DAVIS & HARMAN LLP

ATTORNEYS AT LAW

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230
FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

May 3, 2010

FILED ELECTRONICALLY

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW, Room N-5655
Washington, DC 20210

Attention: Lifetime Income RFI

Re: RIN 1210–AB33: Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans

Dear Sir or Madam:

We are writing on behalf of the Committee of Annuity Insurers (the "Committee") in response to the request for information that the Department of Labor and the Department of the Treasury (collectively, the "Agencies") published on February 2, 2010, regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans (the "RFI"). The Committee is a coalition of life insurance companies formed in 1982 to participate in the development of federal policy with respect to annuities. The Committee's current 31 member companies represent more than 80% of the annuity business in the United States and are among the largest issuers of annuity contracts in connection with employer-sponsored retirement plans and individual retirement arrangements ("IRAs"). A list of the Committee's member companies is attached.

The Committee greatly appreciates the opportunity to comment on lifetime income options in retirement arrangements. Achieving financial security in retirement is a critical goal of all Americans, and we strongly support public policies that help individuals meet that goal. In recent years, considerable attention has been given to the importance of saving for retirement, and rightfully so. However, accumulating retirement savings is only one half of the retirement security equation. The other half is making those savings last throughout retirement. This second and equally crucial component of retirement security has garnered too little attention to date, and the Committee commends the Obama Administration and the Agencies for elevating its prominence in the retirement security discussion.

Our comments in response to the RFI are set forth below. They generally relate to a variety of technical issues under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 (the "Code") that we believe, if addressed, will give individuals better access to sources of guaranteed lifetime retirement income. Our comments with respect to employer-maintained retirement plans are meant to encompass 401(a), 403(b), and governmental 457(b) plans, as well as section 408(k) SEPs and section 408(p) SIMPLEs. Our comments with respect to issues that arise under ERISA are, of course, specific to plans subject to ERISA and should not be read to suggest that similar issues arise under state law.

We have organized our comments by reference to the numbered questions set forth in the RFI, with each of our responses to an RFI question beginning on a new page. We have focused our comments on the areas where we believe we can contribute the most. We also have combined questions where we believe they are thematically related. A table of contents for our comments is set forth below. Should any questions arise in connection with our comments, or if the Committee can be of any assistance to the Agencies in their consideration of this important issue, please contact Joseph McKeever (jfmckeever@davis-harman.com), Jason Bortz (jkbortz@davis-harman.com), Mark Griffin (megriffin@davis-harman.com), or Bryan Keene (bwkeene@davis-harman.com). All of the foregoing individuals also can be reached by phone at 202-347-2230.

Table of Contents

Response to RFI Question 1

Advantages for participants of receiving benefits in the form of lifetime payments

The first question set forth in the RFI asks for comments on the advantages and disadvantages for participants of receiving some or all of their benefits in the form of lifetime payments. In that regard, converting a retirement nest egg into a sustainable stream of retirement income can be a daunting task for an individual to undertake without the right tools. In addition to uncertainty about future personal expenses, inflation, and asset returns, it is impossible for an individual to predict how long he or she will live and therefore how long that nest egg will need to last. As a general matter, we know that individuals are living longer and spending more time in retirement than ever before. For example, today about one in three 65-year-old women will live to age 90 (with about one in 30 living to age 100), and the average retiree can now expect to spend approximately one-fourth of his or her life in retirement.[1] While living a longer life is certainly a welcome development by any measure, living longer than expected could leave one with little or no income in the later years of retirement. This risk of guessing wrong on how long a life one's nest egg will need to last – commonly called "longevity risk" – is a risk that every retiree faces. And with 77 million baby boomers poised to enter retirement in the coming years, the societal need to help individuals address that risk is escalating.

At the same time, some of the tools traditionally available to individuals to hedge the longevity risk they face are not as widely available as they once were. As the Agencies observe in the RFI, recent decades have witnessed a significant shift from defined benefit plans to defined contribution plans. The shift corresponds to a reduction in the proportion of retirement benefits paid in the form of guaranteed income for life.[2] In addition, the other major source of guaranteed lifetime income available to retirees – Social Security – currently replaces only about 40% of pre-retirement income, which is substantially lower than the 70-80% that many financial planners say is needed to maintain one's standard of living in retirement.[3] Moreover, the Social Security income replacement rate is declining,[4] and the imminent retirement of the baby boom generation will only increase the growing strain on the program.

As the RFI recognizes, part of the solution to this looming crisis is for employer-maintained retirement plans to facilitate better access to, and more use of, arrangements designed to provide a stream of income that is guaranteed to continue as long as an individual lives. Participants with better access to the tools they need to hedge their own longevity risk will be better positioned to enjoy a financially secure retirement, and less likely to find it necessary to rely on federal, state, and local means-tested programs for the aged in their later years.

---

[1] JEFFREY R. BROWN, THE NEW RETIREMENT CHALLENGE 4 (Americans for Secure Retirement, Sept. 2004) (available online at www.paycheckforlife.org/issue-briefs). In contrast, at the beginning of the 20th century life expectancies at birth were only 58.3 years for women. *See id*. at 4.

[2] *Id.* at 6.

[3] SOC. SEC. ADMIN., SSA PUBLICATION NO. 05-10035, RETIREMENT BENEFITS 8 (2010).

[4] Andrew G. Biggs & Glenn R. Springstead, *Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income*, SOCIAL SECURITY BULLETIN, Oct. 2008, at 14-15.

Other than defined benefit plans and Social Security, the only means by which individuals can obtain guaranteed lifetime income are annuity products. Annuities provide insurance protection against longevity risk by pooling that risk among a large group of individuals, so that no single individual bears the burden of the entire risk alone. These insurance products are available in a variety of forms that can be tailored to meet the individual's or the plan's specific needs. For example:

- Traditional life-contingent annuities, whether purchased at retirement or during one's working years and then "annuitized" at retirement, provide periodic income payments that cannot be outlived. When purchased incrementally over time, traditional life-contingent annuities also can help hedge against interest rate fluctuations that affect annuity purchase rates.

- Life-contingent variable annuities protect against longevity risk as well as inflation risk by providing lifelong income and access to returns that have the potential to exceed the rate of inflation. Such products also can offer "guaranteed minimum accumulation benefits," which guarantee a minimum rate of return before annuity payments commence, while still allowing the holder to participate in equity markets. Similarly, "guaranteed minimum income benefits" under variable annuities can provide lifetime income that is based at least in part on equity market returns while still providing a guaranteed floor, below which the periodic payments will not fall.

- Annuity products also can offer "guaranteed lifetime withdrawal benefits" – whether embedded in a deferred annuity product or offered as a "stand-alone" product coupled with an individual account. Both types provide participants with flexibility to meet their current income needs while insuring them against the risk of outliving their retirement assets.

- "Longevity insurance" provides retired individuals an affordable way to protect against the risk of running out of income from their other retirement assets if they outlive their life expectancy.

As evident from the foregoing summary, annuity products often combine insurance against longevity risk with other "living benefits" that protect against additional financial risks that retirees face, including investment risk and inflation risk. In all their various forms, however, the key features of annuities that help mitigate the longevity risk individuals face are that they (1) provide a retirement income stream that is guaranteed to continue for life, and (2) are backed by a life insurance company that is regulated by the states and licensed to provide insurance protection against longevity risk by pooling that risk and distributing it among the retiree population. Our comments in response to the RFI generally are intended to encourage broader use of all forms of annuity products that provide guaranteed lifetime income, including traditional life-contingent annuities, life-contingent variable annuities with so-called "living benefits," and longevity insurance.

Annuity contracts have a long history in the retirement plan context. Many of the earliest employer-sponsored retirement plans were arrangements where employers made contributions to group or individual annuity contracts. Today, annuities are used in plans in a variety of ways. Some plans are funded through group annuity contracts in lieu of a trust. The contract will invariably provide an annuity distribution option that participants may elect. Some trusteed plans will similarly provide for an annuity distribution option. Other plans hark back to the earliest retirement plans by allowing participants to invest in deferred annuities. These in-plan annuity investment options typically operate as distribution options as well. The Committee believes that the use of annuities as distribution options as well as combination investment and distribution options should be encouraged in plans.

The Committee also strongly encourages the use of commercial annuity products in connection with IRAs. In addition to providing insurance against longevity risk, most annuity products are inherently portable, meaning that employees can be issued an individual annuity contract or a certificate under a group annuity while in the plan or upon leaving the plan. Alternatively, many individuals choose to roll over their plan balances to an individual retirement arrangement at retirement, and in such cases an annuity purchased by the individual retirement account or as an individual retirement annuity remains portable and is not affected by changes in employer. There is a robust IRA marketplace for annuities, with numerous issuers and a diversity of contract types available. Accordingly, the Committee believes that annuity purchases through IRAs can and should be encouraged.

The Committee also believes that more retirees will elect life-contingent distributions from annuities in both IRAs and defined contribution plans if steps are taken to encourage employers that do not currently offer such options under their plans to do so, and to provide investment education and advice to participants about the "decumulation" phase of retirement. By elevating the options that are available to participants and strengthening the dialogue about longevity risk, we believe that more individuals will take all or a portion of their retirement savings in the form of life-contingent distributions from an annuity, which are the only sure means of insuring against the risk of outliving one's savings.

Response to RFI Questions 18-20

Questions 18 through 20 of the RFI inquire about various aspects of providing plan participants with educational materials regarding the advantages and disadvantages of distribution options that provide guaranteed lifetime income. Our responses to those questions are set forth below.

Part A:
DOL guidance should clarify the extent to which employers may provide investment education on decumulation

As the RFI recognizes, recent years have witnessed a trend away from defined benefit plans to defined contribution plans and hybrid plans, with a corresponding trend away from annuities toward lump sum distributions. As a result, plan participants are more responsible for managing their own exposure to longevity risk in a way that ensures their savings will last throughout their retirement years. Without adequate education about the financial risks associated with this task and the tools available to achieve it, participants will be ill-equipped to make informed decisions regarding their own retirement security. As a result, the Committee strongly supports efforts to improve participant education regarding the decumulation phase of retirement generally, and the availability of tools that provide guaranteed lifetime income specifically.

In that regard, the Department of Labor (hereinafter, the "DOL") can help facilitate guaranteed lifetime income options in ERISA-covered plans by providing guidance on the extent to which an employer may provide distribution education to plan participants. The ERISA Advisory Council's Working Group on Financial Literacy of Plan Participants and the Role of the Employer in 2007 and the recent Working Group on Approaches to Retirement Security in the United States in 2009 both identified the need for guidance clarifying the extent to which an employer may provide information and education about distributions without providing fiduciary investment advice. An employer is under no obligation to provide advice about the decumulation phase of retirement. However, an employer that is interested in doing so may be reluctant if it means providing fiduciary investment advice and, therefore, taking on potential fiduciary liability.

