

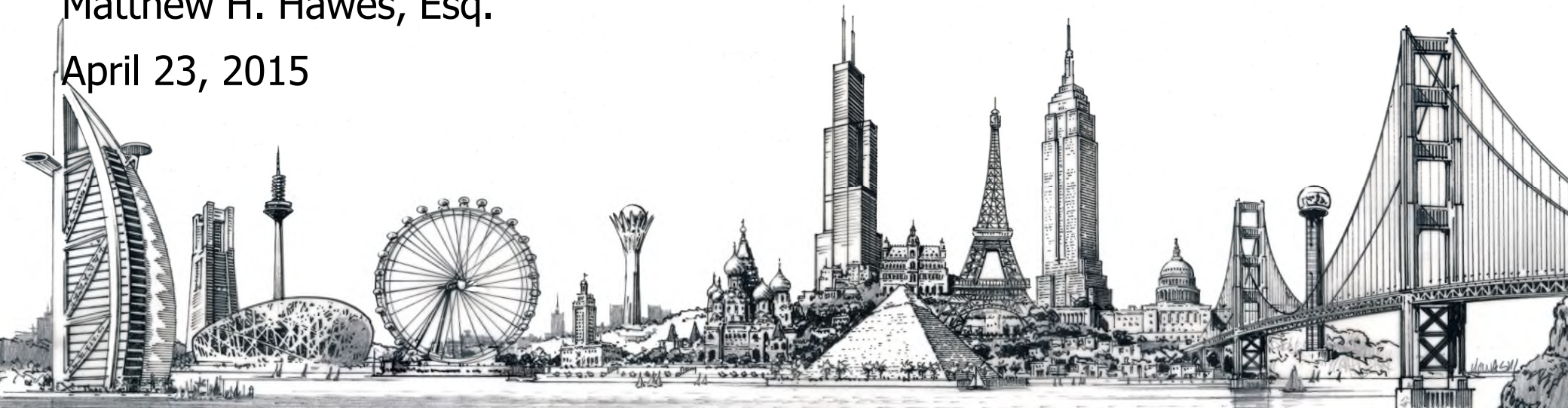
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# **LIFETIME INCOME OPTIONS IN RETIREMENT PLANS**

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# OVERVIEW OF TODAY'S DISCUSSION

Background on factors and concerns driving interest in lifetime income options

- Retirement system in transition
- Demographics and longevity

Government responses

- Treasury/Internal Revenue Service
- Department of Labor

Options for defined contribution plan sponsors to consider

- Qualified Longevity Annuity Contracts (QLACs)
- Target Date Funds with Deferred Annuities

# BACKGROUND

## Retirement system in transition

- Continuing transition from defined benefit plans to defined contribution plans, but employee retirements just starting
- Participants primarily responsible for decision-making
- Education and legal changes have been focused on expanding 401(k) plan participation and assets (automatic enrollment and escalator features, fee disclosures, Qualified Default Investment Alternatives)

## Growing concern that retirees may exhaust or outlive retirement savings

- Increased life expectancy and increased costs of retirement
- Uncertainty regarding future of Social Security

# BACKGROUND (cont'd)

Annuity distribution features rare in defined contribution plans (other than, perhaps, for 403(b) plan participants)

Even where available, little participant interest – why?

- Absence of control over investment
- Fees/cost of annuity
- Concern over lost value in the event of early death
- Fixed payment amount; inability to make changes or withdrawals

# GOVERNMENT RESPONSE

Broad efforts by government regulators to:

- Improve access to, and use of, lifetime income products
- Address concerns that participants lack sufficient information to evaluate defined contribution plan accounts in terms of lifetime income stream

Recent IRS and DOL guidance to encourage use of lifetime income options

- Clarified QJSA/QPSA rules applicable to deferred annuity contracts (Rev. Rul. 2012-3)
- Clarified defined contribution to defined benefit plan “rollovers” (Rev. Rul. 2012-4)
- Proposed simplifying method for calculating a distribution as partial lump sum and partial annuity (Prop. Reg. 1.417(e)-1)

# GOVERNMENT RESPONSE (cont'd)

Recent DOL guidance designed to address concerns that participants lack adequate information to evaluate sufficiency of future retirement income

- Notice of proposed rulemaking describing lifetime income disclosure regulations (78 Fed. Reg. 26727 (Proposed May 8, 2013))
- Benefit statements would be required to include:
  - Current account balance and monthly lifetime annuity payments as if participant had already reached normal retirement age
  - Projected account balance and estimated lifetime monthly income stream based on reasonable assumptions (savings rate, earnings, etc.) at normal retirement age

See DOL lifetime income calculator: <http://www.dol.gov/ebsa/regs/lifetimeincomecalculator.html>
- Plan sponsor concerns about potential lawsuits based on “unrealized expectations”

# OPTIONS FOR PLANS

Offering access to education on longevity issues and consequences of early withdrawal of plan balances

- Issues concerning fiduciary nature of communication (i.e., is financial advice to leave money in plan subject to fiduciary standard?)

