actions to correct breaches of the law.

[1] According to APRA officials, the term "guarantee" in this context reflects the policy intent that all could be guaranteed to be included in the mandatory arrangements, as opposed to the historical approach which was that superannuation was provided at the discretion of employers. There is no guarantee of investment performance.

[2] Industry and corporate funds are non-profit entities in that dividends are not paid to shareholders of the trustee company. The directors of the trustee company represent the interests of the fund members and the employer-sponsor(s) in equal numbers, although an independent director may also be appointed.

Australia (cont.)

Types of plans (cont.)

Corporate funds are set up by an employer for their employees, although many meet their obligations by contributing to industry or retail funds on behalf of their employees

Retail funds are for-profit entities usually run by banks or investment companies. They often have a large number of mid to higher priced investment options and are open to anyone.

Self-managed superannuation funds are available to individuals who create and manage their own plan, which entails establishing a trust and a bank account. Up to four people can be in a self-managed fund, however each individual must be a trustee or director of the trustee company and no “arms-length” employees are permitted, according to APRA officials.

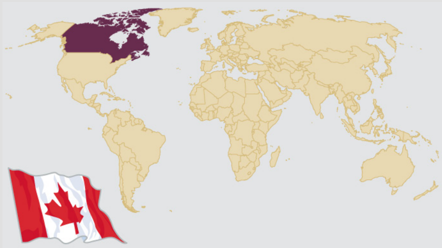
Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

National pension system

Australia’s Age Pension is a pay-as-you-go public pension funded out of general revenues. The Age Pension is designed to provide biweekly retirement income equal to about 28 percent of average wages,[2] as well as other benefits such as assistance for health care and transportation, to residents of Australia age 65 and older.[3] The Age Pension is means tested for both income and assets, so accumulations in superannuation will reduce biweekly payments from the Age Pension. According to APRA officials, the Age Pension is essentially a “safety-net” provided for those unable to provide for themselves.

[2]Australia uses male total average weekly earnings as a measure of average wages.

[3]Women born before1949 become eligible at age 64½.



At a glance

Although, most private voluntary occupational pension plans have been DB, almost all new plans are DC, and a typical DC plan would require employee contributions of 5 percent of earnings and matching employer contribution.

- **Total system assets:** 47.42 billion Canadian dollars (*about $45.16 billion*) as of 2011
- **Percentage of workers with DC accounts:** 5 percent as of 2011

Types of plans

Voluntary private plans are known as registered private pension plans and can either be DC plans or DB plans. In general, money payable to a member of a plan can only be used to provide retirement income, even if a member leaves the plan. Once benefits are vested, they are usually "locked-in," which helps to ensure that a member will have regular income at retirement, and creditors cannot seize locked-in pension benefits.

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

Appendix II

Canada

Highlights of the spend-down phase

DC Spend-down options

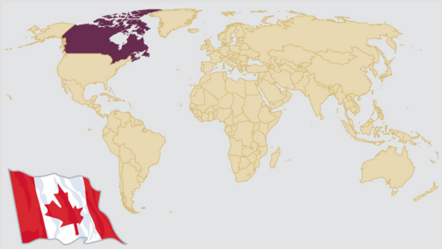
- **Lump sums:** Partial lump sums may be available under certain conditions. These conditions vary by jurisdiction.
- **Programmed withdrawals:** Registered income funds and life income funds are available to participants, depending on the jurisdiction. Minimum distribution requirements, beginning at age 71, apply to these products. In addition, where life income funds are available, participants' accounts may be subject to maximum distribution requirements, set as fixed percentages of account balances, at each age, designed to last up to a certain age. In a few jurisdictions, regulators have allowed plans to offer a type of programmed withdrawal, known as a variable benefit. Instead of transferring a participant's balance to a third party, assets remain in the plan and are distributed by the plan.
- **Annuities:** An array of other life annuities is available in the retail market. The most common form is a single life pension with a minimum guarantee of 5 or 10 years of payments. A plan administrator must purchase an annuity for a participant of a DC plan if the member does not elect to exercise of their options. According to regulators, the take-up rate for annuities is relatively low.