The DOL has published guidance in Interpretive Bulletin 96-1 on the line between investment education and investment advice in ERISA-covered plans that permit participant investment direction, and we believe that comparable guidance on the decumulation phase could encourage life-contingent forms of payout. To be useful, the decumulation guidance should be as comprehensive as the guidance provided in Interpretive Bulletin 96-1. At a minimum, it should encompass models that provide information on partial annuitization, *i.e.*, using a portion of a plan balance to purchase a lifetime annuity, and that integrate with non-annuity investments. As a result, for example, a computer model might suggest that X% of a participant's account be annuitized and suggest an investment allocation for the remaining Y% of the account.[5] It is also important that the guidance contemplate interactive questionnaires, worksheets, and software to

[5] *See* Part B of this response to RFI questions 18-20, below, for more discussion of the use of computer-based models to educate participants about decumulation.

allow participants to consider the impact of different approaches to annuitization. This would, for example, allow participants to more fully explore longevity risk in retirement and, therefore, to make informed decisions about retirement.

We also recommend that the DOL amend Interpretive Bulletin 96-1 to address deferred annuities. In particular, the guidance should make clear that investment education may be provided on deferred annuities offered as investment options under employer-maintained plans to the same extent it may be provided on other investment options. This might be readily apparent as a matter of law, but the silence in the Interpretive Bulletin may give some employers pause.

Part B:
DOL guidance should clarify that investment advice based on computer models must take into account annuity investment options available under the plan

Two of the most prominent methods of providing investment advice to plan participants in ERISA-covered plans involve computer models that take into account a plan's underlying investment options. One computer-based approach relies on the use of a model that is developed by a qualified independent third party (the "SunAmerica Opinion").[6] The other relies on the statutory prohibited transaction exemption enacted as part of the Pension Protection Act of 2006 (the "PPA").[7] In general, a PPA computer model must take into account all of a plan's investment options in order to obtain the benefit of the statutory prohibited transaction exemption. It does not appear that a computer model based on the SunAmerica Opinion must take into account all of the plan's investment options.

Proposed regulations issued in February 2010 would provide that a PPA computer model may disregard a deferred annuity investment option that otherwise is available under a plan.[8] Presumably, a computer model relying on the SunAmerica Opinion may do so as well. The Committee believes that such an approach would mean that deferred annuities offered as part of a participant-directed plan's investment menu will rarely be recommended as investments and, therefore, that the prospects of such annuities being used to provide life-contingent payouts will be greatly reduced. We realize that some of the current computer models are not capable of taking into account annuity investment options, but we are not aware of any reason that inherently precludes consideration of in-plan annuities. Thus, we strongly believe that advice provided pursuant to one of the computer model approaches should take into account available deferred annuities.[9]

---

[6] ERISA Advisory Op. 2001-09A (Dec. 14, 2001).

[7] Pub. L. No. 109-280, § 601, 120 Stat. 780, 952-66 (2006) (adding sections 408(b)(14) and 408(g) to ERISA and sections 4975(d)(17) and 4975(f)(8) to the Code).

[8] 75 Fed. Reg. 9,360 (Mar. 2, 2010).

[9] Various other issues involving in-plan deferred annuities are discussed in our response to RFI questions 14 and 25. *See* page 9, *infra*.

Response to RFI Questions 14 and 25

Question 25 in the RFI asks how the 401(k) or other plan qualification rules affect plan sponsors' and participants' interest in the offering and use of lifetime income, and whether changes to those rules could or should be made to encourage lifetime income without prejudice to other important policy objectives. Similarly, question 14 in the RFI asks about the impediments to plan sponsors' including lifetime income options in their plans. We believe that several changes could be made to better encourage lifetime income protections, specifically, in-plan annuities that serve as both accumulation and distribution vehicles.

One particularly promising avenue for increasing the extent to which participants purchase guaranteed lifetime income protections is to include annuity investments as part of a participant-directed plan's investment menu. Consider, for example, a deferred fixed annuity contract that allows participants to purchase a lifetime income stream commencing at normal retirement age. Such an arrangement may have the virtue of allowing participants to lock in current interest rates and mortality tables and purchase annuity income on a payroll deduction basis, thereby mitigating interest rate and mortality risk in much the same way that the practice of dollar cost averaging tends to average the unit cost of an investment over time.

Another option might be a variable or fixed annuity contract investment option that allows a participant to purchase a guaranteed lifetime withdrawal benefit ("GLWB"), which provides that a participant may withdraw a specified portion (*e.g.*, 5%) of a notional account balance (*e.g.*, premiums plus 4% interest) for life regardless of the contract's cash value. Such an investment would provide both protection against adverse investment experience as well as a contingent guaranteed life annuity.

Deferred annuities offered as plan investment options and plan distribution options have the virtue of beginning the conversation about retirement security at an earlier age and enhancing the likelihood that a participant will choose a life-contingent payout. There are, however, barriers to such in-plan annuities that need to be addressed through published guidance. As discussed below, those barriers include uncertainty regarding certain aspects of how an in-kind distribution of an annuity contract from a plan is treated.

Part A:
The Agencies should facilitate the inclusion of deferred annuity investment options in defined contribution plans

One concern expressed by some plan sponsors with respect to in-plan deferred annuity options is the plan's ability to eliminate the option at some point in the future. This need may arise, for example, because the plan changes its recordkeeper and the new recordkeeper cannot, or will not, support the deferred annuity investment option. It may also arise in connection with a business transaction in which a plan with an annuity investment option is merged into a plan that does not have an annuity investment option.

The current retirement plan rules, however, make it difficult for an employer to eliminate a deferred annuity. The plan fiduciary invariably has the authority to unilaterally eliminate an investment option. This includes the ability to liquidate an investment and move the proceeds to another plan investment. In fact, a plan fiduciary can rely on the DOL's qualified default investment alternative regulations to limit fiduciary liability where a participant is moved from a current fund and defaulted into a new fund. In the case of a deferred annuity investment option, however, such an elimination could have unintended consequences, including potentially causing participants to lose valuable economic rights. In that regard, ordinarily only the cash surrender value of an annuity contract is payable to participants' accounts if the contract is eliminated, which would cause participants to lose value if they are "in the money" on a contract guarantee, such as a GLWB feature. In fact, some contracts may not even provide for a cash surrender value and will only provide for liquidity through annuitization. Not surprisingly, an employer may be reluctant to offer a deferred annuity as an investment option unless the employer is comfortable that it will be able to exit the arrangement in the future without adverse consequences for participants.[10]

The current retirement plan rules also make it difficult for the employer to distribute an annuity contract to affected participants. The limitations on in-service distributions will bar a distribution of an annuity contract in many circumstances.[11] Moreover, even where distributions are permitted, the retirement plan rules generally provide participants with the right to defer distributions until attainment of normal retirement age.[12] As a result, even where a distribution is permitted, the employer generally cannot force one. The net effect is that it can be challenging for an employer to eliminate an annuity investment option, which has the corollary effect of discouraging some employers from adding deferred annuities as investment options. We believe that more employers will be amenable to offering deferred annuity investment options, particularly options involving life-contingent forms of payout, if there is a clear exit strategy available to them.

The current law rules applicable to qualified plan distributed annuity contracts provide a foundation. A qualified plan distributed annuity contract is an annuity contract that has been distributed from the plan and that remains tax-deferred even though it is not part of the plan and not part of an IRA.[13] Qualified plan distributed annuities must satisfy a number of ERISA and tax qualification requirements, including the required minimum distribution, anti-cutback, rollover, and spousal consent requirements.[14]

Guidance could permit an in-service distribution of a qualified plan distributed annuity contract. As mentioned above, the rules applicable to qualified plan distributed annuity contracts currently impose a number of tax qualification and ERISA requirements on the issuer. The list of continuing rules could be expanded for an annuity distributed to a participant in-service, for example, as a result of a recordkeeper change, to include the in-service distribution restrictions. Thus, for example, the contract could prohibit distributions until a participant has had a

[10] The anti-cutback rule may also prove to be a barrier to the extent an annuity form of distribution is available at a time when a single sum form of distribution is not available. *See* Code § 411(d)(6)(E).

[11] *See*, *e.g.*, Code § 401(k)(2)(B).

[12] Code § 411(a)(11).

[13] Treas. Reg. § 1.402(a)-1(a)(2).

[14] *See*, *e.g.*, Treas. Reg. §§ 1.401(a)(9)-6, Q&A-4 (required minimum distributions), 1.401(a)(31)-1, Q&A-17 (rollover rights), and 1.401(a)-20, Q&A-2 (ongoing spousal consent).

distributable event under the terms of the plan that distributed the contract, for example, a severance from employment. The issuer would be responsible for administering the applicable qualification requirements, including, for example, ascertaining that employees have experienced a severance from employment or are eligible for a hardship withdrawal. The issuer could coordinate with the employer through bilateral information sharing to the extent necessary to ensure that the qualification requirements for both the distributed contracts and the ongoing plan are met. Such an approach would have the virtue of facilitating annuity investment options while preserving important retirement policies, such as limiting retirement plan leakage.

A closely related issue is the extent to which ERISA will continue to apply to annuity contracts that are distributed from a plan. It would be very difficult for issuers to coordinate with the employer on the Form 5500 and other ERISA-imposed disclosure requirements. For these reasons, we believe that ERISA should cease to apply to the in-service distributed annuity contract in the same manner that it currently does not apply for post-severance distributed annuity contracts.[15]

We realize there may be concerns about participants losing protections under ERISA. However, as mentioned above, the requirements that apply to qualified plan distributed annuity contracts include the protections of the anti-cutback rule and the ongoing application of the spousal consent requirements. Moreover, the DOL could extend certain additional rules to distributed annuity contracts, for example, by extending participant-level fee disclosure mandates to distributed annuity contracts. On balance, we believe that participants would be affected in only modest respects by an in-kind distribution of an annuity contract that ceases to be a plan asset and would benefit from having a deferred annuity investment option available.[16]

Part B:
Treasury Department guidance should enhance portability for annuity investment options in defined contribution plans

It is important that plan participants who invest in a deferred annuity investment option have the ability to carry their deferred annuity with them after severance from employment. Portability is essential to the attractiveness of deferred annuity investment options. In this regard, a plan that offers a deferred annuity investment option but provides only for cash distributions (and not in-kind distributions of the annuity contract) will force participants to choose between (1) leaving their investment intact within their former employer's plan, and (2) taking a cash distribution that may involve incurring surrender charges and forgoing valuable economic rights embedded in the deferred annuity contract, such as a living benefit that is in the money.

