

November 13, 2006

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
200 Constitution Ave, N.W.
Washington, DC 20210
Attn: Default Investment Regulations

Re: Proposed Regulation on Default Investment Alternatives Under Participant Directed Individual Account Plans

To Whom It May Concern:

I am writing to provide a brief comment on the proposed Default Investment regulations. Thank you for the opportunity to comment.

As background, I am an associate professor of finance at the University of Illinois at Urbana-Champaign, as well as the Associate Director of the Retirement Research Center at the National Bureau of Economic Research. I have written extensively on issues related to retirement income security, including numerous papers in peer-reviewed economics journals. I have also been an active participant in public policy debates about retirement security, including serving as a Senior Economist at the White House Council of Economic Advisers from 2001 to 2002.

I write today to express two basic views about the proposed Default Investment regulations.

1. Overall, the move to clarify default investment rules as a way of encouraging employers to automatically enroll plan participants into 401(k)'s and similar savings vehicles is good policy, and should clearly help to increase average retirement savings.
2. However, I am concerned that the current definition of a "qualified default investment alternative" is overly narrow, and may have the effect of biasing plan investment choice against a number of existing and even yet-to-be created financial products that might play an important role in providing retirement income security. In particular, I am concerned about the lack of recognition of the important role that guaranteed retirement income, such as that provided by life annuity products, ought to play in the portfolios of many Americans.

The background information provided in the proposed regulations clearly indicates that the EBSA staff that drafted the proposed regulations has an in-depth understanding of the power of default options as described in existing academic research. As such, and given

time and space constraints, please allow me to focus on the second issue. My overall concern is that the regulations place too much emphasis on “savings” aspect of investment options, at the expense of the equally important “retirement income” aspect of investment options.

A large body of academic research has clearly indicated the important role that guaranteed lifetime income products, such as life annuities, play in insuring retirees against the risk of outliving their resources. Indeed, it is my opinion that one of the major shortcomings of most existing self-directed retirement plans is that they fail to provide adequate options in the payout phase for insuring against longevity risk. A full discussion of the reasons for this shortcoming is well beyond the scope of this letter, but it is at least partially influenced by the regulatory environment.

In recent years, a number of insurance companies have begun to place an increasing focus on consumer needs in this area. Insurers have begun developing new products that allow individuals to invest, during the accumulation period, in products that offer valuable options to convert the accumulated account balance into a lifelong income stream upon retirement. Such annuitized income streams can be shown to substantially increase the well-being of retirees by providing a higher sustainable level of income than any alternative investment strategy of comparable risk. Indeed, academic research suggests that providing access to annuitized income during retirement is equivalent, in terms of overall improvements in well-being, to an increase in wealth of as much as 50 percent.

My primary concern with the proposed regulations is that the qualified default investment alternatives are focused solely on asset allocation, with little or no consideration given of how these assets will ultimately be converted into an income stream at retirement. While one might be tempted to view the accumulation and payout issues as separable, this view is overly narrow and misses a valuable opportunity to encourage firms to offer investment options that encourage individuals to consider opportunities to insure that they have adequate income in retirement. As already noted, a number of companies have begun to offer investment options that include implicit or explicit options to annuitize, a feature that has value over and above the underlying portfolio allocation decision.

Furthermore, as nearly 80 million baby boomers approach retirement, the incentive for financial services providers to develop new and innovative products to more broadly address retirement income security will be large. As such, I anticipate that the marketplace of ideas will bring forward many new products that combine features of asset accumulation with features that address the broad range of risks faced by retirees, including longevity risk, inflation risk, and even medical expenditure risk.

In my opinion, a severe shortcoming of the proposed regulations is that “the relief provided by the proposed regulation is conditioned on the use of certain investment alternatives,” and that these investment alternatives are entirely divorced from considerations related to the payout phase. As such, the regulations may have the effect

of unintentionally biasing plan sponsors to focus on issues of asset allocation, instead of on issues that might be of even greater importance to ultimate retirement income security.

I would strongly encourage the Department of Labor to broaden the class of qualified default investment alternatives to include products that are designed to address the retirement *income* needs of retirees, rather than focusing solely on portfolio allocation issues. *To put it simply, saving enough for retirement is only half of the equation. Making those savings last for a lifetime is the other half, and this aspect appears to have been neglected in the formation of these regulations.*

I apologize for the brevity of these comments. I would be happy to provide the Department of Labor with a detailed set of academic and policy papers that speak to the importance of guaranteed lifetime income as part of a retirement portfolio, if such information would be deemed helpful.

Thank you for the opportunity to comment.

Sincerely,

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