Design changes to make accessing plan money easier

- Partial withdrawals
- Post-termination loans

Managed retirement accounts

- Personalized investment advice

Add annuity distribution feature

# OPTIONS FOR PLANS (con't)

## Investment alternatives

- Qualified Longevity Annuity Contracts (QLACs)
- Target Date Funds with deferred annuity features
- Others?



# QUALIFIED LONGEVITY ANNUITY CONTRACTS (QLACs)

Final Regulations issued July 2014 establish basic QLAC requirements as follows:

- Premiums must equal the lesser of 25% of the account balance or \$125,000
- Distributions must start by a specified date but not later than age 85
- Benefits paid after employee's death generally must be payable in the form of a life annuity
- No conversion or cash surrender right; may not be a variable or equity-indexed contract
- Purchaser and IRS disclosures

# QUALIFIED LONGEVITY ANNUITY CONTRACTS (QLACs) (cont'd)

## Key Elements to Final QLAC Regulations

- Opportunity correct participant's payment of excess premiums (i.e., over the 25%/ \$125,000 cap) without disqualification of the QLAC
  - Change addressed comments on the difficulty of tracking participants who do not purchase QLACs in lump sums
- Return of premiums permitted if participant dies early
  - More attractive to those who are unwilling to risk loss of premiums paid to buy the annuity

# QLAC BARRIERS AND HURDLES

Portability - how to deal with “lifetime guarantees” purchased with a portion of a defined contribution plan account balance when something happens to the plan or participant

- Employer terminates the plan
- Plan changes vendors and/or ceases the purchase of these products
  - Mapping annuity guarantees from one carrier to another carrier
  - Redemption costs/fees
- Participants terminate employment and seek distribution of annuities

# BARRIERS AND HURDLES (cont'd)

## Fiduciary issues

- Concerns surrounding the risk of fiduciary liability associated with selecting an annuity provider
- Regulations issued by the DOL in 2008 provide a “safe harbor” for demonstrating prudence in selecting annuity providers for plan distributions
  - Conditions for satisfying “safe harbor” are vague and subjective
  - Concerns over solvency risk of a long-term issuer or a product that proves inferior to others on the market

## Unisex pricing

- May be unfavorable for male participants

## Nondiscrimination testing

- Annuities must be currently available to a nondiscriminatory group of employees
- Providers may have restrictions, such as minimum account values

# BARRIERS AND HURDLES (cont'd)

## Possible anti-cutback protections

- Annuities/QLACs may be considered hybrid investment options/distribution option for anti-cutback purposes
- Protected benefit problem if plan specifies distribution options under the annuity contract and the plan changes annuity carriers

## Administrative issues

- Monitoring the \$125,000/25% limit for QLACs could pose challenges, particularly when participants make multiple annuity purchases
- Complications could arise when administering loan limits, qualified domestic relations orders, and QLACs purchased with after-tax money

# BARRIERS AND HURDLES (cont'd)

## Other barriers and hurdles

- Participant fear of locking-up money
- Current low interest rates make longevity annuities very costly
- QLACs cannot be variable or equity-indexed annuities – thus, funds used to make the purchase are “out of the market” and beyond participant control
- Product features may be confusing to both participants and plan sponsors
- Concerns about the insurance carrier’s long-term financial stability

# TARGET DATE FUNDS WITH DEFERRED ANNUITY FEATURE

IRS and DOL released coordinated guidance to help defined contribution plans add a lifetime income feature as part of TDF

- IRS guidance (Notice 2014-66) addresses possible nondiscrimination testing concerns regarding lifetime income features in TDF
- TDF series that meets certain requirements will be considered a single “benefit, right or feature” for nondiscrimination testing purposes
  - Only difference among TDFs is asset allocation mix, which is designed to achieve age-band-appropriate investment risk; all other rights and features are the same
  - Younger participants must be able to “age in” to TDF with deferred annuity option
  - Cannot include “guaranteed minimum” or “guaranteed lifetime withdrawal” benefit
  - Cannot hold employer securities that are not readily tradable

