

Special Commentary

Final clarification of the annuity selection safe harbor for defined contribution plans and new lifetime income disclosure requirement

New law addresses plan sponsor fiduciary responsibilities when offering income annuities; requires lifetime income disclosures

On December 20, 2019, bipartisan legislation was passed by Congress and signed into law, which is designed to enhance workplace defined contribution (DC) retirement plans, such as 401(k) plans, by removing regulatory obstacles and expanding access to savings and lifetime income. The new law is the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, which was contained in the Consolidated Appropriations Act, 2020. While there are many provisions included in the SECURE Act of 2019, there are two specific provisions that are covered in this Special Commentary whitepaper:

- Fiduciary safe harbor for selecting a lifetime income provider
- Disclosure regarding lifetime income

Safe harbor for annuity carrier selection: why a workable safe harbor was needed

With original annuity safe harbor, plan sponsors had fiduciary liability concerns

For many years, the insurance industry has advocated for a workable annuity carrier selection safe harbor for 401(k) plans to permit reliance on state insurance regulators for financial strength, and focus instead on provider and product selection process requirements, as is customary with other fiduciary safe harbors.

For historical background, as a result of a provision included in the Pension Protection Act of 2006, the U.S. Department of Labor (DOL) issued a regulation in 2008 regarding the fiduciary standard to be applied by DC plan sponsors when selecting an annuity provider. That standard, incorporated in DOL regulation 29 CFR §2550.404a-4, contained a fiduciary safe harbor for the selection of annuity providers for the purpose of benefit distributions from DC plans.

The 2008 safe harbor had addressed some of the concerns raised by plan sponsors about the “safest available annuity” standard promulgated by the DOL with respect to defined benefit plans (29 CFR §2509.95-1). This included the statements that the fiduciary does not have to choose the “safest” annuity available, and that the fiduciary duty generally applies at the time of selection (with an ongoing duty to monitor the selection and act prudently with regard to future annuities provided). However, even with the simplification of the fiduciary standard that the DOL promulgated, DC plan sponsors continued to express concern about their ability to implement the standard without exposure to fiduciary liability, particularly with regard to their obligations once an annuity provider had been selected. The primary concern was the complexity of the provision on assessing carrier financial strength and the related uncertainty over adequacy of effort to qualify for fiduciary protection. That previous guidance required an employer to look at the capital requirements, liquidity and solvency of an insurer for the duration of an annuity contract.

DOL clarified the time of selection standard in 2015 but some fiduciary concerns remained

On July 13, 2015, the DOL, through its Employee Benefits Security Administration, published a Field Assistance Bulletin (FAB) clarifying the duty of an employer in selecting and monitoring an annuity provider for benefit distributions from 401(k) and other DC plans. In FAB 2015-02, Selection and Monitoring under the Annuity Selection Safe Harbor Regulation for Defined Contribution Plans, the DOL clarified the “time of selection” standard in the DOL’s 2008 safe harbor rule covering the applicable fiduciary responsibilities when selecting and monitoring annuity providers for a DC plan. It explained that, under the safe harbor, the ongoing monitoring obligations generally end when the plan no longer offers the annuity as a distribution option, not when the insurer finishes making all promised payments. At the time that FAB 2015-02 was released, the DOL noted that it was considering issuing additional guidance on the annuity selection safe harbor that would primarily focus on the condition in the safe harbor relating to the ability of the annuity provider to make all future payments under the annuity contract. However, that guidance had not been released, hence the SECURE Act of 2019 was signed into law on December 20, 2019.

Safe harbor for annuity carrier selection: what the new law means

New law makes clear plan sponsors' role in evaluating an annuity provider

This new safe harbor utilizes state insurance regulators and an annual certificate provided to the employer confirming an insurer's solvency. This simplifies the insurer review process for employers, negating the need for them to conduct ongoing review of an insurer's capital requirements, liquidity and solvency. Instead, in summary, the employer is able to rely on written representations from the insurer, which must confirm that the insurer has complied with certain regulatory, financial reporting and auditing requirements; undergoes an examination by the insurance commissioner in its state of domicile at least every five years; and, agrees to notify the employer of any changes in such circumstances.

Specifically, the language of the new law states that Section 404 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104) is amended by adding at the end the following: "With respect to the selection of an insurer for a guaranteed retirement income contract, the requirements of subsection (a)(1)(B) will be deemed to be satisfied if a fiduciary: "engages in an objective, thorough, and analytical search for the purpose of identifying insurers from which to purchase such contracts" and adheres to the following: "considers the financial capability of such insurer to satisfy its obligations under the guaranteed retirement income contract; considers the cost (including fees and commissions) of the guaranteed retirement contract; and considers the cost (including fees and commissions) of the guaranteed retirement income contract offered by the insurer in relation to the benefits and product features of the contract and administrative services to be provided under such contract."

In the law, "'guaranteed retirement income contract' means an annuity contract for a fixed term or a contract (or provision or feature thereof) which provides guaranteed benefits annually (or more frequently) for at least the remainder of the life of the participant or the joint lives of the participant and the participant's designated beneficiary as part of an individual account plan."

Additionally, consistent with FAB 2015-02, the new law states that the fiduciary must conclude that “at the time of the selection, the insurer is financially capable of satisfying its obligations under the guaranteed retirement income contract” and “the relative cost of the selected guaranteed retirement income contract...is reasonable.” The law does not require the fiduciary to review the appropriateness of a selection after the purchase of a contract for a participant or beneficiary.