Providers

Programmed withdrawal products are generally offered by financial institutions, such as banks and trustee companies. Private insurance companies offer annuities.

Regulators

Plans are generally regulated at the provincial level, so policies vary by province and the federal level. At the federal level, the Office of the Superintendent of Financial Institutions regulates and supervises private pension plans in federally regulated areas of employment, such as banking, telecommunications and inter-provincial transportation. It is also the regulator for pension plans established with respect to employment in the Yukon, the Northwest Territories, and Nunavut.



Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

Canada (cont.)

National pension system

Canada has a two-tier social security system that provides the majority of retirement income for the average worker. The system includes the Old Age Security program, which provides monthly payment to residents who are 65 years of age and over as well as a guaranteed income supplement—a family income-tested benefit—to low-income pensioners; and the Canada Pension Plan, which pays a monthly retirement pension to people who have worked and contributed to the Canada Pension Plan.[4] The amount of the Canada Pension Plan benefit a person is entitled to depends on how much and for how long that person contributed to the plan.

[4]The Canada Pension Plan operates in every province and territory, except Quebec, which has its own similar pension program, the Quebec Pension Plan.

At a glance

Chile instituted a DC pension system in 1981. Workers who entered the labor market after that date are mandated to contribute to an individual DC account.

- **Total system assets:** 77.5 trillion Chilean pesos (*about $162 billion)*as of 2012
- **Percentage of workers with DC accounts:** About 59 percent of those in the labor force currently contribute as of 2012

Types of plans

Workers are free to choose a licensed for-profit service provider, known as an AFP (Administradoras de Fondos de Pensiones) to manage their individual accounts. Currently, there are six AFPs. New entrants to the labor force are defaulted to the AFP with the lowest fee as determined by a bidding process, which takes place every 2 years. They are required to remain in this AFP for 2 years, after which they can freely choose a service provider.

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

Appendix II

Chile

Highlights of the spend-down phase

DC Spend-down options

- **Lump sums:** Participants may take some of their account balance as a lump sum payment provided the remaining balance is enough to generate a pension equal to 100 percent of the maximum pension with solidarity support, 261,758 Chilean pesos (about $520) monthly as of December 2012, and 70 percent of the participant's average monthly taxable wage for the previous 10 years.
- **Programmed withdrawals:** AFPs administer this option with the monthly amount determined annually by a government formula based on account balance, expected rate of return, inflation, and gender-specific life expectancy.
- **Annuities:** Administered by life insurance companies, the annuity calculation is based on age and gender-specific life expectancy. Participants can combine options such as temporary programmed withdrawals with a deferred annuity, or purchase an immediate annuity with a portion of their account balance and programmed withdrawals with the rest. Annuities are inflation-indexed. Annuities are not allowed if the pension they generate is smaller than the Basic Solidarity pension, which as of December 2012 was 80,528 Chilean pesos (about $160) monthly.

Providers

- AFPs administer programmed withdrawals. Insurance companies offer annuities to participants.

Regulators

- **The Superintendent of Pensions** closely supervises and regulates AFPs, including issuing licenses for them to participate in the system. On an ongoing basis, the Superintendent of Pensions monitors plan providers for compliance with investment option guidelines, reserve requirements, fee structure, and other requirements.
- **The Superintendent of Securities and Insurance** supervises insurance companies, which includes setting rules and regulations about solvency principles and monitoring insurance company offers through the SCOMP system.[5] Together with the Superintendent of Pensions, it maintains a list of approved pension advisors.

[5]SCOMP is the Spanish acronym for Electronic Consultation and Offer System for Annuities and Phased Withdrawals. It is an electronic quotation system that shows participants different spend-down options in a comparable format.

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

Chile (cont.)

National pension system

Chile has a public pension system with two components targeted at the poorest 60 percent of the population age 65 and over who meet residency requirements. There is a Basic Solidarity Pension for individuals who have not contributed to individual accounts and pass the means test. Participants who contributed to individual accounts and pass the means test receive a Pension Solidarity Complement if their monthly pension is below a threshold amount of 261,758 Chilean pesos (about $520) as of December 2012.

