



Elevate in-plan lifetime income conversations

Understanding the evolution of lifetime income in retirement plans

It's important for retirement plan advisors to keep in mind that while many concepts from the retail annuity market are the same in the retirement plan space, there are also many differences.

For example, the priorities and trade-offs that plan sponsors must evaluate for their participants are different from what an individual would consider in the retail space. Further, the Employee Retirement Income Security Act (ERISA) requires due diligence that is different from the due diligence conducted in the retail space for an individual investor.

While both retail annuities and in-plan lifetime income options can be appropriate for plan participants, it's critical to recognize their distinctions.

Reimagining defined contribution (DC) plan design

Retirement savings is usually considered to have three parts:

1. **Social Security**
2. **Pension**
3. **Supplemental retirement savings**

DC plans have historically filled the role of the third part — supplemental retirement savings. In private sector plans today, the second part — pensions — are generally not available. For this reason, the DC plan design is being reimagined to include lifetime income as a component of the private sector retirement plan, essentially combining the second and third parts in some cases.

Although the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) of 2019 is what ignited the fire for new solution innovation for lifetime income, it was really the culmination of over a decade of work in this arena. For plan advisors who want to help plan sponsors bridge the gap from the historic way of thinking about lifetime income to the new solutions, understanding this backdrop may be useful.

Chilling effect on annuities

Historically, the most common way for a participant to obtain a stream of income was if the plan document allowed for annuity payments as a distribution option. However, this type of defined benefit (DB) annuitization was never a workable solution because of the administrative, legal and financial burdens they imposed on a plan sponsor.

This became an even greater challenge in 2002 when the Department of Labor (DOL) required that an annuity purchased by a DC plan must meet something called the safest available annuity standard.¹ That standard previously only applied to DB plans and had a further chilling effect on annuities in DC plans because it set a virtually unachievable standard for DC plan fiduciaries. The DOL unsuccessfully attempted to resolve this issue several times, but it was not until years later that Congress was able to address it as part of the SECURE Act.

Key terms

Guaranteed lifetime income*

This is the idea that the participant will receive a stream of income for life — guaranteed. There are multiple ways to guarantee the stream of income, resulting in different amounts, but the overall theme is that there is a stream of income that endures through the individual's retirement years. This includes Social Security.

Lifetime income

This umbrella term refers to any in-plan solutions that are designed to provide participants with a stream of lifetime income regardless of whether it's guaranteed.

¹ DOL Advisory Opinion 2002-14A, December 18, 2002.

Promoting lifetime income on Capitol Hill

From 2002 to 2019, there were several attempts to promote lifetime income in the marketplace as the need continued to grow, but none of these efforts had much of an effect. The Government Accountability Office (GAO) and the DOL both published reports raising their concerns about the demise of the pension plan and the need to fill the gap in lifetime income to ensure participants had retirement security.²

The DOL and the Department of the Treasury (Treasury), however, took key steps that made it possible for the SECURE Act to finally succeed in incorporating lifetime income changes.

■ Lifetime income treated as a plan investment instead of a plan protected benefit

In 2012, the Treasury issued the qualified longevity annuity contract (QLAC) regulations and Revenue Ruling 2012-03. These new rules affirmed for plan sponsors that their DC plans could treat lifetime income financial products as investments of the plan rather than as a benefit feature of the plan.

If lifetime income were to be treated as a protected benefit, it would be very difficult to change or eliminate any chosen design, and participants would need to be grandfathered into the selected lifetime income program made available to them under the plan. Affirming lifetime income options as investments instead allowed plan sponsors the flexibility they needed to design (and change, as needed) lifetime income programs appropriate for their participants.

■ Participant awareness

The DOL published proposed rules in 2013 requiring lifetime income disclosures to be included in participant statements. The purpose of this rule was to raise awareness among plan participants of what type of lifetime income their account balances would provide. Although these rules were never finalized, they set the stage for eventually being incorporated into the SECURE Act; the Interim Final Rule became effective on September 18, 2021.³ Participants now receive statements that show their balance as a stream of income.

■ Lifetime income as part of a qualified default investment alternative (QDIA)

The DOL issued a key letter to the Treasury approving the use of lifetime income annuity contracts as part of a QDIA when used with a series of target-date funds (TDFs).⁴ This letter gave DC plan providers confidence that lifetime income programs can be widely used as part of a plan's retirement glide path, which could be adopted as a QDIA.

Regulators' concerns about lifetime income

While recognizing the need for lifetime income, the DOL also raised concerns where lifetime income is made available as an option in the plan, including:

- Long-term viability of the insurer providing the guarantee*
- Inflation risk
- Limited death benefits
- Withdrawal options
- Transparency of products
- Portability

² See, e.g., Retirement Security: Annuities with Guaranteed Lifetime Withdrawals Have Both Benefits and Risks, but Regulation Varies across States, available at [gao.gov/products/gao-13-75](https://www.gao.gov/products/gao-13-75). See also, e.g., 401(k) Plans: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants, available at: [gao.gov/assets/gao-16-433.pdf](https://www.gao.gov/assets/gao-16-433.pdf).

³ DOL, Pension Benefit Statements-Lifetime Income Illustrations, Interim Final Rule, available at [federalregister.gov/documents/2020/09/18/2020-17476/pension-benefit-statements-lifetime-income-illustrations](https://www.federalregister.gov/documents/2020/09/18/2020-17476/pension-benefit-statements-lifetime-income-illustrations).

⁴ IRS Notice 2014-66, Lifetime Income Provided Through Target Date Funds in Section 401(k) Plans and Other Qualified Defined Contribution Plans, available at [irs.gov/pub/irs-drop/n-14-66.pdf](https://www.irs.gov/pub/irs-drop/n-14-66.pdf).