A fiduciary will be deemed to satisfy the requirements of the new law if the fiduciary obtains written representations from the insurer that:

- the insurer is licensed to offer guaranteed retirement income contracts and
- the insurer, at the time of selection and for each of the immediately preceding seven plan years:
 - operates under a certificate of authority from the insurance commissioner of its domiciliary State which has not been revoked or suspended
 - has filed audited financial statements in accordance with the laws of its domiciliary State under applicable statutory accounting principles;
 - maintains (and has maintained) reserves which satisfies all the statutory requirements of all States where the insurer does business; and,
 - is not operating under an order of supervision, rehabilitation, or liquidation.

Additionally, the insurer must undergo, at least every five years, a financial examination by the insurance commissioner of the domiciliary State (or representative, designee, or other party approved by such commissioner). The insurer will notify the fiduciary of any change in circumstances occurring after the provision of the representations above which would preclude the insurer from making such representations at the time of issuance of the guaranteed retirement income contract. Additionally, the fiduciary is not required to review the appropriateness of the selection [of an insurer] after the purchase of a contract for a participant or beneficiary.

According to the new law, a fiduciary may consider the value of a contract, including features and benefits of the contract and attributes of the insurer (including, without limitation, the insurer’s financial strength), in conjunction with the cost of the contract. However, nothing in the law shall be construed to require a fiduciary to select the lowest cost contract.

How can plan sponsors add an income annuity to their DC plan?

Enhancing a DC plan with income annuities

According to MetLife's latest research, nearly all workers and retirees (95%) say it's important for retirees to have a source of guaranteed income they cannot outlive.¹ Eight in ten employers (82%) that had been awaiting clarification on the annuity safe harbor said they were likely to offer a guaranteed income option within the next five years once the clarification was issued.²

An income annuity can be added to a DC plan in five simple steps:

1. Select the provider
2. Amend the plan
3. Notify plan participants and beneficiaries
4. Modify the summary plan description and the election benefit form
5. Establish procedures for administration and 5500 filing

Lifetime income disclosure requirement: translating savings into income

Many plan sponsors and participants recognize the value of showing an annuity equivalent

The DOL has stated that it has authority to require lifetime income illustrations under Section 105(a)(2) of ERISA, which contains the content requirements for benefit statements. Section 105(a)(2)(A)(i)(I) requires a benefit statement to indicate the participant's or beneficiary's "total benefits accrued." ERISA Section 109(c) provides that the Department may prescribe the format and content of any report, statement or document required to be furnished to plan participants and beneficiaries. In addition, ERISA Section 505, in relevant part, provides that the Department may prescribe such regulations as the Department finds necessary or appropriate to carry out the provisions of Title I of ERISA. Collectively, these provisions provide the authority for the Department to promulgate a rule that would require a participant's current and projected account balance to be illustrated as an estimated lifetime income stream of payments, in addition to being presented as an account balance.

¹MetLife's Evolving Retirement Model Study, 2020.

²Ibid.

Providing both the accumulated balance and its lifetime monthly income equivalent encourages and enables DC plan participants to think about – and use – their DC plan as a retirement income plan, rather than a savings plan without the context of a practical, long-term goal.

Lifetime income disclosures: provisions of the new law

DC plan benefits statements required to show accumulated balance and its lifetime monthly income equivalent

The new law amends ERISA (29 U.S.C. 1025(a)(2)) on disclosure regarding lifetime income. First, in the case of pension benefit statements, a lifetime income disclosure shall be required to be included in only one pension benefit statement during any one 12-month period. A lifetime income disclosure shall set forth the lifetime income stream equivalent of the total benefits accrued with respect to the participant or beneficiary. In the new law, the term “lifetime income stream equivalent of the total benefits accrued” means the amount of monthly payments the participant or beneficiary would receive if the total accrued benefits of such participant or beneficiary were used to provide lifetime income streams based on assumptions specified in rules prescribed by the U.S. Secretary of Labor. The Secretary shall prescribe assumptions – either a single set of specific assumptions or ranges of permissible assumptions – which administrators of individual account retirement plans may use in converting total accrued benefits into lifetime income stream equivalents.

Not later than one year after the date of the enactment of this law, the Secretary shall issue a model lifetime income disclosure, written in a manner so as to be understood by the average plan participant, which meets the following criteria:

- explains that the lifetime income stream equivalent is only provided as an illustration;
- explains that the actual payments under the lifetime income stream, which may be purchased with the total benefits accrued, will depend on numerous factors and may vary substantially from the lifetime income stream equivalent in the disclosures;
- explains the assumptions upon which the lifetime income stream equivalent was determined; and,
- provides such other similar explanations as the Secretary considers appropriate.

The lifetime income streams described in this ERISA amendment are a qualified joint and survivor annuity (as defined in section 205(d)), based on assumptions specified in rules prescribed by the Secretary, including the assumption that the participant or beneficiary has a spouse of equal age, and a single life annuity. Such lifetime income streams may have a term certain or other features to the extent permitted under rules prescribed by the Secretary.

There is a limitation on liability described in the law, which states that no plan fiduciary, plan sponsor or other person shall have any liability under this title solely by reason of the provision of lifetime income stream equivalents, which are derived in accordance with the assumptions.

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