Appendix II

Singapore

At a glance

Singapore's mandatory DC system, the Central Provident Fund (CPF), was established in 1955 to provide financial security for employees in their retirement. The system is comprised of individualized accounts fully funded by both employer and employees. Contributions are distributed among three types of individual accounts.

- **Total system assets:** 230,158 million Singaporean dollars (SGD) (*about $181,227 million)* as of 2012
- **Percentage of workers with DC accounts:** over 80 percent of the resident workforce

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

Highlights of the spend-down phase

DC Spend-down options

- **Lump sums:** At age 55, participants may withdraw their CPF savings in excess of the minimum sum of $148,000 SGD (about $116,535) in their retirement account and a minimum of 40,500 SGD (about $31,900) in their medisave account. Participants who do not have savings in excess of the minimums are allowed to withdraw $5,000 SGD (approximately $3,900).
- **Programmed withdrawals:** Prior to 2013, the primary spend-down option was a programmed withdrawal administered by the CPF Board designed to last for approximately 20 years from the participants "drawdown age," which is currently 65.
- **Annuities:** In 2009, Singapore introduced a new government-managed life annuity system, known as CPF Lifelong Income Scheme For the Elderly (CPF LIFE), to address the challenges of increasing life expectancy and an aging population. From 2013, participants with retirement account balances of at least 40,000 SGD (about $31,500) are automatically placed on CPF LIFE. The government offers two types of annuities, a basic and standard plan. The standard plan is the default plan for participants. The standard plan provides higher monthly payments as compared to the basic plan, but leaves a smaller bequest for the participant's family and other beneficiaries

Providers

The CPF Board administers the CPF Fund and CPF LIFE. Private insurance companies offer a variety of annuity products in the retail market.

Regulators

CPF Board was established by law to be the trustee and administrator of CPF. The CPF Board is also responsible for investing participants' savings in special securities issued by the government. The CPF Board works closely with the Ministry of Manpower and other relevant Ministries on policies that affect CPF, even though the power to initiate changes to provisions on CPF schemes rests with the Minister of Manpower.

Singapore (cont.)

Types of plans (cont.)

Until age 55, CPF savings are maintained in three accounts:

- **Ordinary account** savings can be used for housing, investment, and other approved purposes.
- **Special account** maintains savings that are set aside for retirement and can be used for investment in retirement-related financial products.
- **Medisave account** savings help CPF members meet their own or their immediate family's hospitalization expenses.

The **retirement account** is created for CPF members when they reach the age of 55. Savings from the ordinary and special accounts up to the minimum sum amount (148,000 SGD as of 2013) are transferred to this account. This amount is set aside for the purpose of providing members with steady income post-retirement.

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

National pension system

CPF is the main source of retirement income for workers. Singapore does not have a multi-pillar retirement system that is similar to the United States. There is no state pay-as-you-go social security. However, there is other government social spending, which indirectly helps retirees with costs, such as health care and housing.

At a glance

Since 1985, Switzerland has had a mandatory system of occupational pension plans for workers with incomes above a certain threshold.[6] Participants do not have a choice of plan, but are placed in their employer's plan. The government regulates minimum contributions, and minimum returns on contributions during accumulation. In 2005, Switzerland extended to some extent coverage of the mandatory system to low-income and part-time workers.

- **Total system assets:** SFr. 625.9 billion dollars (*about $658.8 billion)* as of 2011
- **Percentage of workers with DC accounts:** About 74 percent of the labor force

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

Appendix II

Switzerland

Highlights of the spend-down phase

DC Spend-down options

- **Lump sums:** Since 2005, plans have been required to offer participants at least 25 percent of their mandatory retirement savings as a lump sum payment.
- **Programmed withdrawals:** Programmed withdrawals are not available to plan participants.
- **Annuities:** Switzerland requires that annuities have disability and survivor benefits. Pension funds may voluntarily index annuity payments for inflation if they are financially able to do so. In the mandatory portion of the DC system, annuities must be the default option. Although official data are not available, researchers estimate that participants annuitize about 80 percent of their account balance.

