Pension Plan Fix-It Handbook

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Government Shines Spotlight on Annuities

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Employers and plan administrators had to contend with a flurry of governmental paperwork issued in February to promote retirement security. The crux of the releases and related regulatory guidance aimed at helping people achieve retirement security by encouraging the use of annuities in retirement vehicles and thereby avoiding the possibility that retired persons will outlive their retirement savings.

This interrelated paperwork includes releases from the Department of Treasury, the IRS, the Department of Labor (DOL) and the White House. On Feb. 2, 2012, the Council of Economic Advisers to the Executive Office of the President issued a report entitled "Supporting Retirement for American Families." At the same time, a press release and a fact sheet were issued as well as an entry on The White House Blog. The DOL's Employee Benefits Security Administration (EBSA) also posted a press release noting the recent final regulations under Code Section 408(b)(2), referring to the IRS guidance as "Guidance Package on Lifetime Income."

Continuing the theme of increasing retirement security through annuities, the government also issued two proposed regulations and two revenue rulings (Rev. Ruls.):

- Proposed regulations that simplify the treatment of certain optional forms of benefit that would permit a participant to receive part of their benefit as lump sum with the remaining part as an annuity.
- Proposed regulations that introduce qualified longevity annuity contracts (QLACs) and modify the required minimum distribution (RMD) regulations accordingly.
- Rev. Rul. 2012-3, which addresses the application of qualified joint and survivor annuity (QJSA) and qualified pre-retirement survivor annuity rules when a deferred annuity contract is purchased under a profit sharing plan.
- Rev. Rul. 2012-4, which addresses rollovers from defined contribution (DC) plans to defined benefit (DB) plans to obtain a low cost annuity.

This column will address the proposed regulations regarding QLACs.

Supporting Retirement for American Families

The report points out the risks associated with living longer than the life span statistics (estimated as 84.9 for a 65-year-old female in 2007; 82.2 for a 65-year-old male in 2007); namely, outliving one's assets.

For many people, DC plans are the main retirement savings vehicle. Many employers that still maintain DB plans have shifted from traditional DB plans to hybrid DB plans, which frequently offer lump sum distributions, a popular choice among participants. As a result, participants are left to manage their retirement assets. Given market volatility and increased longevity, there is a risk that participants will outlive their assets. Enter the QLAC. QLACs are permitted in qualified DC plans, IRAs under Section 408 and eligible government 457 plans. The proposed QLAC regulations do not apply to Roth IRAs.

Qualified Longevity Annuity Contract

QLACs would offer participants a choice to take part of their distribution as a lump sum and part of their distribution as an annuity beginning at a later age, between ages 80 and 85. The proposed regulations modify the Code Section 401(a)(9) RMD regulations to facilitate DC plans offering QLACs. The premise is that a QLAC could help participants avoid depleting their account

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balances too quickly and outliving their assets. As you know, the "devil is in the details."

What is a QLAC?

A QLAC is an annuity contract other than a variable/equity indexed contract or similar contract that is purchased from an insurance company for an employee that satisfies *each* of the following:

1) Premiums paid cannot exceed the lesser of $100,000 or 25 percent of the participant's account balance. The dollar limit is reduced by premiums paid to any other QLAC under the plan or other eligible plan. The percentage limit is reduced by premiums paid under any other QLAC offered under the plan. The dollar limit will be adjusted periodically.
2) Distributions must begin no later than a specified annuity starting date that is coincident with or next following the employee's attainment of age 85.
3) The QLAC must satisfy the RMD requirements applicable to annuities.
4) The contract doesn't provide for any commutation benefit, cash surrender value or similar benefit.
5) A life annuity is the only benefit payable to a designated beneficiary after the death of the employee. Certain requirements apply depending on whether the designated beneficiary is a surviving spouse or non-spouse beneficiary.
6) The contract, when issued, states that it is intended to be a QLAC.

There also are reporting and disclosure requirements. The issuer of a QLAC must prepare both an initial disclosure and an annual report.

The initial disclosure must indicate that the contract is intended to be a QLAC and include:

- a plain-language description of the dollar and percentage limits;
- the annuity starting date and, if applicable, the ability to begin payments before the annuity starting date;
- the amount of the periodic payment payable after the annuity starting date (if estimated, the assumed interest rate);
- a statement that there is no commutation benefit or cash value surrender option;
- a statement describing any death benefit payable under the contract, including any differences between benefits payable if an individual dies before or after the annuity starting date;
- a description of administrative procedures; and
- other information as required by the government.

The calendar year annual reports must be filed by the issuer on a form the government prescribed. The report must include the basics such as the name and address of the issuer and the individual who purchased the contract and other identifying information. In addition, the report must indicate whether or not payments have begun as well as the premium payments.

Impact on RMD calculations

For purposes of calculating the RMD for calendar years beginning on or after Jan. 1, 2013, the account balance used in calculating the RMD would not include the value of the QLAC that is held under the plan.

Without this modification, the value of an annuity offered under a plan is included in the account balance used to calculate the RMD. If the remainder of the account is drawn down such that the RMD must come from the annuity, it requires the participant to begin annuity distributions earlier than intended. Deferred annuities with early commencement dates increase the premium and represent an impediment to the use of longevity contracts.

More QLAC details

The QLAC regulations are proposed and cannot be relied upon until they are final. Comments on the proposed regulations are due by May 3, 2012.

For purposes of determining the maximum limits, the plan administrator can rely on the participant's representations unless the plan administrator has knowledge to the contrary. The preamble notes that this reliance is not available with respect to a controlled group situation.

The proposed QLAC regulations would allow a participant to elect an earlier annuity starting date than the date specified in the contract; for example, the participant could elect the annuity starting at age 80 rather than at age 85.

Next Steps

This feature could be of interest to plan sponsors who should become familiar with Guidance Package on Lifetime Income and how it will apply to their plans.

This column is only an overview of the proposed regulations. There are a number of administrative and fiduciary issues that remain to be addressed. As you read

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all the guidance, consider raising your questions in a comment letter. Such issues could include:

- fiduciary aspects of selecting an annuity provider;
- QDRO implications; and
- a tracking mechanism to monitor the contribution limit for plans in a controlled group.

Remember, "the devil is in the details."

Finding out More

To view the "Supporting Retirement for American Families" report, go to http://www.whitehouse.gov/sites/default/files/cea_retirement_report_01312012_final.pdf.

To view the press release, go to http://www.treasury.gov/press-center/press-releases/Pages/tg1407.aspx. For the fact sheet, go to http://www.treasury.gov/press-center/press-releases/Documents/020212%20Retirement%20Security%20Factsheet.pdf. For the White House blog entry, go to http://www.whitehouse.gov/blog/2012/02/02/america-built-last-strengthening-economic-security-retirement. To view EBSA's press release, go to http://www.dol.gov/ebsa/newsroom/2012/11-1653-NAT.html.

For the proposed regulations on annuity regulations, go to http://www.gpo.gov/fdsys/pkg/FR-2012-02-03/pdf/2012-2341.pdf.

For the proposed regulations on QLACs, go to http://www.gpo.gov/fdsys/pkg/FR-2012-02-03/pdf/2012-2340.pdf.

To view Rev. Rul. 2012-3, go to http://www.irs.gov/irb/2012-08_IRB/ar07.html. To view Rev. Rul. 2012-4, go to http://www.irs.gov/irb/2012-08_IRB/ar08.html.