There are a number of different approaches to facilitating portability. First, a plan may distribute an annuity contract that is a qualified plan distributed annuity contract. Such an annuity contract is a tax-deferred vehicle akin to an individual retirement annuity. One possible limitation to a qualified plan distributed annuity is that it may not be eligible to receive additional

[15] DOL Reg. § 2510.3-3(d)(2)(ii).

[16] An alternative approach might be to permit in-service distributions of annuity contracts only in circumstances involving a complete discontinuance of an annuity investment option.

contributions. It is apparent, of course, that a qualified plan distributed annuity contract cannot receive employer or employee contributions because it is no longer part of a plan. However, we believe that a plan distributed annuity contract should be able to receive rollovers, and we recommend guidance clarifying this point.

Second, a plan may provide for an in-kind distribution of the deferred annuity contract in the form of a nonqualified annuity contract. The annuity does not need to satisfy the rules that apply to qualified annuities described in Code section 401(f), which are essentially plan funding vehicles used in lieu of a qualified trust. Similarly, the annuity does not need to satisfy the rules applicable to a plan distributed annuity contract that is intended to be a stand-alone tax-deferred vehicle.[17] Rather, the distribution is equivalent to an in-kind distribution of property. In order to defer tax on such a distribution, the nonqualified annuity must be rolled to an individual retirement account. It is clear under current law that a rollover of a nonqualified annuity contract in this manner is allowed, but it would be helpful if this point was made more prominently.[18]

Third, a participant may elect a rollover to an individual retirement annuity of a deferred annuity contract that is distributed from a plan. In connection with the distribution, an IRA endorsement would be added to the contract, and the issuer would provide the individual with a disclosure statement that is required under the income tax regulations to be provided to IRA purchasers. Such a distribution would appear to constitute an "eligible rollover distribution" from the plan that qualifies for tax-free rollover treatment to an IRA.[19] In this regard, the income tax regulations relating to eligible rollover distributions consider the tax-free rollover of (1) distributions <u>from</u> a plan distributed annuity contract, and (2) the distribution of property, such as employer securities.[20] However, these regulations do not directly address the creation of an individual retirement annuity as a means of effecting a rollover. We believe that the timely addition of an IRA endorsement to a plan distributed annuity contract should be treated as a tax-free rollover to an IRA, and we recommend guidance clarifying this point.

As reflected above, the Committee is comfortable with the current law treatment of each of these three means of effecting annuity portability on a tax-deferred basis. These paths are, however, poorly understood by employers and even many benefits practitioners. These are relatively new transactions, and we believe that portability would be greatly enhanced by a clear articulation of these three different options.

---

[17] Treas. Reg. § 1.402(a)-1(a)(2).

[18] *See, e.g.*, Treas. Reg. § 1.402(c)-2, Q&A-3 (defining eligible rollover distribution as any distribution other than a listed distribution); Treas. Reg. § 1.402(a)-1(a)(2) (discussing a transferable annuity contract as an eligible rollover distribution).

[19] *See* Code § 402(c)(4); Treas. Reg. § 1.402(a)-1(a)(2).

[20] *See* Treas. Reg. § 31.3405(c)-1, Q&A-12, Q&A-13.

Part C:
DOL guidance should clarify when a plan distributed annuity contract ceases to be a plan asset

A plan that offers an annuity distribution option may either hold the contract during the payout phase or distribute the annuity contract as part of an in-kind distribution. As mentioned above, a distributed annuity contract that satisfies a variety of qualified plan requirements is a tax-deferred vehicle.[21] As a general matter, it is preferable from the perspective of an ERISA plan to distribute the annuity contract if that contract would no longer be considered a plan asset subject to reporting on the Form 5500, and an in-kind distribution would more clearly establish that the participant should look to the insurer, rather than the plan, for any questions. For this reason, it would be helpful if the DOL issued guidance clarifying the status of distributed annuity contracts as plan assets.

The only DOL guidance addressing whether a distributed annuity contract is a plan asset is a regulation dealing with the extent to which a participant is covered by a plan.[22] It effectively provides that an individual is not a participant covered by a pension plan for purposes of ERISA if (i) an annuity contract has been issued to the individual, (ii) the entire benefit rights of the individual are fully guaranteed by an insurance company, and (iii) the rights under the contract are enforceable solely by the individual without the employer's involvement. The DOL has clarified that the "entire benefit rights" of an individual are not guaranteed or distributed for purposes of the regulation if an employee is continuing to accrue benefits.[23] Instead, the regulation is directed at "situations where employment has been severed, where the employee is fully vested and changes into employment not covered by the plan, or where the employee has earned the maximum benefit he can earn under the plan."[24] Put differently, the mere fact that a retirement plan is funded through individual annuity contracts does not mean that the plan has no assets. It is only after the ability to make contributions to the plan is discontinued that the individual assets are effectively treated as distributed from the plan.

The foregoing regulation does not address a situation where a participant takes an in-service distribution of an annuity contract and continues to receive contributions to the plan (but not the contract).[25] We believe that a distribution of an annuity contract should be treated the same as any in-kind distribution in this context – as ending plan asset status. We appreciate that it may be appropriate for a distributed annuity contract to remain a plan asset in limited circumstances, for example, if the employer has retained rights under the contract, such as a right to exchange the contract for another contract. We also appreciate that the analysis may be

[21] Treas. Reg. § 1.402(a)-1(a)(2) (describing tax treatment of a plan distributed annuity contract and referencing qualification requirements that apply to the contract after distribution).

[22] DOL Reg. § 2510.3-3(d)(2)(ii).

[23] *See* 40 Fed. Reg. 34,533 (Aug. 15, 1975) (preamble to regulation); ERISA Advisory Op. 77-10 (June 2, 1977).

[24] ERISA Advisory Op. 77-10.

[25] It is, however, implicit in Interpretive Bulletin 95-1 that a distribution of an annuity contract ends plan asset status. The Interpretive Bulletin applies to both ongoing plans as well as terminated plans. However, its primary application is to terminated plans. As a result, the notion that an-kind distribution of an annuity contract ends plan asset treatment has been somewhat obscured.

different where the annuity contract receives ongoing contributions since ongoing contributions would be inconsistent with the notion that the contract is no longer part of the employer's plan. However, in the vast majority of circumstances, these issues will not be raised and the contract should cease to be a plan asset upon distribution.

Another issue that should be addressed is the distribution of an individual certificate under a group annuity contract.[26] It may be attractive for a plan to acquire a group annuity contract as a vehicle for offering payout annuities. However, the plan may distribute all of the rights under the arrangement by issuing individual certificates that are effectively equivalent to individual annuity contracts. To this end, we believe that the clarification requested above regarding when a distributed annuity contract is no longer a plan asset should apply equally to a distributed individual certificate.

[26] The question of whether a distribution of an individual certificate is the functional equivalent of a distribution of an individual contract has been an issue under the plan termination provisions of the final regulations under Code section 403(b). *See* Treas. Reg. § 1.403(b)-10(a).

Response to RFI Questions 26-27

Questions 26 and 27 of the RFI ask whether changes could or should be made to the rules relating to qualified joint and survivor annuities and spousal consents in order to better encourage the use of lifetime income or to better facilitate the use of deferred annuities that offer guaranteed lifetime income distribution options. These rules apply only to plans that are subject to ERISA, notwithstanding that the rules are in both ERISA and the Code. As discussed below, we believe that clarifications can and should be made with respect to the spousal consent requirements in the context of deferred annuities.

Part A:
Treasury Department guidance should clarify that an investment in a deferred annuity investment option under a defined contribution plan is not an election of a life annuity triggering spousal consent requirements

Under the general spousal consent rules of the Code and ERISA (the "general spousal consent rules"), benefits under a plan must be paid in the form of a qualified joint and survivor annuity (a "QJSA"), absent spousal consent to the contrary.[27] An exception applies in the case of a profit-sharing plan that meets certain death benefit requirements (the "profit-sharing plan rules"), in which case benefits must be paid in the form of a QJSA in accordance with the general spousal consent rules only if a participant elects a distribution in the form of a life annuity.[28] The fundamental notion reflected in the profit-sharing plan rules is that a surviving spouse will have death benefit protection either in the form of a death benefit under the plan or, if a life annuity is elected, survivor annuity payments.

The language in the statute implementing the profit-sharing plan rules provides that a plan is exempt from the general spousal consent rules only if the "participant does not elect a payment of benefits in the form of a life annuity."[29] Treasury regulations add a further gloss by providing that the general spousal consent rules apply if the "participant elects at any time (irrespective of the applicable election period…)" a life annuity option.[30] Thereafter, the general spousal consent rules apply to the participant's entire benefit or, if there is a separate accounting, the portion of the participant's account subject to the election.

The Committee believes that a mere investment in a deferred annuity contract is not an election of a life annuity option for purposes of the profit-sharing plan rules. At times, however, questions have arisen about whether an investment in a deferred annuity offered as an investment option triggers the general spousal consent rules, and we believe it would be appropriate for the Treasury Department to clarify the issue.[31] Consider, for example, a profit-sharing plan that offers a menu of investment options, including a deferred fixed annuity contract. The annuity

---

[27] Code § 401(a)(11); ERISA § 205(b)(1).

[28] *Id.*

[29] Code § 401(a)(11)(B)(iii)(II); ERISA § 205(b)(1)(C)(ii).

[30] Treas. Reg. § 1.401(a)-20, Q&A-4.

[31] The Treasury Department, rather than the DOL, has interpretive authority for the spousal consent rules under the Reorganization Act of 1978.

contract is also used to offer annuity payouts from the plan. Assume a participant who is age 35 elects to invest 25% of his account balance in the deferred fixed annuity contract. The participant later elects to change his investment allocation and instead invest in a mutual fund option. If the investment in the annuity option is considered an "election of a life annuity," then 25% of the participant's account would be subject to the general spousal consent rules, if there is a separate accounting, even though the participant is no longer invested in the annuity investment option and the participant never made an election to receive a payout in the form of a life annuity.[32]

We understand and appreciate the importance of the general spousal consent rules. There is an important public policy benefit to ensuring that life-contingent annuity payments are made in the form of a QJSA if a participant is married. However, from the perspective of employers, the possibility that an investment in an annuity option may trigger the general spousal consent rules is a major barrier to offering an annuity investment option. The general spousal consent rules are widely perceived as administratively onerous. This is largely because spousal consent is not something that can be done electronically and generally requires the employer's involvement, *i.e.*, it cannot be easily delegated to a plan service provider.