Providers

Spend-down options may be administered by independent foundations that manage plans.

Regulators

- **Oberaufsichtskommission** (OAK Commission) came into being in 2012 to harmonize regional oversight and regulation of trust-based pension plans. The Commission also oversees the Guarantee Fund that protects participants in the event that a pension plan becomes insolvent, as well as the Substitute Occupational Benefit Institution that extends coverage to employers who do not meet their pension obligation and those who are not otherwise covered and who wish to voluntarily be covered, such as the self-employed, among others.
- **The Swiss Financial Market Supervisory Authority** is responsible for overseeing insurance companies. It ensures that insurance companies comply with laws and regulations and fulfill their licensing requirements.
- **The Federal Social Office of Insurance** plans, manages, and monitors Switzerland's social insurance systems to ensure they function effectively.

[6] Officials in Switzerland said the majority of plans in Switzerland are hybrid plans. These hybrid plans are similar to cash balance plans, which in the United States are legally classified as DB plans because participants' benefits are determined by a benefit formula. However, a cash balance plan has certain features, such as notional "individual accounts" that are similar to DC plans.

Switzerland (cont.)

National pension system

Switzerland's old age and survivors' insurance (AHV/AVS) is a pay-as-you-go public pension that is funded by payroll contributions and general revenues. The system has two components: an earnings-related public pension funded mainly by payroll contributions and an income-tested supplementary benefit funded by general revenues. Payment amounts for the earnings-related benefit are based on lifetime earnings. Payments in retirement are indexed to prices and earnings. The government coordinates benefits between AHV/AVS and occupational pension plans so that combined, they replace about 60 percent of preretirement income for workers with lower incomes.

Types of plans

Mandatory occupational plans are administered by independent foundations and may be sponsored by a single employer or group of employers. Plans are managed by boards of trustees with equal employer and employee representations. The organization of plans also varies by degree of risk coverage with respect to longevity, premature death or disability.

Autonomous plans bear all the risk.

Autonomous plans with reinsurance hand over some of the risk to a reinsurance company.

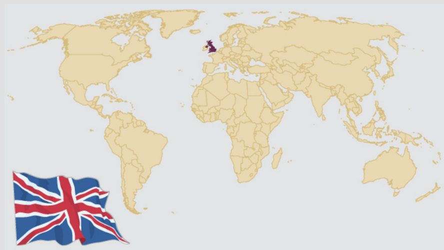
Semiautonomous plans include two cases: (1) a plan hands over only the risk of death or disability to an insurance company and consequently still bears the risk of longevity; and (2) the plan buys the old-age pensions from the insurer too.

Fully insured plans are plans in which all the risks are covered by an insurance company.

Savings associations by construction bear no actuarial risks, because only old-age savings are accumulated.

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.



At a glance

Voluntary DC plans make up most of the private pension system in the U.K. An individual may be a member of a number of different pension plans simultaneously. From October 2012, in a staged process, employers were required to automatically enroll their eligible employees into a pension plan—including a new low-cost DC pension saving plan called the National Employment Savings Trust—and provide a minimum contribution.

- **Total system assets:** £385.9 billion (*about $584.70 billion)*as of 2010
- **Percentage of workers with DC accounts:** about 17 percent of employees as of 2012

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

Appendix II

United Kingdom

Highlights of the spend-down phase

DC Spend-down options

- **Lump sums:** Participants may take up to 25 percent of plan assets as a tax-free lump sum, subject overall to 25 percent of the individual's lifetime tax-free pension allowance and individual plan rules.
- **Programmed withdrawals:** Under a capped drawdown, participants have the ability to withdraw up to 120 percent of the value of an amount equal to what they would get from a level payment single-life annuity each year. Plan administrators are responsible for reviewing these withdrawals every 3 years and resetting maximum withdrawal limits as needed. Participants who can demonstrate secure income of at least £20,000 (about $30,300) per year may take withdrawals without limit while leaving the balance of the fund invested. This option is known as flexible drawdown.
- **Annuities:** Participants can choose from a number of different options for single-life and joint-life annuities, including level or escalating payments, a guarantee period, and impaired or enhanced rates.

