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DOL Proposes to Include “Lifetime Income Illustrations” in Benefit Statements

On May 8, 2013 the Department of Labor (“DOL” or the “Department”) published an Advance Notice of Proposed Rulemaking (“ANPRM”) or “pre-rule” that focuses on providing lifetime income stream illustrations to participants of 401(k) and other defined contribution plans on benefit statements required by Section 105 of ERISA. (The ANPRM would not apply to benefit statements provided to participants of defined benefit plans.) Specifically, the ANPRM provides proposed operative language under Section 105 that would:

- require defined contribution plan administrators to describe a participant’s “total benefits accrued” on his/her pension benefit statement with four different figures, including a current account balance, projected account balance at normal retirement age, and a lifetime income stream illustration for each of these; and
- provide methodologies (including safe harbor rules) for calculating a participant’s projected account balance at normal retirement age and converting a participant’s current and projected account balances into lifetime income stream illustrations.

The ANPRM solicits comments on this language and related issues. Comments are due on or before July 8.

DOL’s Lifetime Income Initiative

Although the ANPRM only addresses a narrow issue presented under ERISA section 105 — that is, how to present a description of a participant’s “total benefits accrued” under a defined contribution plan, it is better understood as a next step in a broader DOL initiative to facilitate access to “lifetime income options” that could provide a lifetime stream of income after retirement to American workers who now primarily save for retirement through defined contribution plans. This initiative began in February of 2010 with a Request for Information that addressed a broad range of issues relating to the availability of lifetime income options, and was followed later that year by two days of public hearings. Some of the comments and other information generated in that process is discussed in the ANPRM.

The ANPRM presents, and seeks comments on, the Department’s current thinking about how lifetime income illustrations should be calculated and presented to participants. DOL specifically requests comments on whether lifetime income illustrations should be required — or only encouraged — and the costs and benefits of requiring lifetime income illustrations on pension benefit statements. Commenting to the DOL on these issues as presented in the ANPRM offers the best opportunity to influence the Department’s thinking, although there will be at least two more regulatory steps (notices of proposed and final rulemaking) before these requirements could be finalized.

Benefit Statement Content Requirements

Section 105 of ERISA, as amended by the Pension Protection Act of 2006, requires ERISA-covered pension plans to provide periodic benefit statements to plan participants. Section 105 requires the statement to indicate, on the basis of the latest available information, “the total benefits accrued.” The ANPRM proposes to require that “total benefits accrued” be reported to participants as four figures for each participant:

- 1) The current fair market value of the participant’s account as of the last day of the period covered by the statement;
- 2) The current dollar value of the participant’s projected account balance at the plan’s normal retirement age;
- 3) The current fair market value of the participant’s account as of the last day of the period expressed as a lifetime income stream; and
- 4) The participant’s projected account balance at normal retirement age expressed as a lifetime income stream.

The ANPRM contains a model table showing how these four values might be presented.

Current Balance \$125,000	Projected Balance \$557,534
Monthly Payment \$625	Monthly Payment \$2,788

It also would require a benefit statement to include an explanation (1) of the assumptions used to establish the projected account values and the lifetime income stream, and (2) that the projections are just projections and not guarantees.

Section 105 requires that pension benefit statements be provided to participants at least once each quarter for a participant-directed defined contribution plan, once each calendar year to participants in a non-participant-directed defined contribution plan, and upon request under certain circumstances.

Projecting an Account Balance at Normal Retirement Age

The ANPRM provides a general rule as well as safe harbor standards for projecting a participant’s account balance at normal retirement age under the plan. The projection must be expressed in current dollars (meaning, discounted for inflation) and must take into account future contributions and investment returns. The general rule allows an administrator to calculate the projection using reasonable assumptions and generally accepted investment theories and does not require any particular method, set of assumptions, or limit the factors to be considered so long as future contributions, investment return and inflation are taken into account.

The safe harbor incorporates specific assumptions for contributions, returns and inflation that plan administrators may rely on as “reasonable” under the regulation. The safe harbor assumptions are:

- Contributions will continue to normal retirement age at the current dollar annual dollar amount plus 3% per year;
- Investment returns are 7% per year; and
- A discount rate of 3% per year is used to convert the projection to current dollars.

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DOL explains its rationale for each of these safe harbor assumptions and requests comments that take into account the purpose for which these assumptions will be used. In this regard, it is worth noting that administrators will likely opt to take advantage of the safe harbor assumptions in calculating projections.

Calculating a Lifetime Income Stream

The ANPRM would require each of the participant's current and projected account balances to be expressed as a lifetime stream of income. A "lifetime income stream" is described as a level monthly payment beginning on an assumed commencement date and continuing for the life of the participant. If the participant is married, the participant's benefit statement must also include an additional lifetime income stream calculation — a stream of payments that includes a survivor's benefit equal to fifty percent of the payment payable to the participant payable for the life of the surviving spouse. DOL explains that it is proposing that a participant's accrued benefit should be described as a lifetime monthly payment as compared to converting the participants benefit following a "drawdown" approach (which assumes a fixed withdrawal over a specified period of years) because a method that projects "lifetime" income is consistent with DOL's goal to inform participants of their financial readiness for the entirety of their retired lives.

The ANPRM provides a general rule and a safe harbor for converting account balances into a lifetime income stream. The general rule requires that the assumptions used be reasonable, taking into account generally accepted actuarial principles. As with the account balance projection calculations, this general rule is designed to permit plans that are already providing a lifetime income stream calculation to follow existing practices and assumptions. The proposed safe harbor provides default assumptions for the interest rate and life expectancy — respectively, the 10-year Treasury constant maturity rate and the IRS's mortality tables. DOL specifically requests comments on these assumptions.

If a plan offers an annuity form of distribution, an administrator may use the actual terms of a contract with an annuity provider when calculating lifetime income streams. With respect to "in-plan" annuity products that are offered as investment options and permit participants to make ongoing contributions toward a current purchase of a future stream of retirement income payments, DOL is seeking additional comments on how to best factor these types of investments into lifetime income illustrations.

We hope this preliminary analysis is of assistance to you. If you have questions, please call your regular Groom attorney or any of the attorneys listed in the sidebar.