From the perspective of plan recordkeepers, the notion that an investment in a deferred annuity will trigger the general spousal consent rules raises substantial recordkeeping challenges. As mentioned above, the general spousal consent rules would apply to a participant's entire account, even if only a portion of the account is invested in a deferred annuity, absent a separate accounting for the portion in the annuity. This would include tracking a subsequent investment change since the regulations provide that the general spousal consent rules apply thereafter once an election of a life annuity is made, even if it is revoked. Thus, in the example above, the recordkeeper would either apply the general spousal consent rules to the participant's entire account or separately track the portion that was once invested in the deferred annuity. As a practical matter, we suspect that few recordkeepers are prepared for separate recordkeeping of this sort and that the presence of a deferred annuity investment option would mean that the entire account would be subject to the spousal consent requirements.

Finally, from the perspective of the participant, if an investment in a deferred annuity is an election of a life annuity triggering the general spousal consent rules, then an investment in the annuity option would carry substantial limitations and restrictions unrelated to the investment decision – namely, the inability to obtain distributions without obtaining spousal consent. In fact, the participant would typically need to obtain spousal consent for each distribution thereafter. In effect, the investment would cause the participant to be subject in perpetuity to a fairly onerous process, notwithstanding that the public policy underlying the general spousal consent rules is not implicated.[33] Taken as a whole, it is apparent that a sweeping interpretation

[32] At most, the terms of the plan may have provided that the participant's benefit invested in the annuity option would be paid in the form of a life annuity at age 65 or such other date as distributions would automatically occur absent an election to the contrary.

[33] In this regard, the plan would typically be structured to meet the death benefit requirements under the profit-sharing plan rules so that the spouse would be the sole beneficiary of the account, absent consent to an alternative beneficiary designation. Put differently, in our experience, it would be very unusual for a plan to fail to meet the death benefit requirements even though those requirements no longer apply as a result of an election of a life annuity.

of when a participant has elected a life annuity would be a significant deterrent to deferred annuity investment options.

The Committee therefore recommends that the Treasury Department issue guidance clarifying that an election of a life annuity has occurred only where a participant has made an irrevocable election to receive life annuity distributions. The essence of the rule is simply that any payments from a profit-sharing plan to a married participant that are made in the form of a life annuity must be in the form of a QJSA absent spousal consent. It is obviously not the right public policy for the spousal consent requirements to be triggered by a mere investment in a deferred annuity, under which no commitment to a life annuity payment stream has yet been made.

We believe that the interpretation we are recommending would clarify a number of questions that have arisen over the years. One is whether the use of a group annuity contract, rather than a trust, as a funding vehicle triggers the general spousal consent rules. At times, some have suggested that the mere fact that a plan is funded through an annuity contract, which would pay benefits in the form of a life annuity unless the participant elects otherwise, is an election of a life annuity. If that view were to prevail or persist, the entire plan would be subject to the general spousal consent rules, notwithstanding that no participant can be fairly said to have elected a life annuity, given the other distributions available under the annuity contract. We believe that it would be appropriate instead to require only that an amount paid as an irrevocable life annuity be paid in the form of a QJSA absent spousal consent.

Another question is whether the purchase of a variable or fixed annuity with life-contingent "living benefits" is considered an election of a life annuity triggering the general spousal consent rules. One popular living benefit is a GLWB (guaranteed lifetime withdrawal benefit), which promises that a participant will be eligible to elect a payout for life of a specified amount, for example, 5% of a notional balance, such as premiums paid plus a fixed interest rate, regardless of whether the cash value in the contract has been exhausted. Such a benefit is a contingent life annuity in the sense that a participant will be eligible to receive guaranteed lifetime income if the participant's cash value is depleted as a result of investment experience, longevity, or both. It seems apparent that an election of a GLWB feature on a deferred annuity should not trigger the general spousal consent rules because the contract has not been irrevocably "annuitized" at that point. The participant may transfer his or her funds out of the variable annuity contract or may elect to discontinue the rider that provides the GLWB. It is simply too remote and tenuous for such an investment to be considered an election of a life annuity that triggers the general spousal consent rules.

Part B:
Treasury Department guidance should clarify the spousal consent rules in the context of trial annuities, GLWBs, and other similar contracts

A related issue is the extent to which a participant should be treated as "electing a life annuity" in circumstances in which payments commence under an annuity contract but the payments are not annuitized payments. This may arise, for example, where a participant who is invested in a deferred annuity contract elects to commence systematic withdrawals that will be followed by life-contingent annuity payments, for example, a program designed around a trial period in which a participant receives payments that are akin to annuity payments but where the contract has a cash value. It may also arise where a participant begins withdrawals from the cash value of an annuity contract with a GLWB feature. We are not aware of any guidance that addresses whether payout elections in these circumstances should be considered elections of a life annuity.[34]

As a threshold matter, we believe that a payout is a "life annuity" payout only to the extent that amounts are "received as an annuity." Treasury regulations define the phrase "amounts received as an annuity" by reference to the "annuity starting date."[35] The regulations define "annuity starting date," in turn, as the later of the first day of the period for which payments are made and "the date upon which the obligations under the contract became fixed."[36] In the examples above, the obligations under the contract do not become fixed until a date subsequent to the date payments commence. In a contract with a GLWB, the obligations under the contract are not fixed until the contract is "in the money," *i.e.*, there is no remaining cash value, because prior to that date the participant may withdraw more or less than the guaranteed minimum withdrawal and, in fact, may surrender the entire contract or withdraw nothing. Similarly, under a contract that provides for a systematic withdrawal followed by a life-contingent annuity, payments under the contract become "fixed" only at the end of the systematic withdrawal period.

The Committee believes that a participant "does not elect a payment of benefits in the form of a life annuity" merely by commencing payments under an annuity contract of this type. We appreciate that the participant has taken a step towards electing a life annuity payout by, for example, beginning systematic withdrawals under a trial annuity. However, the participant is free to start and stop, or modify, the payment stream at any time prior the date the obligations under the contract become fixed. At most, the participant can be viewed as establishing a system under which a failure to make an affirmative election prior to the annuity starting date will result in the election of a life annuity. However, even under this view, it is only when the participant fails to opt out of life annuity payments in a timely manner that there has been an election of a life annuity.[37] Put simply, the mere commencement of payments prior to the annuity starting date is not an election of a life annuity.

In our view, there is a life annuity payout under a GLWB or trial annuity arrangement as of the date the obligations under the contract become fixed. In a GLWB, this is when there is no

[34] A recent private letter ruling addresses a similar issue in the context of a trial annuity, which provided for systematic withdrawals prior to the start of life-contingent annuity payments. The ruling concludes that the commencement of payouts constitutes an election of a life annuity to the extent of the deferred life-contingent annuity payments, but not to the extent of any systematic withdrawals. Priv. Ltr. Rul. 200951039 (Sept. 21, 2009). Assuming a plan provides for a separate accounting of the portion of the account balance subject to spousal consent, the participant could take distributions without regard to spousal consent provided that the withdrawals did not reduce the amount of the deferred life annuity payouts.

[35] Treas. Reg. § 1.72-2(b)(2).

[36] Treas. Reg. § 1.72-4(b).

[37] This is analogous to a default election under an automatic contribution arrangement in a section 401(k) plan. The mere fact that deferrals will be made unless an affirmative election to the contrary is made does not mean that there has been an election – negative or otherwise. The election occurs only when the participant fails to opt out of the automatic contribution arrangement or otherwise makes an affirmative election.

remaining cash value and, in a trial annuity, this is when the systematic withdrawal program ends. The participant's election of the life annuity payout occurs only when the life annuity payments commence. Prior to that date, it is simply too tenuous and remote to characterize a participant as having elected a life annuity.

Treasury regulations provide that spousal consent may not be validly provided more than 180 days before the annuity starting date. This window may be ill-suited to annuities of the types described above. Consider, for example, a participant who chooses to invest in an annuity contract with a GLWB rider. The GLWB may not be in the money under the contract for many years, if ever, so that it will not be clear when or whether the life annuity will commence. However, at the time of the investment, the participant may need to elect whether the GLWB is a single life annuity or a joint and survivor annuity. That is, the participant may need to elect the measuring lives, which may in turn affect the charge for the GLWB. If the participant intends to elect a single life annuity, then the participant should be able to obtain spousal consent in connection with the start of withdrawals made from the cash value pursuant to the GLWB provision, rather than in connection with the annuity starting date. The participant and the spouse should not be forced to wait until the 180-day window before the annuity starting date.

We recognize that spousal consent obtained at the time of a mere investment in a deferred annuity contract may be remote to the commencement of payments, which is presumably the concern reflected behind the notion that spousal consent generally must be proximate to the annuity starting date. The Committee believes, however, that spousal consent should be valid if it is obtained in connection with the investment in a GLWB or other similar contract. For a life annuity like a GLWB, the only practical time to obtain spousal consent is at the time of the initial investment.

We note also that some plans take approaches designed to facilitate compliance with the election timing requirements. One approach is to provide that a participant may only elect a GLWB that is a single life annuity. However, if the participant does not obtain timely informed spousal consent during the election window, a joint and survivor annuity that is the actuarial equivalent of the single life annuity is paid. This approach provides a very practical solution, but it does prevent a participant from purchasing a GLWB that is based on the joint lives of the participant and a spouse. Rather than force plans into such an approach, we believe that a spouse should be able to execute an effective waiver at the time of the initial investment.

Response to RFI Question 28

Question 28 of the RFI inquires about how the minimum distribution requirements under Code section 401(a)(9) affect defined contribution plan sponsors' and participants' interest in the offering and use of lifetime income. The Committee believes that guidance can and should be issued under section 401(a)(9) that encourages lifetime income, including longevity insurance, from defined contribution plans and IRAs without prejudice to other important policy objectives. As discussed below, guidance should be issued that:

(a) encourages the use of longevity insurance,

(b) clarifies the ability of a designated beneficiary to take life-contingent annuity payments,

(c) clarifies the treatment of an annuity under an individual account plan, and

(d) clarifies the after-death distribution rules for Roth IRAs to accommodate annuity payments that commence during the owner's lifetime.

Part A:
Treasury Department guidance should clarify the required minimum distribution rules to encourage the use of longevity insurance

Longevity insurance provides retired individuals with an affordable way to protect against running out of income if they outlive their life expectancy. In general, a longevity insurance contract is an annuity which provides a very limited death benefit (if any), and pays a stream of periodic payments for the individual's life (or the joint lives of the individual and his designated beneficiary) commencing late in life, *e.g.*, age 85. Unlike other deferred annuity contracts, a longevity insurance contract provides no cash surrender value. An individual can use a portion of his retirement savings, such as his IRA assets or balance in an employer retirement plan, to insure his longevity risk by purchasing longevity insurance contract that provides a life annuity commencing at the end of his life expectancy, determined at the time payments commence. The individual would then be free to spend down his remaining assets over his specified life expectancy. If the individual outlives his life expectancy, *e.g.*, lives beyond age 85, the longevity insurance would make lifetime payments to the individual. Longevity insurance can provide valuable lifetime income at a low cost. However, as discussed below, the use of longevity insurance with IRAs and qualified plans is hindered by the section 401(a)(9) required minimum distribution rules.

