Special Commentary

Meet the QLAC — initial considerations for defined contribution (DC) plan sponsors

The issuance of the final Qualifying Longevity Annuity Contract (QLAC) regulation by the U.S. Treasury Department on July 1, 2014 was a very important development that carries the potential to play a central role in facilitating greater retirement security for qualified plan participants, and ultimately enabling more effective workforce management for plan sponsors. This Special Commentary was developed to help provide perspective on the QLAC rule and some initial observations on both its strategic (longer term) and tactical (more immediate) implications for DC plan sponsors.

Meet the QLAC

The regulation provides an exception to the Required Minimum Distribution (RMD) rules for funds within individual account qualified plans that are applied to a QLAC, up to the lesser of $130,000 or 25% of the total account balance. In order to qualify for the exemption from application of the RMD rules, the QLAC is a very simple type of longevity annuity: it's deferred (payments don't begin until an advanced age), fixed (not an investment product) and may be provided either with or without a return of premium feature. A QLAC provides longevity insurance to the participant, ensuring that if the participant lives longer than average life expectancy, the insurance will provide income rather than the participant trying to rely on a dwindling savings balance to finance retirement income over an unpredictable period of time.

As the first company to develop a longevity insurance product in 2004, MetLife had worked, both as an individual company as well as through industry organizations, to build understanding and consensus on the need for required minimum distribution (RMD) rules to harmonize with longevity insurance, especially in light of the potential that this type of longevity solution has to maximize the effectiveness of retirement programs and increase retirement readiness of participants.

We have been close to this issue since the Treasury Department and Internal Revenue Service released the package of proposed regulations and revenue rulings on guaranteed lifetime income options in February of 2012, and many of the specific suggestions we made in our May 2012 Treasury Department testimony were ultimately included in the final regulation.

Strategic implications to consider

- **Future plan design expansion:** The QLAC regulation may offer, or lead to offering, opportunities to update plan designs to add an income element within the plan. Accordingly, the regulation may help employers think about the importance of lifetime income and rethink how this may expand their retirement income plan design options.
- **Awareness of longevity risk:** Consider how this rule can enable employers to help their employees mitigate the greatest and widely misunderstood risk they face in retirement — living longer than average and for longer than their assets are available for income. Longevity insurance may be a new concept to many employees, and so it offers an opportunity for participant education about the plan, and a chance to reframe the DC plan as a retirement income plan rather than a savings account.
- **Consider the context:** The QLAC regulation clearly reflects another thoughtful effort on the Treasury Department's part to provide the tax flexibility needed to make "planning in" income into DC plans a practical reality for plan sponsors. Taken together with the April 2014 guidance designed to encourage qualified plan "roll-ins," the regulation is part of an expanded landscape for DC plans with which plan sponsors will be able to work in the future. This both recognizes the role that DC plans are already beginning to play as the primary retirement plans for millions of American workers, and is in line with many plan sponsors who are moving to a more engaged DC plan management model.

Tactical implications to consider

The final QLAC regulation addressed a number of major practical modifications identified with respect to the proposed QLAC regulation. The following summarizes the key modifications included in the final regulation:

- **Return of premium (ROP) death benefit:** Commentators suggested that the QLAC regulation permit a lump-sum ROP death benefit to encourage individuals to purchase QLACs, and advised that industry experience with longevity annuities indicated that, when offered, many individuals elected a ROP death benefit, despite the additional cost. The final regulation adopted this suggestion and a QLAC may offer a lump-sum ROP death benefit that is payable after the death of the individual or after the death of the individual and the individual's spouse.
- **Correction of excess contributions:** Just as RMD rules apply in the aggregate to all of the tax advantaged accounts that an individual maintains, the RMD exception likewise applies to the individual rather than to each plan or account. As plans and their administrators will not have knowledge of accounts other than their own, a reasonable cure for inadvertent excess contributions was clearly needed. In the final regulation, an annuity's QLAC status is preserved as long as excess contributions are returned to the non-QLAC portion of an individual's account by the end of the calendar year following the calendar year of the excess contributions, either in cash or as a non-QLAC annuity.
- **QLAC identification to the participant:** The final regulation required that an annuity contract contain a statement in a rider or an endorsement that it is intended to be a QLAC. If the QLAC is issued under a group annuity contract, then the statement should be included in the certificate.

While all of these clarifications are workable and welcome, as with the promulgation of any rule, additional practical questions often arise as retirement plan practitioners analyze the rule and consider a wide range of plan administration and contractual matters. For example, we expect that further technical clarifications may be needed in a number of areas, including:

- how to handle qualifying certificates and riders that meet QLAC requirements when the group contracts from which they are issued may contain additional features that do not satisfy such requirements;
- how QJSA administration will integrate with the QLAC's inception or annuity starting date;
- how QLACs would be handled in the event of a plan termination or change in QLAC provider; and,
- how the QLAC would be reflected on benefit statements.

Conclusion

The final QLAC regulation is a significant step both in its own right and as a further expression of regulatory focus on the importance of guaranteed lifetime retirement income. It's important, however, that it be viewed not as a single silver bullet, but rather as the first of four core elements of regulatory structure that are ideally needed to fully support transitioning "old model" DC plans to "new model" DC plans, reflecting the emerging changes in the nature of plan sponsor engagement with their plans. This trend may also be described as moving from a model where the employer role is limited primarily to investment selection and diversification and the plan is positioned as a supplemental savings plan and measured by participation rates, to one characterized by more comprehensive employer engagement, auto features, and a focus on retirement outcomes. In our view, the remaining three elements are a workable safe harbor for annuity carrier selection, DC plan results expressed in income terms to participants, and confirmation that retirement income education and tools comprise education rather than advice. We look forward to continuing to work with plan sponsors, industry practitioners and the regulatory community as this work advances.

Please contact your MetLife representative or call 1-877-638-2862 if you would like to discuss these ideas in greater depth.

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