

LIFETIME INCOME OPTIONS

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LIFETIME INCOME OPTIONS

I. Lifetime Income Options

One of the key retirement security goals of the Obama Administration is to “reduce barriers to annuitization of 401(k) plan assets” and promote “guaranteed lifetime income products, which transform at least a portion of retirees’ savings into guaranteed future income, reducing the risks that retirees will outlive their savings or that their living standards will be eroded by investment losses or inflation.”¹

A. DOL and IRS Request for Information. In connection with the Administration’s goals to promote DC plan annuitization, the DOL, Internal Revenue Service and the Treasury Department issued a joint release on February 2, 2010, requesting information regarding lifetime income options for participants in retirement plans. In this release, these agencies announced that they were currently reviewing the rules under ERISA and the related rules under the Internal Revenue Code, to determine whether and how they could enhance the retirement security of participants by facilitating access to lifetime income arrangements. The requests for information addressed a range of topics, including participant education, required disclosures, 401(k) plan and other tax-qualification rules, selection of annuity providers, ERISA Section 404(c) and QDIAs.

B. The Retirement Security Project. The Retirement Security Project, a joint venture of the Brookings Institution and the Urban Institute, has released two white papers regarding DC plan annuitization. These papers have generated a significant amount of interest, given the fact that they were co-authored by Mark Iwry, who was recently appointed by the Treasury Secretary to serve as the Deputy Assistant Secretary for Retirement and Health Policy. The white papers include proposals to encourage DC plan annuitization by using deferred annuities as the default investment for participants for certain purposes.

C. Legislative Proposals. A number of bills have been introduced in Congress, which are designed to provide tax incentives to save for retirement through annuities (e.g., Lifetime Pension Annuity for You Act, Retirement Security for Life Act). These bills typically encourage annuitization by exempting a percentage of annuity income up to a stated threshold (e.g., \$5,000 for individuals or \$10,000 for couples). Although they typically do not extend this exemption to annuity payments from defined benefit plans, they do exempt annuity payments made from DC plans.

In contrast to these tax-related measures, the Lifetime Income Disclosure Act puts a different spin on the subject of lifetime income and 401(k) plans.² Under this proposed legislation, 401(k) plan sponsors would be required to inform participants annually of how their account balances would translate into guaranteed monthly payments – a “retirement paycheck for

¹ *Annual Report of the White House Task Force on the Middle Class*, February 2010.

² U.S. Senators Jeff Bingaman (D-NM), Johnny Isakson (R-GA), and Herb Kohl (D-WI) introduced this bill in December 2009.

life." The goal of this legislation is to give participants an understanding of how much projected retirement income they can expect from their savings. The legislation directs the DOL to issue tables that employers may use in calculating an annuity equivalent and model disclosures. Employers and service providers who use the model disclosure and guideline assumptions would be insulated from liability under ERISA.

D. Tax Requirements. The IRS addressed various tax-qualification requirements for DC plans with variable group annuity investment options for participants in PLR 200951039. This private letter ruling was helpful to the benefits community since it illustrated how these plans were viewed with respect to the age 70 ½ minimum distribution requirements and for purposes of the QJSA rules. In sum, DC plans with annuity investment options were not subject to any "surprise" interpretations with respect to these rules.

E. Lifetime Income Hearing by Senate Special Committee on Aging. On June 16, 2010, the U.S. Senate Special Committee on Aging convened a hearing entitled, "The Retirement Challenge: Making Savings Last a Lifetime." The hearing explored options to help retirees transform their retirement savings into lifetime income, taking a close look at 401(k) plan participants in particular. According to Senator Kohl, chairman of the Senate Special Committee on Aging, the hearing was the start of a legislative debate about how the government can help Americans make their retirement savings last a lifetime. In his opening statement, he stated that, "[o]ur goal is to find ways to ensure retirees have access to lifetime income options that provide adequate consumer protections at a reasonable cost." In his view, the focus of most education efforts have been on encouraging people to save, and not about how to make their savings last.