Code section 401(a)(9) imposes minimum distribution requirements on employer retirement plans and IRAs that provide generally for the distribution of an individual's interest in the arrangement over the life or life expectancy of the individual (or over the joint lives or joint life expectancies of the individual and a designated beneficiary). Under section 401(a)(9), the individual must take required minimum distributions ("RMDs") with respect to the plan or IRA that are computed based on the individual's account balance in the arrangement. For this purpose, the regulations under section 401(a)(9) provide generally that the account balance of an annuity contract prior to the date annuity payments commence is the entire interest in the contract, and that the entire interest consists of the contract's cash value and the "actuarial present value" of any additional benefits provided under the contract.[38]

Under these rules, in the case of a longevity insurance contract held in an employer retirement plan or an IRA, the value of the longevity insurance contract is taken into account in calculating RMDs with respect to the plan or IRA. However, because longevity insurance typically has no cash value from which distributions can be made, the longevity insurance contract by itself cannot satisfy the RMD rules prior to the time the benefit payments begin. Rather, the longevity insurance contract must be held in an account with other liquid assets that can be used to make RMDs. It can be difficult to ensure that there will be sufficient other, liquid assets in the plan or IRA to satisfy the minimum distribution requirements. This problem can become more serious as the need for longevity insurance increases, *i.e.*, as the individual approaches the end of life expectancy and the fair market value of the longevity insurance contract increases.

This problem can be avoided if the individual's RMDs can be determined without regard to the value of longevity insurance prior to the date annuity payments commence. In that regard, the Committee recommends that the Treasury Department issue guidance clarifying that prior to the date that payments commence under longevity insurance, the value of longevity insurance is disregarded for purposes of determining the value of the employee's entire interest under a plan, and thus the employee's account balance in the plan. This clarification is provided in a bill (H.R. 2748) that was introduced in the House of Representatives on June 8, 2009. However, we believe that legislation is not necessary to implement this change and that the Treasury Department should implement the change by amending the regulations under Code section 401(a)(9).

Part B:
Treasury Department guidance should clarify a designated beneficiary's ability to take life-contingent annuity payments under the RMD rules

Code section 401(a)(9)(B) sets forth the minimum distribution requirements that apply after the death of the employee. Those requirements differ depending on whether the employee dies prior to the "required beginning date," or on or after that date. The regulations permit an employee to commence taking life-contingent annuity payments at any time while the employee is alive, without regard to whether annuity payments begin before or after the required beginning date, and without regard to whether the designated beneficiary is the employee's spouse. As such, the regulations remove certain limitations that existed under the 1987 proposed regulations under section 401(a)(9) regarding an employee's ability to receive life-contingent annuity payments.[39] Nonetheless, uncertainty remains under the regulations about the ability of a

[38] Treas. Reg. § 1.401(a)(9)-6, Q&A-12.

[39] Under the 1987 proposed regulations, life-contingent annuity payments could commence after the employee's required beginning date only if made to the employee, or the employee and the employee's spouse, and only if their life expectancies were being recalculated as of the required beginning date. The life expectancy of a non-spouse designated beneficiary could not be recalculated, and life-contingent annuity payments beginning after the required beginning date could not be made to such a beneficiary. These limitations were removed by the existing regulations. *See* Treas. Reg. § 1.401(a)(9)-6, Q&A-1, Q&A-2.

designated beneficiary to take life-contingent payments commencing after the employee's death. As explained below, the Committee believes that guidance should be issued clarifying the ability of a designated beneficiary to select life-contingent annuity payments.

Section 401(a)(9)(B)(i) provides that if an employee dies after the required beginning date, any remaining portion of the employee's interest must be distributed to the designated beneficiary at least as rapidly as under the method of distribution being used as of the date of death (the "at-least-as-rapidly rule"). The regulations under section 401(a)(9) provide that annuity payments commencing after distributions are required to begin, *e.g.*, after the employee's death, will satisfy the minimum distribution requirements if they are made in accordance with the requirements of Treas. Reg. section 1.401(a)(9)-6, which addresses the treatment of annuity payments.[40] However, those requirements do not address the treatment of annuity payments that commence both after the employee's death and after the required beginning date.[41] Thus, it appears that the regulations do not permit a designated beneficiary (even a designated beneficiary who is the employee's surviving spouse) to elect to have any remaining interest distributed in the form of lifetime annuity payments. Rather, it appears that the remaining interest must be paid over a period not exceeding the longer of the deceased employee's remaining life expectancy and the designated beneficiary's life expectancy.[42] This treatment is inconsistent with—

- the treatment of individual accounts under the regulations, which allow distributions for the surviving spouse's life by permitting the surviving spouse to recalculate life expectancy annually for as long as the surviving spouse is alive;[43]

- allowing the employee to select a joint life annuity that provides for lifetime payments to the designated beneficiary after the employee's death;[44] and

- the goal of encouraging distributions to be made in a manner that will continue for as long as the employee and his or her beneficiary survive.

Accordingly, we recommend that the Treasury Department clarify the section 401(a)(9) regulations to provide that if an employee dies after the required beginning date, the employee's designated beneficiary may elect to receive the remaining interest in the form of a life annuity.

If an employee dies prior to the required beginning date, any remaining interest must be distributed within 5 years after the employee's death (the "5-year rule"), or over the life of the designated beneficiary or a period not extending beyond the life expectancy of the designated beneficiary (the "lifetime payout rule"). It appears that a designated beneficiary who elects to take distributions over his or her life expectancy under the lifetime payout rule may later begin

---

[40] Treas. Reg. § 1.401(a)(9)-5, Q&A-1(e).

[41] Treas. Reg. § 1.401(a)(9)-6, Q&A-3(b).

[42] Treas. Reg. § 1.401(a)(9)-5, Q&A-5(a).

[43] Treas. Reg. § 1.401(a)(9)-5, Q&A-5(c)(2).

[44] Code § 401(a)(9)(A)(2).

life-contingent annuity payments under that rule.[45] However, this is not entirely clear under the provisions of the section 401(a)(9) regulations addressing the treatment of annuity payments,[46] and it should be clarified as well.

Part C:
Treatment Department guidance should clarify the treatment of an "annuitized" annuity contract under an individual account plan

As indicated above, the section 401(a)(9) regulations set forth different rules for determining RMDs from an annuity and an individual account. The regulations provide that an annuity contract under an individual account plan is treated as an individual account prior to the date annuity payments commence. However, the regulations do not clearly address the treatment of an annuity under an individual account plan after annuity payments commence, *e.g.*, a payout annuity held by an individual retirement account and not distributed out of the account. Thus, it is uncertain how the RMD rules apply in such cases. This uncertainty may discourage individuals from receiving part or all of their retirement savings held in an individual account in the form of a life-contingent annuity.

As a result, we suggest that the Treasury Department consider amending the regulations to provide safe harbor methods of computing RMDs where annuity payments have commenced under an annuity contract held in an individual account plan. Set forth below are two possible safe harbor methods that we believe could work for this purpose:

- *The individual account method.* The RMDs for a year with respect to the individual account plan will equal the account balance of the plan, divided by the applicable distribution period, where the account balance reflects the fair market value of the annuity. This approach ignores whether the annuity payments meet the annuity rules under the RMD regulations.

- *The hybrid method.* If the annuity payments satisfy the annuity rules under the RMD regulations, for calendar years after the calendar year in which the annuity payments commence, the RMDs with respect to the individual account plan will equal (1) the amount of the annuity payments for the year that constitute RMDs, plus (2) an amount determined by separately applying the individual account rules to the remaining account balance, if any.

Such clarification would help encourage individuals to take at least part of their retirement savings that are held in individual accounts in the form of lifetime annuity payments.

[45] *See* Treas. Reg. § 1.401(a)(9)-5, Q&A-1(e).

[46] *See* Treas. Reg. § 1.401(a)(9)-6, Q&A-3(b).

Part D:
Treasury Department guidance should clarify the after-death distribution rules for Roth IRAs to accommodate annuity payments commencing during the owner's lifetime

Roth IRAs are not subject to the section 401(a)(9) minimum distribution requirements while the owner is alive. After the owner's death, the owner's remaining interest in the Roth IRA must be distributed under the after-death distribution rules set forth in section 401(a)(9)(B). The after-death distribution rules differ depending on whether the individual dies before the required beginning date (in which case a 5-year rule or lifetime distribution rule applies), or dies on or after that date (in which case the at-least-as-rapidly rule applies).

The Roth IRA regulations take the position that the after-death distribution rules apply to a Roth IRA as if the owner died <u>before</u> the required beginning date, meaning that the 5-year rule or the lifetime payout rule applies, rather than the at-least-as-rapidly rule.[47] As a consequence, it is quite difficult to structure life annuity payments during the owner's life in a manner that will comply with this requirement after the owner's death.

To elaborate, the section 401(a)(9) regulations provide that if annuity payments commence prior to the required beginning date, the annuity starting date is treated as the required beginning date for purposes of section 401(a)(9).[48] Hence, if the owner dies on or after the date annuity payments commence, the annuity payments made after the owner's death will necessarily satisfy the requirement in section 401(a)(9)(B)(i) that any remaining interest be distributed at least as rapidly as under the method of distribution being used at the time of death (*i.e.*, the at-least-as-rapidly rule). However, as noted above, the Roth IRA regulations provide that the at-least-as-rapidly rule does not apply to Roth IRAs. Rather, the remaining interest must be distributed under the 5-year rule or the lifetime payout rule. As a result, annuity payments commencing during a Roth IRA owner's life that satisfy the lifetime distribution rules under section 401(a)(9) nevertheless will fail to satisfy these after-death distribution rules unless, by chance, the owner happens to die at a time when post-death annuity payments are to be paid (1) for a remaining period certain that does not exceed the greater of 5 years or the designated beneficiary's remaining life expectancy, or (2) for the life of the designated beneficiary, without a guarantee period or with one that does not exceed the designated beneficiary's remaining life expectancy.[49]

---

[47] Treas. Reg. § 1.408A-6, Q&A-14.

[48] Treas. Reg. § 1.401(a)(9)-6, Q&A-10.

