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DOL Clarifies Safe Harbor on Defined Contribution Annuity Distribution Options

On July 13, 2015, the Department of Labor ("DOL") issued Field Assistance Bulletin 2015-02 ("FAB") interpreting the safe harbor regulation promulgated by DOL under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") for plan fiduciary selection of annuity providers under defined contribution plans that offer annuity distribution options (the "Safe Harbor"). *See* 29 C.F.R. § 2550.404a-4. Through the FAB, DOL attempts to address what it believes to be confusion among plan fiduciaries regarding how to comply with the Safe Harbor with regard to the selection and monitoring of annuity providers.

In the FAB, DOL confirms, among other things, that the conditions of the Safe Harbor provide that a plan fiduciary's responsibility to monitor an annuity provider ends when he or she selects a new annuity provider, not when the original annuity provider finishes making all promised payments under annuity contracts it issued on behalf of plan participants and beneficiaries. In addition, the FAB also clarifies that the statute of limitations for imprudent selection of annuity providers begins to run on the date that plan assets are used to purchase the annuity.

Some plan fiduciaries and insurance companies will find the guidance in the FAB helpful to the extent a defined contribution plan offers an immediate annuity distribution option (e.g., joint and survivor or single life annuity) or a qualified longevity annuity contract option ("QLAC") (including some deferred income annuities). Unfortunately, however, the FAB does not address how the Safe Harbor applies when the fiduciary selects an insurance company that provides other "guaranteed lifetime income" options or features in a defined contribution plan, such as deferred income annuities that may not be a QLAC, guaranteed minimum income benefit features, and guaranteed lifetime withdrawal benefit features.

Background

Under the Safe Harbor, a plan fiduciary will be deemed to satisfy their duties of prudence, if before selecting an annuity provider and contract, if the plan fiduciary:

- Engages in an objective, thorough, and analytical search for the purpose of identifying and selecting providers from which to purchase annuities;
- Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;

- Appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract;

- Appropriately concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and

- If necessary, consults with an appropriate expert or experts.

The Safe Harbor also requires that a fiduciary periodically review annuity providers and their annuity contracts, including the costs of the annuity contract and the financial ability of the annuity provider to make future payments under the annuity contract. However, DOL stated in the FAB that the fiduciary's "selection and monitoring of an annuity provider is judged based on the information available at the time of the selection, and at each periodic review, and not in light of subsequent events."

The Duty to Monitor Annuity Providers

Based upon the foregoing, DOL stated that "the periodic review requirement in the Safe Harbor does not mean that a fiduciary must review the prudence of retaining an annuity provider each time a participant or beneficiary elects an annuity from the provider as a distribution option." Rather, the regularity with which such review must be conducted is based on the "facts and circumstances." DOL provides, as an example, that a review may be necessary when a "red flag" event occurs, such as a major insurance rating service downgrading the annuity provider or several annuitants submitting complaints about a pattern of untimely payments by the annuity provider.

Further, the FAB also states that a plan fiduciary's obligation to monitor an annuity provider ends when the plan fiduciary replaces the current annuity provider under the plan with a new annuity provider. DOL appears to limit its guidance to two types of annuities, an immediate annuity and a QLAC.

In the case of an immediate annuity, if the plan fiduciary selects, in accordance with the Safe Harbor, Insurance Company A to be the annuity provider for an immediate annuity distribution option under the plan, and then later replaces Insurance Company A with Insurance Company B, the duty to monitor Insurance Company A ends upon such replacement.

DOL came to a similar conclusion with regard to a QLAC. DOL noted that pursuant to such an option, participants can make single premium payments from their accounts to purchase a QLAC at retirement. In addition, DOL noted certain features of the QLAC, including that premiums cannot be withdrawn, the premiums in most cases cannot be converted to a lump sum, that participants receive a certificate at retirement evidencing their rights under the QLAC, and that neither the plan nor the plan sponsor own an interest in the QLAC. If a plan fiduciary selects, in accordance with the Safe Harbor, Insurance Company A to be the QLAC provider, and later replaces Insurance Company A with Insurance Company B, the duty to monitor Insurance Company A ends upon such replacement.

DOL also took the opportunity to clarify the relevant statute of limitations for breach of fiduciary duty in selecting and monitoring annuity providers. Under ERISA, a plan participant or beneficiary may bring an action for breach of fiduciary duty up to (a) six years after the date of the last action constituting a party of the breach, or (b) three years after the earliest date on which the participant or beneficiary had actual knowledge of the breach. Thus, a claim for

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imprudent selection of an annuity contract could be brought up to six years from the date that plan assets were used to purchase the annuity contract.

Takeaways

The FAB appears to have been issued largely in response to recent guidance by IRS and the Treasury Department regarding the ability to include QLACs in qualified plans without violating certain provisions of the Internal Revenue Code of 1986, as amended (the "Code"). Longevity Annuity Contracts, 79 Fed. Reg. 37633 (July 2, 2014). Relatedly, it appears that DOL issued the FAB in conjunction with the White House Conference on Aging to "encourage more employers to offer lifetime income annuities as a benefit distribution option."[1]

In our view, the FAB is just as noteworthy for what it does not address, which is how the Safe Harbor applies to the selection of insurance companies that provide guarantees for other "guaranteed lifetime income" products, particularly those that are provided "in plan." According to the FAB, DOL intends to address "fiduciary selection and monitoring of annuity providers and contracts that are offered as investment options under defined contribution plans as part of its project on the Department's regulatory agenda to evaluate possible amendments to the Safe Harbor Rule."

Presumably, DOL will address the application of the Safe Harbor to a broader array of "guaranteed lifetime income" products in a future rulemaking. In the meantime, plan fiduciaries and insurers must continue to look to current law, including the Safe Harbor, as a basis for selecting issuers of these products without the benefit of helpful guidance from DOL.

[1] Fact Sheet – White House Conference on Aging, *available at* http://www.dol.gov/ebsa/newsroom/fswhconferenceonaging.html.

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