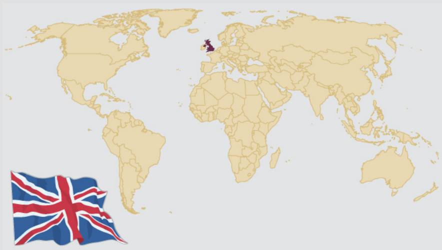
Providers

Plan administrators, which may be a trustee or for-profit provider, are responsible for administering programmed withdrawals. Private insurance companies offer a variety of annuity products in the retail market.

Regulators

- **The Pensions Regulator** is solely responsible for regulating trust-based plans and coordinates with other entities on regulating contract-based plans. It has the authority to oversee the administration of these plans and contributions made to them. For DC plans, its statutory objectives include protecting the benefits of plan participants and promoting and improving understanding of good administration of plans.
- **The Financial Conduct Authority** and **the Prudential Regulatory Authority** share oversight of contract-based plans and financial service providers. The Financial Conduct Authority was the successor to the former authority, the Financial Services Authority. It is responsible for ensuring fairness in the conduct of firms towards their employers and participants, overseeing smaller insurers, as well as asset managers and advisory firms. The Prudential Regulatory Authority, the smaller of the two new entities, is a subsidiary of the Bank of England and tasked with monitoring the safety and soundness of larger insurers, banks, and asset managers.

United Kingdom (cont.)



Types of plans

Trust-based plans (41 percent of DC participants) These are employer-sponsored plans and are usually non-profit entities managed by a board of trustees that typically hire one or more service providers for recordkeeping and investment management services. The trustees are responsible for selecting and vetting the investment options.

Contract-based plans (59 percent of DC participants) For contract-based plans, an employee deals directly with a for-profit service provider that performs both recordkeeping and investment management services. The service provider selects which investment options are available to the participant. These plans are owned entirely by the worker

Source: GAO analysis of foreign agency documents and interviews with Australian officials and industry experts; State Department (base map); Art Explosion (flags).

Note: GAO did not conduct an independent legal analysis of the laws, regulations, or policies of the countries selected for this review.

National pension system

The basic state pension is a regular payment from the government once an individual reaches a certain age.[7] The amount depends on the number of qualifying years, at least 30 years, individuals have of National Insurance contributions. As of August 2013, the maximum full basic state pension is £110.15 per week (*about $167*). There is also an earnings-related element called the state second pension, which give individuals who earn lower wages or cannot work as much as other the change to receive a better state pension. Under current rules, there is a cap on annual earnings of £40,040 (about $60,700).

[7]The date an individual reaches basic state pension age depends on when he or she was born. For men born before December 6, 1953, the current age is 65. For women born after April 5, 1950 but before December 6, 1953, the age is between 60 and 65. The age men and women are eligible for benefits is expected to increase to age 66 by October 2020.

Appendix III: Comments from the Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

OCT 3 1 2013

Charles A. Jeszeck
Director, Education, Workforce, and Income Security
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review the Government Accountability Office's (GAO) draft report entitled "Other Countries' Experiences Offer Lessons in Policies and Oversight of Spend-down Options for the U.S." We appreciate GAO's interest in helping 401(k) plan participants sustain an income throughout retirement. As your report points out, American workers are primarily saving for retirement through 401(k) plans, which have become the dominant type of plan private sector employers are offering in the United States.

In recognition of the foregoing, the Department is considering what steps it could take to facilitate access to, and use of, lifetime income options in defined contribution plans. Lifetime income or other similar arrangements could help reduce the risk that retirement savings will be exhausted. As your report notes, in February 2010, the Department, in conjunction with the Department of the Treasury, published a Request for Information (RFI) soliciting public input on a variety of issues relating to offering and selecting lifetime income products. As your report also notes, later, in May 2013, the Department published an Advance Notice of Proposed Rulemaking (ANPRM) soliciting public input on an approach EBSA has developed for pension benefit statements to show an estimated lifetime stream of payments in addition to a lump sum account balance. In addition to lifetime income illustrations, the volume of public comments received in response to the RFI suggested support for further consideration or action by the Department of Labor in two other areas: participant education; and assistance in compliance with fiduciary standards in selecting annuity providers in defined contribution plans.