[49] This problem is illustrated by the following example. Assume Jack Smith, who is 76 years old, wishes to annuitize his Roth IRA for life with a guaranteed period of 15 years, *i.e.*, payments will be made for the longer of Jack's life or 15 years. Jack wishes to name his sister Susan, who is 75 and lives with him, as his beneficiary, so if Jack dies before receiving payments for 15 years, the remaining payments will be made to Susan. Such a payment stream would satisfy the at-least-as-rapidly rule under the after-death RMD rules. However, since the Roth IRA regulations do not provide for the use of the at-least-as-rapidly rule, Jack cannot know whether this annuity stream will satisfy the after-death RMD rules applicable to his Roth IRA, because the answer depends on when Jack dies. If Jack dies 10 years later, when Susan is age 85, and there are 5 years of guaranteed payments remaining, Susan would be able to continue the payments and satisfy the RMD rules. (This is because Susan's life expectancy at the time of Jack's death is 7.6 years, which is longer than the period over which the remaining payments will be made.) But, if Jack were to die 1 year after he purchased the annuity, when Susan would be entitled to the remaining 14 years of payments, she cannot receive the remaining guaranteed payments without violating the RMD rules. (This is because Susan's life expectancy at age 76 is only 12.7 years, which is shorter than the remaining guaranteed period.)

It is possible to mitigate this problem by limiting a period certain to the life expectancy of the designated beneficiary at the time the annuity is purchased or to only name a spouse as the designated beneficiary. However, even those approaches would not assure compliance with the Roth IRA regulations because the designated beneficiary may be changed or die after the annuity payments begin. The only way to assure compliance with the Roth IRA regulations is to restrict the annuity options that are available to pure life or joint life annuities (with no guarantee periods), or to limit any period certain to no more than 5 years. For many individuals, and for obvious reasons, these are unattractive choices.

This problem can be addressed, and life-contingent annuitization of Roth IRAs can be encouraged, by clarifying that the at-least-as-rapidly rule applies after the death of a Roth IRA owner where annuity payments that commence during the owner's life satisfy the annuity rules under the section 401(a)(9) regulations.

Response to RFI Questions 30-35

Questions 30-32 of the RFI inquire about the current use of, and potential changes to, the safe harbor under DOL regulation section 2550.404a–4 regarding the selection of providers of guaranteed lifetime income in connection with employer-sponsored retirement plans that are subject to ERISA. Similarly, questions 33 and 34 of the RFI inquire about the availability and use of guaranteed lifetime income distribution options in ERISA section 404(c) plans, and whether guidance should better encourage such plans to offer lifetime income options. Likewise, question 35 of the RFI asks whether there are actions, regulatory or otherwise, that the Agencies could or should take to encourage the use of lifetime income features in connection with qualified default investment alternatives.

As discussed in more detail below, there are several approaches that a plan sponsor may take in deciding to offer annuity distribution options under a plan. One approach is to allow a participant to use all or a portion of his or her account balance to purchase a commercial annuity.[50] A plan could, for example, offer to purchase any commercially available annuity at the direction of the participant, or offer only to purchase commercially available life-contingent annuities. This approach is comparable to an open brokerage window as part of a plan's investment menu, which permits a participant to invest in virtually any investment available through a broker. We refer to an arrangement that allows a participant to purchase any available commercial annuity as an annuity "purchase window."

At the opposite end of the spectrum from an open annuity purchase window is an annuity distribution option offering a single issuer and contract. Under this approach, the plan makes available only a single annuity product from a specified provider. A third approach might provide a middle ground between the foregoing two approaches by offering a menu of annuity issuers under the plan that is akin to a menu of investment options in a plan that permits participant investment direction. Regardless of the approach, certain improvements in the guidance pertaining to fiduciary duties in selecting annuity providers could help encourage plans to offer more lifetime income options.

Part A:
DOL guidance should clarify the fiduciary rules applicable to the selection and monitoring of distribution annuities

The Committee certainly understands and agrees that the selection of an annuity issuer and contract is a fiduciary act subject to the duty of prudence and loyalty. The Committee also greatly appreciates the DOL's safe harbor regulation addressing the fiduciary process in selecting an annuity contract and issuer for distributions. The safe harbor regulation is a vast improvement on the standard previously reflected in Interpretive Bulletin 95-1[51] and Advisory Opinion 2002-14A.[52]

---

[50] The annuity would of course have to be one that satisfies the applicable plan rules, including, among others, the prohibition against sex-distinct mortality tables in Title VII and the Equal Pay Act.

[51] 29 C.F.R. § 2509.95-1.

[52] Dec. 18, 2002.

We believe, however, that plan fiduciaries do not clearly understand the nature of their fiduciary responsibilities with respect to annuities and, therefore, the nature of their potential liability. For many years, the only guidance discussing the fiduciary standards applicable to the selection of an annuity provider for the purpose of benefit distribution was Interpretive Bulletin 95-1 and Advisory Opinion 2002-14A. Many understood the guidance to impose a heightened fiduciary standard applicable to the designation and selection of an annuity contract as an optional form of distribution from a defined contribution plan. The genesis of this interpretation was less the substance of the guidance than it was the use of the phrase "safest available annuity" in the guidance. While the guidance recognized that cost is a permissible consideration for defined contribution plans, and even that more than one provider might be the safest available annuity provider, the use of the phrase "safest available annuity" suggested that the paramount consideration is the highest possible degree of safety. Notwithstanding the safe harbor regulation and repudiation of Advisory Opinion 2002-14A, the "safest available annuity" standard continues to surface in conversations about fiduciary responsibility and to dampen enthusiasm for an annuity payout option. We believe that the DOL should further distance individual account plans from the safest available annuity standard by publishing educational material or other guidance that firmly states that fiduciaries are not responsible for selecting the safest available annuity.

The safe harbor regulation also reflects that the selection of an annuity contract is in some respects qualitatively different than the selection of an investment fund. An annuity contract providing guaranteed lifetime income has a potentially very long duration and there is a theoretical possibility that the issuer will become unable to meet its payment obligations. That is, there is a risk that the issuer will become insolvent (although the state insurance regulatory system and state guarantee funds substantially mitigate that risk for policyholders). For this reason, the safe harbor regulation provides that the plan fiduciary must conclude that the annuity provider is financially able to make all future payments under the annuity contract.[53]

The requirement that a plan fiduciary evaluate the claims-paying ability of an issuer is often a barrier to the offering of annuities in plans. Many plan fiduciaries find such an evaluation a daunting task, particularly given the detailed considerations that were reflected in Interpretive Bulletin 95-1, which some advisers still look to in counseling plan fiduciaries. We urge the DOL to consider whether there are reasonable and appropriate ways to make this process less intimidating to plan fiduciaries, for example, by shifting the fiduciary focus from the predictive question of whether the issuer will be able to make all future payments to a more concrete evaluation of the financial strength and quality of the issuer.

We also are concerned that some fiduciaries misapprehend the scope of their fiduciary responsibility in evaluating claims paying ability. The DOL could bring greater certainty to this issue by making clear that a fiduciary is not responsible for the decision to offer an annuity form of distribution. The decision to offer an annuity distribution option is a settlor, not a fiduciary,

[53] DOL Reg. § 2550.404a-4(b)(4).

function. It is a plan design decision.[54] The potential fiduciary liability is for the prudent selection and monitoring of the annuity distribution option.

This is a significant distinction. The counterparty risk inherent in offering a life-contingent annuity does not fall within the fiduciary's scope of responsibility. The fiduciary is responsible only for prudently selecting and monitoring the particular annuity contract or contracts that are available. Put differently, in order to establish fiduciary liability, a plaintiff could not merely aver that it was imprudent to offer an annuity form of distribution. The plaintiff would have to establish that the particular annuity was imprudent relative to other annuities.

Very broadly speaking, this standard is analogous to the standard that applies to a qualified default investment alternative. A plan fiduciary cannot be liable for investing participants on a default basis into, for example, a target date fund, if all of the other requirements are satisfied. Instead, the fiduciary is only liable for selecting an imprudent target date fund.[55] The qualified default investment alternative regulations have had an enormous effect on fiduciary behavior with the percentage of plans offering a target date fund (regardless of whether the plan has default contributions) skyrocketing.

Similarly, we believe that very simple guidance affirming that a plan fiduciary cannot be held liable for the offering of an annuity distribution option *per se* could have very positive consequences. We note, however, that it would be very important for any guidance to make clear that it is not breaking new ground, but rather confirming current law.

There is, of course, an alternative approach. One can reasonably view decisions about the forms of distribution that are available under a plan as a fiduciary decision. After all, a decision about decumulation is arguably a form of investment decision, and it is clear that all investment decisions are fiduciary in nature, even if such decisions are made by the employer in the plan document as a design decision. Under this view, an employer has a fiduciary obligation to prudently select and monitor a plan's distribution options to ensure that those options mitigate the risks associated with retirement payouts, including, among others, longevity risk and the risk that participants will retire during an adverse market (sometimes called "point-in-time risk").

Consider for a moment a world in which plans treat distribution options in the same manner as they treat investment options. If section 404(c) of ERISA is extended to distribution elections, plans might offer as a matter of course a variety of different payout forms, including lump sums, systematic withdrawals, and life-contingent annuities. These different forms of distribution would provide participants with a diversified range of vehicles and approaches for managing their retirement security. Most importantly, however, the current discontinuity between the level of fiduciary responsibility associated with offering a lump sum or installment

---

[54] The only discussion of this issue appears to be informal testimony at an Advisory Council Hearing. *See* ERISA Advisory Council Report on the Spend Down of Defined Contribution Assets at Retirement (2008) (testimony of Robert Doyle stating that the addition of an annuity distribution option is a settlor activity).

[55] At some level, this is very modest fiduciary relief. The distinction between liabilities for imprudent selection of a particular fund as opposed to imprudent selection of a particular fund type is easier to articulate than apply.

form of payout and an annuity form of payout would be eliminated. All distribution options would be subject to fiduciary responsibility. The only difference relative to annuities would be consideration of the issuer's ability to make all anticipated benefit payments.

We appreciate that such an approach would represent a significant change. While we urge the Department to consider the notion, we recognize that there will be a natural reluctance to move the employer community in this direction. At a minimum, however, the idea is a useful one because it highlights the current discontinuity in the level of fiduciary responsibility associated with various distribution options. It is this discontinuity that needs to be minimized. While there will and should be a fiduciary review of whether an issuer can make all anticipated benefit payments, the prevailing notions of fiduciary responsibility create a strong bias away from annuities simply because there is no fiduciary responsibility at all associated with other options. This bias needs to be minimized either by clarifying that offering of an annuity form of distribution is a settlor decision or by extending fiduciary responsibility to the selection of any distribution option.

Part B:
DOL guidance should encourage plans to offer a reasonable menu of annuity providers for distribution purposes

As indicated above, one approach to offering annuity distribution options within an employer-sponsored plan is where the employer chooses to establish a menu of distribution annuities that is akin to a menu of investment options in a plan that permits participant investment direction. Consider, for example, a plan that offers to purchase a single premium immediate life annuity from any of six different issuers at a participant's direction. The contracts might have different features; for example, some contracts may be variable contracts and others fixed. Some may have different hedges against inflation; for example, some might be equity-indexed annuities and others might have cost-of-living adjustments. In addition, the issuers might have different profiles; for example, one might be a mutual organization and one might be a member of a large international financial services enterprise.

