STATEMENT OF ELIZABETH MACGOWAN
ON BEHALF OF THE INDEXED ANNUITY LEADERSHIP COUNCIL
BEFORE THE ERISA ADVISORY COUNCIL
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I am Elizabeth MacGowan, Vice President of Strategy & Business Development at National Life Group®.[1] Being the first insurer to offer fixed indexed annuities ("FIAs") to non-ERISA 403(b) plans, our company has years of experience offering lifetime income to retirement savers. Today, we have approximately 377,000 FIA policies in force, most of which are issued to public school teachers, clergy, and employees of small non-profit organizations. I hope that my testimony today will provide some insight to the Advisory Council on how to extend to participants in ERISA qualified plans what we offer 403(b) participants, especially as a possible qualified default investment alternative ("QDIA").

I am here today testifying not only on behalf of National Life Group®, but also on behalf of the Indexed Annuity Leadership Council ("IALC"). The IALC is a consortium of life insurance companies that offer fixed indexed annuities ("FIAs") and is comprised of Allianz Life Insurance Company of North America, American Equity Investment Life Insurance Company, Athene Annuity and Life Company, Life Insurance Company of the Southwest, Midland National Life Insurance Company, National Life Insurance Company, and North American Company for Life and Health. In 2011, the IALC was established with a commitment to providing complete and factual information about the use of FIAs as a part of a balanced financial plan. The IALC mission is to help educate consumers, the media, regulators, and industry professionals about the benefits of FIAs.

A recent IALC survey conducted in March of this year shows Americans' concern that they may outlive their retirement savings. According to the survey, 78% of workers are looking for lifetime income when it comes to retirement planning, while nearly as many (76%) seek stability of income, and principal protection from market volatility (71%). Our study shows that almost one-fifth of all Americans approaching retirement are at the low end of the readiness spectrum, having saved 20 percent or less of the money they will need for retirement. Furthermore, one-third of American workers believe that they will spend more in retirement than they have saved

[1] National Life Group® is a trade name of National Life Insurance Company, Montpelier, VT, Life Insurance Company of the Southwest, Addison, TX and their affiliates. Each company of National Life Group is solely responsible for its own financial condition and contractual obligations. Life Insurance Company of the Southwest is not an authorized insurer in New York and does not conduct insurance business in New York.

for retirement. Personally, I suspect in reality the percentage of Americans who risk outliving their retirement savings is far greater.

The capacity of pension plans to offer automatic enrollment has certainly increased participation rates. Given what we know today about the need for lifetime income options, however, it is appropriate to revisit the QDIA rules that were adopted more than a decade ago. The default investment option for too many working Americans is more than a temporary investment; according to a 2015 Vanguard report,[2] participants in automatic enrollment plans are up to three times more likely to remain in the default investment option designated by the employer than to select an alternate investment option after 3 years (the period studied). Despite its importance to retirement security, the QDIA rules prevent the use of many kinds of annuities, including FIAs, from serving in a QDIA in an ERISA plan.

Fixed annuities, including FIAs, are products that currently respond to consumer demand for lifetime income features.

Fixed indexed annuities have been available for more than 20 years. Today, in-force fixed indexed annuity policies represent approximately $303.4 billion in asset value. FIAs are contracts that provide protection against market loss because insurance companies, rather than policyholders, assume the risk of market downturns. The policyholder can select an interest crediting method to policy values which can be (1) a declared in advance fixed rate, or (2) an interest rate based on a formula that references a market index. However, the index is merely used to compute interest earnings credited to the policy, and there is no actual investment by the policyholder or the insurance company in the particular index; instead, the general account of the insurance company stands behind the policy. There is no risk of loss of principal so long as policyholders do not surrender their contracts prematurely, and any earnings credited to the policy are guaranteed and cannot be lost or reduced in future periods. The policy typically allows a policyholder to change the interest crediting method annually.

State insurance commissioners regulate FIAs and approve the contract terms. In addition, FIAs are backstopped within state prescribed limits by state guaranty funds in the event that an insurance company becomes insolvent.

FIAs are not structured as short-term contracts. If a policyholder decides to cash-out the policy prematurely, the policyholder may incur a surrender charge. Typically, policies provide for the waiver of such charges under certain circumstances, and these charges decrease over a period that generally is seven to ten years. Surrender charges are an important part of FIA contracts. These charges protect insurance companies from losses due to early termination and allow these

[2] JEFFREY W. CLARK, ET AL., AUTOMATIC ENROLLMENT: THE POWER OF THE DEFAULT, VANGUARD (2015).

companies to make long-term investments, thereby allowing higher earning potential for policyholders.