At the hearing, Phyllis Borzi (Assistant Secretary of Labor) and Mark Iwry (Deputy Assistant Secretary for Retirement and Health Policy at the Treasury Department) presented their early analysis of the responses they received to the RFI on lifetime income options, jointly released by the DOL, IRS and Treasury on February 2, 2010. The RFI attracted more than 780 responses from the public. Many of the comments were submitted by individuals who said they were worried that the RFI was the first step in a government plan to take over 401(k) plans. However, Assistant Secretary Borzi clarified that the DOL and the Obama administration had no intention of taking over workers' 401(k) plans. She indicated that the agencies simply wanted to know if promoting lifetime income vehicles were a good idea, and, if so, if there were ways for the government to improve access to them. These comments from the DOL were consistent with Senator Kohl's opening statement, in which he had also clarified that he was in favor of making lifetime income options available at a fair price, and that he did not advocate any type of mandate that would force people to purchase lifetime income products.

F. Joint Hearing by DOL, IRS and Treasury in September 2010. On September 14th and September 15, 2010, the DOL, IRS and the Treasury Department held a 2-day joint hearing to consider the specific issues raised in the various comments submitted by the public in response to the RFI regarding lifetime income options.³

In contrast to the jointly released RFI on February 2, 2010, which solicited comments on a broad array of topics concerning lifetime income options, the September hearing focused on 5 specific areas of concern.

They included the following 2 areas of general policy-related interest:

- i Specific Concerns Raised by Participants. Participants and participant representative groups had expressed concern about lifetime income options in general (*e.g.*, inflation risk, product complexity and fees, the long-term viability of issuers of annuity products, limited availability of death benefits and withdrawal options). The agencies heard testimony exploring and addressing these concerns.
- i Alternative Designs of In-Plan and Distribution Lifetime Income Options. The respective agencies were also interested in exploring the different ways in which lifetime income options can be made available in plans, including both insurance and non-insurance design solutions (*e.g.*, managed payout funds).

The hearing also focused on the following 3 areas of specific interest:

- i Fostering Education to Help Participants Make Informed Retirement Income Decisions. The agencies were interested in hearing about the type of information that would help participants make better informed decisions regarding their retirement income. DOL Interpretive Bulletin 96-1 provides guidance on how plan sponsors can provide “investment education” to participants without fiduciary liability, and the DOL appears to be interested in expanding it to cover “retirement income education.”
- i Disclosure of Account Balances as Monthly Income Streams. Along the lines of various legislative proposals such as the *Lifetime Income Disclosure Act*, the agencies were interested in hearing how participants may be more likely to choose lifetime income options if their benefit statements were to include disclosures noting what their individual accounts are worth when converted to a hypothetical monthly benefit.

³ The agency representatives involved in coordinating the hearing include (i) Mark Iwry, Senior Advisor to the Secretary, Deputy Assistant Secretary for Retirement and Health Benefits, Department of the Treasury, (ii) Nancy Marks, Division Counsel/Associate Chief Counsel, Tax Exempt and Government Entities, IRS, and (iii) Phyllis Borzi, Assistant Secretary, EBSA, DOL.

- i Modifying Fiduciary Safe Harbor for Selection of Issuer or Product. Under current law, a DOL regulatory “safe harbor” provides guidelines on how a plan fiduciary can prudently select an annuity provider for its DC plan.⁴ This safe harbor is largely procedural, requiring an objective, analytical search for an annuity provider, in consultation with an expert as necessary. The agencies heard testimony on whether these safe harbor standards should be modified, and whether they should apply more broadly to other types of lifetime income products.

Given the specificity of these 3 areas, it appears that the DOL and Treasury Department (and IRS) have narrowed their areas of focus, which could signal that these agencies are preparing to move ahead with rulemaking in these areas.

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⁴ 29 CFR 2550.404a-4.