

The New Fiduciary Rule and Annuities

DOL clarifies some items



THE OBAMA administration views how people draw down their retirement savings to be just as important as encouraging them to save in the first place. It is particularly concerned with the risk that retirees will outlive their assets, and wishes to mitigate this risk by motivating plan sponsors and participants to annuitize retirement benefits.

If a defined contribution (DC) plan sponsor is interested in offering lifetime income options, it can do so on a voluntary basis, taking one of three approaches. First, participants may be directed to external annuities outside the plan. Just as retirees may roll over their 401(k) plan account balance to an individual retirement account (IRA), they may also roll it over to an individual retirement annuity, leaving the selection of the provider up to the participant.

Second, if the sponsor of a defined contribution plan wants to be more proactive, it may provide, inside the plan, a group annuity that gives participants both investment and distribution options.

Finally, the plan sponsor may offer an annuity distribution option within the plan, pursuant to which a plan fiduciary selects the annuity provider. When a participant retires, his entire account balance is used to pay the purchase price of a distribution annuity, either immediately or deferred, and the annuity contract is distributed to the participant.

Choosing an annuity provider is a fiduciary function, governed by the Employee Retirement Income Security Act (ERISA)'s standards of prudence and loyalty. Uncertainty over the scope and duration of this duty has made some sponsors reluctant to offer distribution annuities, but in Field Assistance Bulletin (FAB) 2015-02, issued this past July, the Department of Labor (DOL) has attempted to clarify certain issues in order to eliminate these qualms.

In 2008, the DOL released a safe harbor ruling specifically for DC plans that provide distribution annuities. Its five components are:

1) The plan sponsor or other plan fiduciary must observe general procedural prudence by engaging in an objective and analytical search to identify and select the annuity provider. This search must avoid improper influences, such as self-dealing and conflicts of interest;

2) The plan fiduciary must use the information it has gathered to assess the annuity provider's ability to make all future payments under the annuity;

3) The plan fiduciary must also consider the annuity's cost—i.e., fees and commissions—in relation to benefits and services under the annuity;

4) The plan fiduciary must then draw appropriate conclusions regarding points 2 and 3, based on the infor-

The plan fiduciary must also consider the annuity's cost.

mation obtained through this process as of the time of the selection; and

5) Finally, expert advice must be sought, as necessary.

FAB 2015-02 indicates that the DOL is considering amendments to the safe harbor and offers some immediate clarifications. The FAB reiterates that a fiduciary is not required to review the appropriateness of its conclusions with respect to an annuity contract once it has been purchased for a specific participant or beneficiary. It goes on to note that the periodic review requirement does not mean that a fiduciary must review the initial decision to retain an annuity provider every time a participant or beneficiary elects an annuity as a distribution. While regular, periodic reviews would be expected, a more rapid response might be required if annuitants have submitted complaints about untimely payments or if insurance rating agencies have downgraded an annuity provider.

The FAB also considers the duration of a plan fiduciary's monitoring duty in the context of two factual examples, the first involving an immediate annuity and the second a longevity option that does not begin providing income until a specified date 10 to 15 years after retirement. In the first example, the fiduciary periodically reviews the provider of the immediate annuities but at some point replaces this product with a more competitive annuity from another provider. The FAB concludes that the fiduciary's monitoring obligation with respect to the first provider ends when the plan stops offering its product.

Similarly, in the example involving the longevity annuity, the FAB indicates that the duty to monitor the provider ends when longevity annuities from that provider are no longer offered as a distribution option by the plan.

The FAB will be helpful to some plan sponsors and their advisers, but more assurance may be needed to convince many more that they would not be exposing themselves to additional liability by offering distribution annuities through their plans.

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