Consumers may add various options or riders to their FIA policy. One of the most popular riders today is a lifetime income benefit rider. Lifetime income riders guarantee a lifetime income that the policyholder cannot outlive. They are an alternative to annuitizing the policy. When a policy is annuitized, it is possible that the policyholder will never receive a payout that equals the account balance at the time it is annuitized. A lifetime income rider, on the other hand, provides for monthly lifetime income that reduces the account balance, and even if the policyholder outlives the account balance, the monthly payments continue. The rider also allows access to all or a portion of the account balance should the policyholder's life circumstances require a payout; and if the policyholder dies before receiving payments equal to the policy's full value, the balance is payable to designated beneficiaries.

FIAs and their features have changed over time to reflect consumer demands. The lifetime income rider is a feature that responds to consumer concerns that committing to an annuitization feature at the beginning of a contract may result in a windfall to the insurance company and little or no payout to the policyholder. Currently, in our 403(b) contracts, a majority of new policyholders elect a lifetime income rider.

The QDIA regulations do recognize the value of offering income protection, because they currently provide that an investment fund product or model portfolio that otherwise meets the requirements of the rules can qualify as a QDIA even if the product or portfolio is offered through variable annuities or similar contracts – thus, permitting contracts or funds that offer annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment fund product or model portfolio.[3] Unfortunately, however, I am told by those who are ERISA experts that because of how the regulation defines the approved types of investments, the typical FIA would not qualify as a QDIA (or at least there is uncertainty as to it qualifying).

We believe that FIAs with a lifetime income rider satisfies ERISA's requirement that a QDIA include asset classes consistent with "capital preservation or long-term capital appreciation, or a blend of both."[4] While today the QDIA regulations only designate life cycle/targeted date funds, balanced funds, and managed accounts as QDIAs, we believe the regulations could be modified to allow FIAs with a lifetime income rider to qualify as a QDIA with appropriate participant protections.

Although our experience in the 403(b) universe requires the policyholder to affirmatively elect to acquire the policy and make decisions about the policy's features, a default investment must be

[3] 29 C.F.R. § 2550.404c-5(e)(3)(vi).
[4] ERISA § 404(c)(5)(A).

subject to appropriate safeguards. We would suggest the following limitations on a FIA with a lifetime income rider used for a QDIA:

- While a participant could always elect a market index for crediting purposes on an annual basis, the default mechanism could be an annually declared fixed rate. This would allow daily interest crediting and prevent the potential loss of partial year earnings since index crediting methods are credited at year end.

- The current DOL regulations require that a participant be allowed to withdraw or transfer assets without any restrictions, fees, or expenses during the first 90 days of the investment in the QDIA. While FIAs generally are required to have a free look period,[5] the period is usually shorter than 90 days. However, we believe the industry could find ways to adapt to the current DOL regulation if required.

- While the current QDIA rules do not prohibit surrender charges after the initial 90 days period, we appreciate that some may be concerned about this annuity contract feature. Surrender charges could be limited in duration and subject to an annual reduction until the charges are eliminated after a certain period. Given the data cited earlier that most default investments are not changed by the plan participant, we believe specifying a maximum period consistent with current industry practices is appropriate. It is important to remember that surrender charges allow an insurance company to maximize amounts that can be credited to a policy by permitting longer term investments to support the interest credit. In addition, FIAs frequently waive surrender charges under certain circumstances such as death, disability, and other specified hardships. In any event, there would always be fiduciary oversight of the product’s fees, as there are with all QDIAs.

- In addition, we would suggest that annual statements to plan participants include disclosure of the surrender charges that remain, the crediting options available, and the time and manner for exercising them. Also, annual statements should show lifetime income amounts that would be paid at a specified retirement age. Finally, we recommend that prior to any participant election becoming effective that would trigger a surrender charge the participant receive a notice describing the surrender charge that will apply.

The IALC believes qualifying FIAs with a lifetime income rider as a QDIA would be an effective way to protect plan participants from outliving their retirement savings. And if properly structured, such products would be totally consistent with ERISA’s policy objectives. From our own company’s experience, we believe it is unfortunate that the opportunities we can offer 403(b) arrangements cannot today be offered to other defined contribution plan participants.

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[5] A free look period is a period of time in which the policyholder may decide to cancel the policy and receive a full refund.

The IALC once again appreciates the opportunity to testify today and I am happy to answer any questions you have about FIAs.