Such an arrangement could have significant virtue. By limiting the universe of available issuers and contracts to a manageable number, the annuity selection process would be less intimidating and more manageable for participants. In addition, the employer could allow issuers to provide marketing materials and investment education materials related to decumulation to participants and, thereby, greatly enhance the dialogue about annuitization and the rate of annuitization.

Further, such an approach could encourage participants to consider spreading their annuity purchases over more than one issuer. In this regard, there are potential advantages to diversification through annuity purchases with more than one provider. There are also advantages to laddering, *i.e.*, purchasing annuities at different times to mitigate the risk of purchasing at a time when interest rates or mortality tables are particularly unfavorable, which might be more apparent to participants in a plan that offers a menu of issuers and contracts.

In our experience, however, employers have been reluctant to limit the universe of available issuers and contracts under an annuity purchase window for fear of fiduciary liability.

These employers have reasoned that the same fiduciary standards of prudent selection and monitoring that apply to the offering of only one issuer and contract apparently also apply to the offering of a reasonable and diverse annuity purchase window. Put differently, the notion has been that nothing in current law provides that a plan fiduciary is not liable for any losses that result from a participant's exercise of control with respect to the election of an annuity provider or contract.

The Committee believes that a diverse and reasonable menu of annuity distribution offerings should be covered by section 404(c) of ERISA, and that the DOL should issue regulations that apply section 404(c) to an annuity purchase menu. Thus, like a plan with participant-directed investment options, the plan's fiduciaries would be responsible for the prudent selection and monitoring of the available annuity distribution options, but would not be liable for any losses that flow from the participant's election of a particular issuer or contract (assuming that the plan's fiduciaries otherwise met their obligations to prudently select and monitor the available options). By extending this familiar set of fiduciary responsibilities to annuity selection, we believe that employers will be more comfortable with the notion of making annuity distribution options available in plans.

Section 404(c) of ERISA on its face refers only to a participant's exercise of control over the assets of his account. It is not limited to plans that permit investment control. Moreover, the selection of an annuity provider from a menu of providers is in effect an investment decision. This point is aptly illustrated by plans that offer a deferred annuity as an investment option as well as a distribution option. It is clear that a participant's investment in the deferred annuity as an investment option is subject to section 404(c), provided the plan otherwise satisfies the applicable requirements. It would be wholly anomalous for the participant's selection to have a different treatment for distribution purposes. Put simply, we are not aware of any statutory or policy barriers to explicitly extending section 404(c) to annuity selection, and it clearly makes sense as a matter of retirement policy.

Moreover, such an approach would provide the DOL with significant authority to ensure that section 404(c) applies to an annuity purchase menu only in appropriate circumstances. The DOL could, for example, establish basic guidance to ensure that the choices constitute a reasonable selection. Similarly, the DOL could establish disclosure requirements to ensure that participants have sufficient information about annuity selection. The section 404(c) regulations for investment options are predicated upon both a diverse menu of options and disclosure of adequate information to participants. A similar predicate could apply to annuity distribution options, which could both encourage the selection of guaranteed lifetime income options and ensure that participants make informed choices.

Guidance to this effect would create an incentive for employers to offer a prudent and diverse annuity selection menu. The employer would be responsible for the prudent selection and monitoring of the annuities that comprise the menu. Participants, on the other hand, would be responsible for the consequences that flow from their particular distribution elections.

Part C:
DOL guidance should clarify the fiduciary rules that apply to plans offering an annuity purchase window

Guidance should make it easier for plans to offer to use all or a portion of a participant's account balance to purchase a life-contingent annuity. As mentioned above, many individual account plans do not offer a life-contingent annuity form of distribution. In the case of plans that do offer such payout options, one approach is to allow the participant to use all or a portion of his or her account balance to purchase a commercial annuity.[56] A plan could, for example, offer to purchase any commercially available annuity at the direction of the participant. Alternatively, a plan might offer only to purchase commercially available life-contingent annuities. These arrangements are comparable to an open brokerage window as part of a plan's investment menu, which permits a participant to invest in virtually any investment available through a broker. As indicated above, we refer to an arrangement that allows a participant to purchase any available commercial annuity as an annuity "purchase window."

Some employers whose plans are subject to ERISA are reluctant to offer an annuity purchase window because of concerns about fiduciary responsibility, and we believe that more employers would offer annuity purchase windows if these rules were clarified. In particular, we believe that two clarifications are needed.

1. *First, guidance should clearly state that plan fiduciaries are not responsible for reviewing the annuity contracts and issuers that are available through an annuity purchase window.*

This is analogous to the treatment of investments in a participant-directed plan that satisfies ERISA section 404(c). The plan fiduciary is responsible for the prudent selection and monitoring of any investments that are designated options, *i.e.*, options that constitute the plan's menu. However, the plan fiduciary is not responsible for the prudent selection and monitoring of the investments that are offered through an open brokerage window and, therefore, are not designated investment options. The rationale in the investment context is simply that the plan fiduciary is not exercising its fiduciary authority to select any particular investment options.[57] This same rationale should apply in the context of an annuity purchase window.

Guidance should also reflect the notion that the employer may impose reasonable limits on the scope of the window without triggering fiduciary liability. In practice, open brokerage windows almost invariably impose limitations on permitted investments to avoid, for example, unrelated business taxable income and prohibited transactions. Others impose more sweeping limitations, for example, by limiting the universe of investment options to mutual funds. We believe that similar limitations should be permitted in an annuity purchase window. For example, an employer should be able to offer a distribution option whereby a participant may

[56] The annuity would of course have to be one that satisfies the applicable plan rules.

[57] 57 Fed. Reg. 46,906, 46,924 n. 27 (Oct. 13, 1992) (preamble to final ERISA § 404(c) regulations stating that "the act of limiting or designating investment options which are intended to constitute all or part of the investment universe of an ERISA 404(c) plan is a fiduciary function"); *see also* DOL Prop. Reg. § 2550.404a-5(f) (discussing fiduciary duty to select and monitor only in context of "designated investment alternatives").

direct the plan to purchase any commercially available life-contingent annuity, rather than any annuity, without triggering fiduciary liability and responsibility.

2. *Second, guidance should reflect that the plan fiduciary is not responsible for monitoring or overriding a participant's selection of a particular contract.*

The DOL's regulation on the safe harbor fiduciary process for the selection of an annuity contract states that a plan fiduciary is not required to review the prudence of a conclusion with respect to any annuity contract purchased for any specific participant if the selection of the contract as a distribution option was otherwise prudent.[58] We believe that a statement along these lines also would be helpful outside of the safe harbor and in the context of an annuity purchase window.

Guidance confirming this analysis would make annuity purchase windows more attractive to employers. We recognize that an annuity purchase window is not an ideal solution. An annuity purchase window is not substantially different than a rollover of plan assets to an individual retirement annuity. It does, however, offer an incremental benefit because the purchase of an annuity through a plan would eliminate a step in the process – rollover to an IRA. More importantly, however, annuity purchase windows send a message to participants that they should consider annuitization. The key participant communications in a plan that offers an annuity purchase window, including summary plan descriptions and benefit distribution forms, reference annuities. This encourages participants to think about the decumulation phase of retirement. We believe this message will, in turn, encourage participants to elect to receive their retirement savings in the form of guaranteed lifetime income both within the plan and through an individual retirement annuity.

Part D:
DOL guidance should clarify that the fiduciary rules for IRA annuity purchase platforms communicated by employers are the same as those that apply to plan annuity purchase windows

As reflected above, our perspective is that employers would like to help employees obtain the retirement security that comes with guaranteed lifetime income but are sensitive to potential fiduciary responsibility for annuity selection. Some employers have attempted to resolve this tension by providing participants with information about services that offer access to a large, but limited, menu of insurers and products for the purpose of rolling a single sum distribution into an individual retirement annuity. These services – sometimes referred to as annuity purchase platforms – are similar in nature to an annuity purchase window in a plan that limits the universe of available insurers and contracts. These platforms, however, provide other services, for example, facilitating comparisons between annuity contracts and providers. The Committee believes that these platforms serve a useful function by facilitating the purchase of lifetime income payments through IRAs.

It is, of course, clear that a rollover from a plan to an individual retirement annuity at the election of a participant does not involve fiduciary responsibility. One issue that arises,

[58] DOL Reg. § 2550.404a-4(c)(2).

however, is whether communications by employers to participants about individual retirement annuity purchase platforms result in fiduciary responsibility with respect to rollovers. The notion could be that the employer is providing fiduciary investment advice by implicitly or explicitly endorsing a rollover to the individual retirement annuity platform because of the employer's role as a plan fiduciary in another capacity.[59] It is also possible to conceptualize the individual retirement annuity purchase platform as a distribution option under the plan and, therefore, subject to whatever fiduciary analysis applies to an annuity purchase window.

Some have taken the position that an employer does not have any fiduciary responsibility with respect to the platform even if the employer is explicitly or implicitly endorsing the platform. Others have focused the analysis on the extent to which the employer is endorsing the platform. Yet others have suggested that the employer retains residual fiduciary responsibility but that the fiduciary responsibility is of a lesser magnitude than if the employer had offered the same platform directly through the plan. This uncertainty has not served participants well, simply because current law muddies the role of the employer and creates a bias away from the offering of annuities through plans.

We believe that the DOL should clearly delineate the circumstances in which employers have fiduciary responsibility with respect to a rollover to an individual retirement annuity. In the vast majority of circumstances, it will be clear that fiduciary responsibility does not exist. However, in circumstances where an employer is communicating to participants about individual retirement annuities, it is important that there be a level playing field between annuity purchase windows in plans and individual retirement annuity platforms that function as part of the plan. To be clear, our purpose is not to criticize individual retirement annuity purchase platforms. We strongly believe that these platforms play a valuable role and should be encouraged. Instead, our point is that the law should not create a bias away from the purchase of annuity protections within a plan. To the extent that an employer may communicate and even endorse an individual retirement annuity purchase platform, we believe that an employer should also be able to communicate and endorse an annuity purchase window within a plan, which would typically involve a limited universe of issuers and contracts.