In the report, GAO recommends that, as the Department of Labor and the Department of the Treasury continue their efforts to determine the actions needed to enhance the retirement security of 401(k) plan participants, they consider the approaches taken by other countries to formalize access to multiple spend-down options for U.S. plan participants that address varying retirement risks and needs. To the extent possible, lessons from other countries should be used to help the Departments ensure plan sponsors have information about their flexibilities and the ability to facilitate access to a mix of appropriate options for 401(k) plan participants. Second, GAO recommends that, as the Department considers changes to participant benefit statements and other disclosures, the Secretary of Labor consider strategies other countries' have employed to help participants make sound decisions, such as providing timely information at or before retirement about available spend-down options and projections of future retirement income.

The first recommendation, referencing six other countries' approaches to expand access to additional options, involves plan design features which historically have not been subject to the Department's regulatory authority under Title I of ERISA. Accordingly, the Department will have to evaluate whether there are available regulatory approaches to address the first recommendation. We agree that participants should have timely information at or before retirement about available spend-down options and projections of future retirement income. We will include this in our evaluation of regulatory approaches that may be available within our existing statutory authority to address the second recommendation.

Further, EBSA participates in multinational pension research and policy discussions and thereby derives insights for consideration in its own policy development. We will continue this activity, and look into the experiences of other countries as we develop proposed regulations.

GAO's third recommendation is that, as the Department continues to review regulatory barriers to lifetime income options for 401(k) plan participants, it consider other countries' approaches to plans offering annuities, such as their reliance on existing solvency requirements and insurance industry standards to provide assurances rather than place responsibility on plan sponsors to make an assessment of an annuity provider's financial stability. In the Fall of 2012, the NAIC Life Insurance Committee appointed the NAIC ERISA Retirement Income Working Group to work with the U.S. Department of Labor, the White House Council of Economic Advisors (CEA), the U.S. Department of the Treasury and any other appropriate federal agencies, in coordination with the NAIC Government Relations Leadership Council (GRLC). The goal of the Working Group is to consider possible options for easing plan sponsor concerns with the financial soundness of annuity providers in connection with the DOL safe harbor for the selection of annuity providers and fiduciary responsibility requirements. Since that time, EBSA has had several meetings with representatives of the NAIC, the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA), the Department of the Treasury and the CEA. The Working Group plans on providing EBSA with a list of "best practices" for fiduciaries when asking states for information about insurers. EBSA will continue to work with the NAIC, NOHLGA, CEA and the Treasury Department, including the Treasury Department's Federal Insurance Office, as we evaluate regulatory approaches to address this third recommendation. We believe these actions also address the December 2012 ERISA Advisory Council report recommendation that the Department partner with NAIC in our effort to develop a more workable safe harbor for the selection of annuities and other lifetime income products.

EBSA is committed to protecting the employer-sponsored benefits of American workers, retirees, and their families. We appreciate having had the opportunity to review and comment on the draft report. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,

Phyllis C Borzi

Phyllis C. Borzi
Assistant Secretary

2

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Charles Jeszeck, (202) 512-7215 or jeszeckc@gao.gov

Staff Acknowledgments

In addition to the contact named above, Tamara Cross (Assistant Director), Tom Moscovitch, Lacy Vong, and Seyda Wentworth made key contributions to this report. Also contributing to this report were James Bennett, Alicia Cackley, Grace Cho, Katie Delgado, Holly Dye, Kathy Leslie, Sheila McCoy, Ernest Powell, Jr., Stephen Sanford, MaryLynn Sergent, Jessica Smith, Roger Thomas, Frank Todisco, Kathleen van Gelder, and Walter Vance.

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