# TARGET DATE FUNDS WITH DEFERRED ANNUITY FEATURE (cont'd)

- DOL guidance – “Mark Iwry” Letter
  - Confirmed that TDFs with deferred annuity may qualify as a QDIA
  - Confirmed that selection of deferred annuity as a plan investment is subject to the annuity selection “safe harbor”
  - Noted that plan sponsor is expected to prudently select designated investment manager and monitor selection at reasonable intervals



# OTHER FORMS OF ANNUITY/INVESTMENTS

Other forms of annuity/investments (not currently available to retirement plans)

- Guaranteed Lifetime Withdrawal Annuities
  - At a cost, annuity provider provides a guaranteed floor on annual withdrawal amounts beginning after specified age

# Questions?

# Biography



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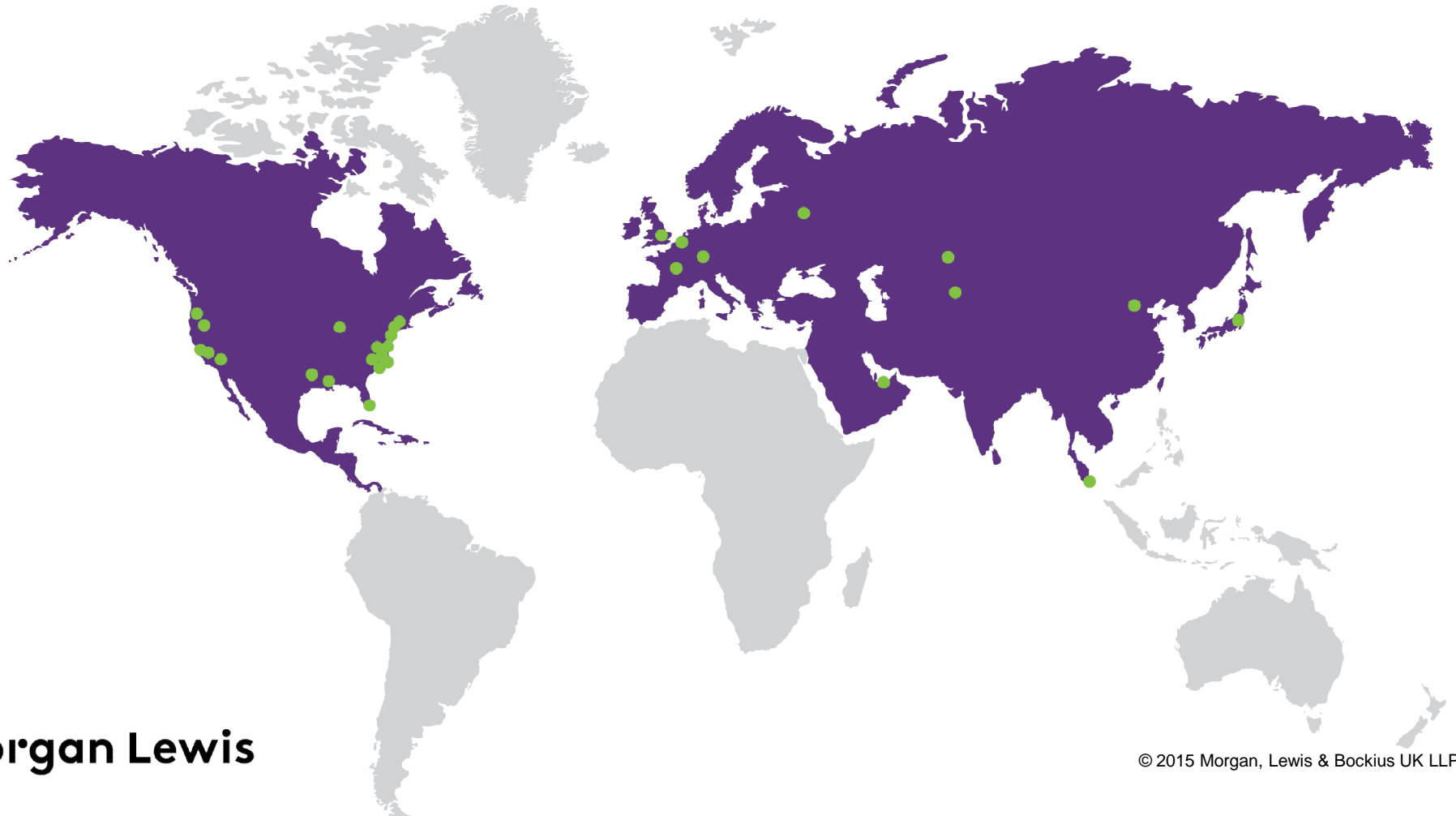
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