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Lifetime Income Requirements: The New Frontier in Defined Contribution Plans?

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During the past couple of years, lifetime income disclosure and distribution requirements have been a subject of interest in Congress as well as at the Department of Labor (“DOL”) and the Internal Revenue Service (“IRS”). Lawmakers and regulators have expressed concern that few defined contribution (“DC”) plan participants think of their account balances in terms of the annual income the account balance will generate throughout retirement, leading them to save too little while they are working and spend the account balance too quickly in retirement. The recent activity in Congress and at the IRS and DOL suggests that some sort of lifetime income requirement will materialize in the next few years.

Activity at the IRS and DOL

In February 2010, the IRS and DOL released a [Request for Information](#) (“RFI”) announcing plans to review ERISA and the Internal Revenue Code to determine whether and how the retirement security of DC plan participants could be enhanced by improved access to arrangements that provide a stream of income after retirement. The RFI included detailed questions on a range of topics, including participant education, lifetime income disclosures in individual benefit statements, qualified joint and survivor annuity (“QJSA”) rules, selection of annuity providers and ERISA section 404(c) relief. The two agencies held a joint hearing in September 2010 to address the issues raised by the nearly 800 comments they received in response to the RFI. (The hearing transcripts are available [here](#).)

The Government Accounting Office compiled a list of [policy proposals](#) made by respondents to the RFI in a June 2011 report prepared for the Senate Special Committee on Aging. The proposals included: 1) requiring that DC plans offer an annuity distribution option; 2) removing the DOL safe harbor requirement that plan sponsors assess the ability of an insurance company to make all future payments under an annuity contract; 3) specifying the conditions under which annuities may be considered qualified default investment alternatives (“QDIAs”); 4) exempting so-called “longevity insurance” products from the required minimum distribution rules; 5) exempting annuity options within DC plans from spousal consent requirements; and 6) clarifying the distinction under DOL guidance between investment education and investment advice.

Lifetime income has remained on the regulatory agenda at the IRS, which included guidance on issues relating to lifetime income from retirement plans in its 2011-2012 Priority Guidance Plan. According to the “Preliminary Plan for Retrospective Analysis of Existing Rules,” published on May 18, 2011, the IRS is reviewing its retirement plan regulations to determine whether any modifications could facilitate the inclusion of lifetime income distribution options in DC plans.

Activity in Congress

Lifetime income requirements have been a subject of interest on the Hill since the release of the RFI. The Committee on Health, Education, Labor, & Pensions (“HELP”) has held a series of hearings on retirement security and related topics. Senators Jeff Bingaman (D-NM) and Johnny Isakson (R-GA), both members of the HELP Committee, and Herb Kohl (D-

WI) have co-sponsored legislation, the Lifetime Income Disclosure Act, that would require plan sponsors to provide an estimate of monthly retirement income (bill text available [here](#).) The legislation, introduced for the second time in February 2011, would require DC plan sponsors to include a projection in each participant's annual pension benefit statement of the amount of monthly payments the participant would begin to receive at the plan's normal retirement age if his or her accrued benefits were used on the date of disclosure to purchase either a single life annuity or a qualified joint and survivor annuity. The bill also would require the DOL to prescribe assumptions - either a single set of assumptions or ranges of permissible assumptions - for DC plan administrators to use in converting participants' account balances into annuity equivalents.

The associations backing the Lifetime Income Disclosure Act include the American Association of Retired Persons, American Society of Pension Professionals and Actuaries and American Council of Life Insurers ("ACLI"). ACLI has also (not surprisingly) supported the Retirement Security Needs Lifetime Pay Act (bill text available [here](#)), introduced in 2009, which would have excluded longevity insurance from the required minimum distribution rules and established a tax break for annuity payouts.

Both the Investment Company Institute ("ICI") and the Plan Sponsor Council of America ("PSCA") oppose a lifetime income disclosure mandate. PSCA has recommended that, as an alternative to a disclosure mandate, the DOL add an income stream calculator to its [website](#) on individual investing and diversification. ICI has argued that encouraging plan sponsors to provide lifetime income disclosures makes more sense than mandating a single approach. The organization has criticized the method of disclosure required by the Lifetime Disclosure Act on the grounds that the projections should include expected future contributions and should, instead of being converted to annuity payments, be calculated by dividing the final account balance by the applicable life expectancy or using 3 or 4 percent of the projected final account balance, as some financial planners do. (The statement is available [here](#).)

The Lifetime Income Disclosure Act also provides that plan sponsors and service providers that use the DOL assumptions are exempt from liability with respect to the projections. A disclosure requirement could still expose plan fiduciaries to liability for miscalculations and other mistakes, however. The ongoing case of *Lorinda Reichert v. Time Inc., et al.* (Case No. 11-03592-WHA (N.D. Cal. Nov. 3, 2011)) is illustrative. Time Inc. and Fidelity Investments are defending themselves against a breach of fiduciary duty claim arising from an incorrect lump sum benefit projection made using Fidelity's online pension calculator. In a recent ruling rejecting the defendants' motion to dismiss, the court found that the participant was owed a fiduciary duty with respect to the preparation of the benefit projection and did not need to allege an intentional misrepresentation in order to make a fiduciary breach claim.

Lifetime Income Distribution Options

Plan sponsors must contend with a number of fiduciary and administrative issues before they can add lifetime income distribution options to DC plans. Although the DOL has established a safe harbor method for the selection of annuity providers, complying with its requirements is difficult, particularly with respect to the various lifetime income products that have been developed in recent years. (For example, insurance companies now sell "longevity annuities" or "longevity insurance" products that provide for payout beginning years after retirement, e.g. at age 85, and annuities that are purchased incrementally.) The DOL may make annuity provider selection much easier, however. The RFI suggests that the agency will consider relaxing or removing the safe harbor requirement that plan sponsors conclude that the annuity provider will be able to make all future payments.

Inclusion of lifetime income distribution options in DC plans increases the complexity and cost of plan administration for a number of reasons. The QJSA rules are triggered once the participant selects an annuity option. Further, it is not clear how lifetime income products should be benchmarked. Changing group annuity contract providers may be difficult. Cost is also an issue. Annuities are expensive, in part because they are calculated based on longer longevity expectations than those of the general population. Further, because annuities in DC plans must offer gender-neutral prices, obtaining an annuity through a plan may be more expensive than purchasing an annuity on the open market.

Conclusion

Washington's interest in lifetime income disclosures and distribution options is natural given the dramatic shift among employer-sponsored pension plans from defined benefit plans to DC plans, which has transferred responsibility for the management of pension assets from employers to workers and retirees. The issue is particularly pressing given the impending retirement of the Baby Boom generation. While it is too early to tell which of the various proposals will be implemented, plan sponsors should expect to see significant changes related to DC plan distribution requirements at some point in the next few years.

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