Positive change: SECURE Act of 2019

The SECURE Act made historic changes to the way DC plans could handle lifetime income programs. The SECURE Act introduced three new features:

- **Disclosures on participant statements**

It requires benefit statements to include an illustration of account balances as a lifetime income stream at least once during any 12-month period, commencing with the statement ending June 30, 2022 (for participant-directed plans).⁵ This provision was initially introduced in 2013 but wasn't finalized until the SECURE Act in 2019.

- **Portability provision**

This creates portability by permitting in-service distribution of lifetime income products when a fiduciary decides to change lifetime income programs as well as trustee-to-trustee transfers of participants' benefits.⁶

- **Safe harbor**

This provides fiduciaries with an optional safe harbor that must be satisfied to meet the prudence requirements with respect to an insurer for a guaranteed lifetime income contract.⁷

This safe harbor is meant to remove the fiduciary's fears that it would have to make a determination as to the viability of an insurer to provide lifetime benefits, and the concern that it could be liable for the future insolvency of an insurance carrier the fiduciary may select. Specifically, the fiduciary will satisfy the safe harbor under the SECURE Act (and be protected from any participant claim related to the future insolvency of an insurance carrier) if it receives written representations from each insurer for a guaranteed lifetime income contract that at the time of selection, the insurer:

- Is licensed to offer guaranteed lifetime income contracts
- Operates under a certificate of authority (that has not been revoked or suspended) from the insurance commissioner of its domiciliary state⁸
- Has filed audited financial statements in accordance with the laws of its domiciliary state under applicable statutory accounting principles⁸
- Maintains (and has maintained) reserves satisfying the statutory requirements of all states where the insurer does business⁸
- Is not operating under an order of supervision, rehabilitation or liquidation⁸
- Undergoes, at least every five years, a financial examination (within the meaning of the law of its domiciliary state) by the insurance commissioner of the domiciliary state (or representative, designee or other party approved by such commissioner)
- Will notify the fiduciary of any change in circumstances that would preclude the insurer from making such representations at the time of issuance of the guaranteed lifetime income contract

These representations should be made at the time the insurance company (or companies) is selected. If the plan will continue to make purchases from the same insurer, it will need to obtain these representations annually.

To help plan fiduciaries satisfy the safe harbor, most solutions in the market today have these disclosures embedded in the offering materials for plan fiduciaries to review. Plan fiduciaries should review the representations with an eye toward statements that may be materially misleading or incomplete, and plan fiduciaries should inquire where reasonable and necessary to do so.

⁵ See, SECURE Act of 2019, Section 203.


⁶ See, SECURE Act of 2019, Section 109.

⁷ See, SECURE Act of 2019, Section 204.

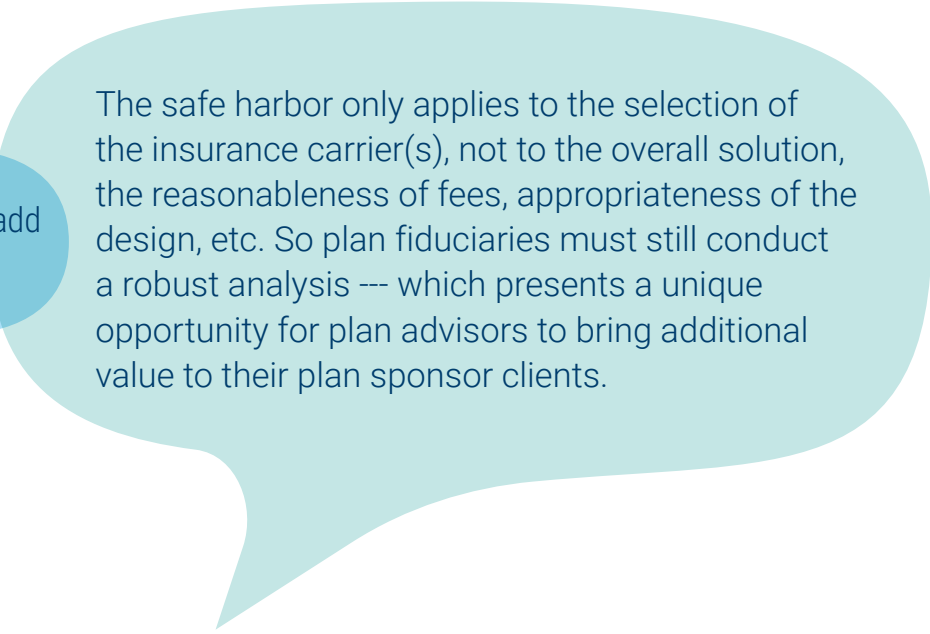
⁸ Required at the time of selection and for each of the immediately preceding seven plan years.

Beyond SECURE Act of 2019

Following SECURE Act of 2019, legislators continued to keep their sites on lifetime income. In SECURE Act 2.0, which was passed on December 29, 2022, Congress again included provisions related to longevity in this comprehensive retirement plan package. For example, Section 202 of SECURE Act 2.0 eliminated the 25% threshold for qualified longevity annuity contracts (or QLACs), increased the dollar limit to \$200,000 and clarified other use cases. In addition to Congress, regulators also continue to keep lifetime income in focus as additional guidance is contemplated and product innovation evolves.



How can I add value?



The safe harbor only applies to the selection of the insurance carrier(s), not to the overall solution, the reasonableness of fees, appropriateness of the design, etc. So plan fiduciaries must still conduct a robust analysis --- which presents a unique opportunity for plan advisors to bring additional value to their plan sponsor clients.

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