Part E:
DOL guidance should encourage plans to offer qualified default investment alternatives that include guaranteed lifetime income elements

The DOL's final regulations on qualified default investment alternatives ("QDIAs") explicitly recognize that an investment option will not fail to be a QDIA solely because it is offered through a variable annuity.[60] Similarly, the guidance suggests that a deferred fixed annuity may be an investment component of a QDIA. The Committee greatly appreciates this guidance. It has been very helpful in facilitating the use of annuity contracts in connection with default investment alternatives. For the most part, however, it does not appear that many plans

[59] *See, e.g.*, ERISA Advisory Op. 2005-23A (Dec. 7, 2005) (treating a person that is otherwise a fiduciary as providing fiduciary investment advice with respect to a rollover where such advice would not be fiduciary investment advice otherwise).

[60] DOL Reg. § 2550.404c-5(e)(4)(vi).

have implemented QDIAs that involve annuity contracts that will also be used as default forms of distribution.

There is little question that default rules have enormous potential to harness inertia to improve participant decision-making. The Committee believes that QDIAs present an opportunity to encourage participants to take a portion of their retirement savings in the form of a life-contingent annuity. Under this approach, participants could be defaulted into a QDIA that includes a life-contingent annuity and that will pay out at least in part in the form of a life annuity absent a participant election to the contrary.

The current QDIA regulations could be improved to encourage default distributions from QDIAs in certain respects. First, the guidance could explicitly provide that a participant will be treated as electing a payout in the form provided under the QDIA if the participant is provided adequate notice of the default form of payout. This is the same approach that is taken with respect to default investments, and we believe that a symmetric approach to payouts would be helpful. Second, the guidance could encourage the inclusion of life annuity options through examples that highlight the use of a QDIA as both a default investment and a default form of distribution. The examples should illustrate the use of a deferred fixed annuity as a component of a target date fund or managed account option during the accumulation phase as well as during the payout phase when life-contingent payments commence. Similarly, an example of a living benefit, such as a GLWB, in connection with a QDIA would be appropriate. We believe that examples would help employers to get comfortable with the notion of taking into account the decumulation phase of retirement when designing a QDIA.

Miscellaneous Comments

In addition to the specific questions from the RFI addressed above, the Committee believes that two other issues not expressly raised in the RFI are worthy of comment. In particular, we believe that guaranteed lifetime income options may be more widely utilized if the Treasury Department would issue guidance addressing uncertainty about the use of life annuities to satisfy an exception to the 10% penalty tax for premature distributions from qualified plans, and the Internal Revenue Service (the "Service") would address certain inefficiencies in the IRA prototype approval program as it relates to annuities. These issues are discussed next.

Part A:
Treasury Department guidance should clarify the forms of life annuities that qualify as "substantially equal periodic payments" under Code section 72(t)(2)(A)(iv)

One aspect of the current tax rules that may discourage the election of life-contingent annuity payments is uncertainty and confusion regarding how such payments can constitute "substantially equal periodic payments" ("SEPPs") for purposes of Code section 72(t)(2)(A)(iv). That section provides an exception (the "SEPP Exception") to the 10% penalty under Code section 72(t)(1) that otherwise is imposed on premature distributions from qualified retirement plans (as defined in Code section 4974(c)). The uncertainty surrounding the treatment of life annuity payments as SEPPs may encourage individuals to elect other forms of payments that do not provide guaranteed lifetime income but that more clearly qualify as SEPPs under existing guidance. As a result, we believe that the Treasury Department should issue guidance clarifying that certain types of annuity payments do in fact satisfy the SEPP Exception.

Code section 72(t)(1) provides that an individual's tax for a year in which he or she receives an amount from a qualified plan is increased by 10% of the taxable portion of such amount, subject to certain exceptions. The SEPP Exception provides that the 10% penalty does not apply to distributions which are part of a series of SEPPs for the employee's life (or life expectancy) or the joint lives (or joint life expectancies) of the employee and a designated beneficiary. Existing published guidance on the calculation of SEPPs is directed at distributions from accounts and deferred annuities, *i.e.*, annuities under which annuity payments have not begun because the contract has not been annuitized.[61] While it is fairly clear that payments made by a simple fixed life annuity, *i.e.*, in equal dollar amounts, with no refund feature or guarantee period would qualify as SEPPs, the status of other forms of life annuities, *e.g.*, a life annuity with a guarantee period, is less clear. Accordingly, some individuals who desire or need to begin receiving amounts from a qualified plan or IRA prior to attaining age 59½ are reluctant to take the amounts as a life annuity, or a joint life annuity, for fear of failing to satisfy the SEPP Exception. To address this concern, we believe that the Treasury Department should issue guidance clarifying that various forms of life (and life expectancy) annuities qualify as SEPPs, including the following:

---

[61] *See*, *e.g.*, Rev. Rul. 2002-62, 2002-2 C.B. 710.

(a) *Periodic payments under a life annuity with a period certain.* The SEPP Exception applies to SEPPs that are (1) life-contingent payments, or (2) guaranteed payments for life expectancy or joint life expectancy. A very common form of life annuity, however, combines lifetime payments with a minimum guarantee period, *e.g.*, annuity payments for life with a 10-year period certain. Guidance should clarify that if SEPPs are made for life or joint lives, a guarantee period can be included and that period can be less than life expectancy or joint life expectancy.

(b) *Annuity payments that increase due to cost-of-living adjustments.* The legislative history of Code section 72(t)(2)(A)(iv) provides generally that payments will not fail to be SEPPs solely because they vary on account of certain cost-of-living adjustments.[62] However, there is no published guidance confirming this general statement. Partly because of this uncertainty, insurers are reluctant to offer individuals who have not attained age 59½ lifetime annuity payments with cost-of-living features that mitigate the effects of inflation. Guidance should be issued clarifying that annuity payments that vary on account of cost-of-living adjustments will be treated as SEPPs.

(c) *Variable annuity payments.* Under existing published guidance, an individual may take periodic distributions from a qualified plan or IRA that are treated as SEPPs, even though the individual's account balance, and thus the amount of each distribution, will vary in accordance with the investment performance of the underlying assets in the arrangement. However, there is no published guidance clarifying that life (and life expectancy) annuity payments under a variable annuity contract that vary in accordance with the investment performance of the contract's underlying assets likewise satisfy the SEPP Exception.

(d) *Annuity payments that increase annually by a constant percentage applied not less frequently than annually.* It is unclear whether life (or life expectancy) annuity payments that increase annually by a constant percentage (*e.g.*, 3%, which is designed to mitigate the effects of inflation) will constitute SEPPs within the meaning of section 72(t)(2)(A)(iv). As a result, insurers are reluctant to offer life annuities to individuals who have not attained age 59½ if the annuities provide payments that increase by a constant percentage. Guidance should be issued clarifying that annuity payments that increase annually by a constant percentage applied not less frequently than annually will be treated as SEPPs, at least in circumstances in which such payments satisfy the requirement under section 401(a)(9) that annuity payments be nonincreasing.[63]

---

[62] *See* S. REP. NO. 99-313, at 615 (1986); STAFF OF THE J. COMM. ON TAX'N, 99TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 717 (J. Comm. Print 1987).

[63] The regulations under section 401(a)(9) allow annuity payments to increase by a constant percentage only if the total future expected payments exceed the total value being annuitized. For this purpose, the total future expected payments must be determined without regard to any increases in annuity payments after the date of determination. *See* Treas. Reg. § 1.401(a)(9)-6, Q&A-14(c) and (e)(3). This effectively constrains the constant percentage by which annuity payments can increase.

The Committee believes that guidance addressing the foregoing points would remove significant disincentives to electing life-contingent annuity payments for individuals who are under age 59½.

Part B:
Guidance from the Service should update and simplify the prototype IRA procedures for annuities

Individual retirement annuities provide unique and valuable benefits to a substantial number of individuals. Only an annuity allows the owner of an IRA to convert retirement savings into a stream of periodic payments guaranteed to continue for as long as the owner (and his or her beneficiary) live. As the RFI recognizes, many individuals currently do not have access to guaranteed lifetime payments through the workplace, meaning that individual retirement annuities serve a critical role in achieving retirement security for many Americans – a role that could be expanded through guidance that better facilitates the offering and use of individual retirement annuities that provide guaranteed lifetime income.

One way that this could be accomplished is by the Service improving and simplifying the prototype approval process currently in place for IRAs. The Committee appreciates the time and effort that the Service dedicates to maintaining the prototype programs for various types of IRAs. Prototype approval provides both purchasers and issuers of IRAs with valuable assurance that the Service views the form of the arrangement as satisfying the applicable requirements of the Code. However, the current prototype procedures for individual retirement annuities discourage insurers from obtaining and maintaining prototype approval of their annuity contracts and require costly and inefficient use of Service and insurance company resources. The Committee believes that the Service can improve and simplify the prototype approval process – and thereby encourage broader use of individual retirement annuities that offer guaranteed lifetime income – by taking the following steps:

(1) provide pre-approved model endorsements for all individual retirement annuity contracts;

(2) update the existing pre-approved model language for individual retirement annuities and the model endorsement for Roth IRAs;

(3) allow an IRA endorsement that has received prototype approval to be used with multiple annuity contracts of the insurer; and

(4) improve the procedures for amending and updating prototype individual retirement annuity documents.

By taking these steps, the IRS can make the prototype IRA approval process more effective, efficient, and reliable for annuity owners, the IRS, and annuity issuers.

* * * * *

Attachment

The Committee of Annuity Insurers
The Willard Office Building
Suite 1200
1455 Pennsylvania Ave., NW
Washington, D.C. 20004

AEGON Group of Companies, Cedar Rapids, IA
AIG American General, Wilmington, DE
Allstate Financial, Northbrook, IL
AmerUs Annuity Group Co., Topeka, KS
AXA Equitable Life Insurance Company, New York, NY
Commonwealth Annuity and Life Insurance Co.
(a Goldman Sachs Company), Southborough, MA
Conseco, Inc., Carmel, IN
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc, New York, NY
Hartford Life Insurance Company, Hartford, CT
ING North America Insurance Corporation, Atlanta, GA
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Life Insurance Company of the Southwest, Dallas, TX
Lincoln Financial Group, Fort Wayne, IN
MassMutual Financial Group, Springfield, Massachusetts
Metropolitan Life Insurance Company, New York, NY
Nationwide Life Insurance Companies, Columbus, OH
New York Life Insurance Company, New York, NY
Northwestern Mutual Life Insurance Company, Milwaukee, WI
Ohio National Financial Services, Cincinnati, OH
Pacific Life Insurance Company, Newport Beach, CA
Protective Life Insurance Company, Birmingham, AL
Prudential Insurance Company of America, Newark, NJ
RiverSource Life Insurance Company (an
Ameriprise Financial Company), Minneapolis, MN
Sun Life of Canada, Wellesley Hills, MA
Symetra Financial, Bellevue, WA
TIAA-CREF, New York, NY
USAA Life Insurance Company, San Antonio, TX

The Committee of Annuity Insurers was formed in 1982 to participate in the development of federal tax and securities law policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.

May 3, 2010