CLARIFICATION OF THE ANNUITY SELECTION SAFE HARBOR FOR DEFINED CONTRIBUTION PLANS

GUIDANCE INTENDED TO ADDRESS PLAN SPONSOR FIDUCIARY RESPONSIBILITIES WHEN OFFERING INCOME ANNUITIES

As part of a comprehensive effort intended to increase awareness about – and the availability of – lifetime income options in defined contribution (DC) plans, the U.S. Department of Labor (DOL), through its Employee Benefits Security Administration, recently published a Field Assistance Bulletin (FAB) clarifying the duty of an employer in selecting and monitoring an annuity provider for benefit distributions from 401(k) and other DC plans under its 2008 annuity selection safe harbor regulation. FAB 2015-02, Selection and Monitoring under the Annuity Selection Safe Harbor Regulation for Defined Contribution Plans, was released on July 13, 2015.

According to the DOL, FAB 2015-02 was “issued in response to questions about the extent of employers’ obligations, and provides guidance regarding these issues, including the application of ERISA’s statute of limitations to claims relating to annuity selection.” Specifically, the guidance is designed to address “concerns about liability by clarifying that an employer’s fiduciary duty to monitor an insurer’s solvency generally ends when the plan no longer offers the annuity as a distribution option, not when the insurer finishes making all promised payments.”

The guidance is expected to both address plan sponsors’ fiduciary responsibilities and encourage more of them to offer income annuities as a DC plan distribution option.

WHY CLARIFICATION WAS NEEDED FROM THE DOL

As a result of a provision included in the Pension Protection Act of 2006, the DOL issued a regulation in 2008 regarding the fiduciary standard to be applied by DC plan sponsors when selecting an annuity provider. That standard, incorporated in DOL regulation 29 CFR § 2550.404a-4, contained a fiduciary safe harbor for the selection of annuity providers for the purpose of benefit distributions from DC plans. The safe harbor stated that “the selection of an annuity provider for benefit distributions from an individual account plan satisfies the requirements of section 404(a)(1)(B) of ERISA if the fiduciary:

(1) Engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities;

(2) Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;

(3) 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;

(4) 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

(5) If necessary, consults with an appropriate expert or experts for purposes of compliance with the provisions of [the language set forth in this safe harbor].”
The safe harbor had addressed some of the concerns raised by plan sponsors about the “safest available annuity” standard promulgated by the DOL with respect to defined benefit plans (29 CFR §2509.95-1). This included the statements that the fiduciary does not have to choose the “safest” annuity available, and that the fiduciary duty generally applies at the time of selection (with an ongoing duty to monitor the selection and act prudently with regard to future annuities provided).

However, even with the simplification of the fiduciary standard that the DOL promulgated, some plan sponsors continued to express concern about their ability to implement the standard without exposure to fiduciary liability, particularly with regard to their obligations once an annuity provider had been selected, even though others had developed and implemented a robust provider selection process they were confident would withstand a challenge under ERISA.

Therefore, in FAB 2015-02, the DOL acknowledged that “[c]onfusion or lack of clarity regarding the nature and scope of fiduciary responsibilities to act prudently in making, monitoring and reviewing annuity selections under a defined contribution plan could lead plan sponsors or their advisors in some instances to overestimate or otherwise misunderstand the duration or extent of those fiduciary responsibilities.”

Specifically, the DOL recognized in FAB 2015-02 that “questions continue to be raised about how to reconcile the ‘time of selection’ standard in the Safe Harbor Rule – which embodies the general principle that the prudence of a fiduciary decision is evaluated under ERISA based on the information available at the time the decision was made – with ERISA’s duty to monitor and review certain fiduciary decisions.” Additionally, the DOL noted that it is considering issuing additional guidance on the annuity selection safe harbor, which will primarily focus on the condition in the safe harbor relating to the ability of the annuity provider to make all future payments under the annuity contract.2

“TIME OF SELECTION” STANDARD ADDRESSED

FAB 2015-02 clarifies the “time of selection” standard in the DOL’s 2008 safe harbor rule covering the applicable fiduciary responsibilities when selecting and monitoring annuity providers for a DC plan. It explains that, under the safe harbor, the ongoing monitoring obligations generally end when the plan no longer offers the annuity as a distribution option, not when the insurer finishes making all promised payments. “Time of selection” is defined in the safe harbor rule as:

(1) the time that the annuity provider and contract are selected for distribution of benefits to a specific participant or beneficiary; or

(2) the time that the annuity provider is selected to provide annuities as a distribution option for participants or beneficiaries to choose at future dates.

FAB 2015-02 further clarifies that “[t]he prudence of a fiduciary decision is evaluated with respect to the information available at the time the decision was made – and not based on facts that come to light only with the benefit of hindsight.” Therefore, under the DOL’s safe harbor rule, “a 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.”

Additionally, FAB 2015-02 holds that “[t]he periodic review requirement in the Safe Harbor Rule 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.”

Two examples were included in FAB 2015-02 to illustrate the selection and monitoring of an annuity provider under the safe harbor rule. The annuity products or features used in the examples are “(1) an immediate annuity which provides for fixed monthly payments that start immediately and continue for the life of the retiree (or beneficiary if a joint life annuity is elected); and (2) a longevity annuity, which is a deferred fixed income annuity purchased at retirement, but income payments start at an advanced age, such as 80 or 85.”
Example 1 – Monitoring and Review Until Annuity Provider Is Replaced: In the example provided for an immediate annuity, the employer has determined during its periodic review process that its immediate annuity provider is no longer able to pay annuity holders, and has replaced that provider with a new annuity provider. According to the DOL, the employer’s obligation to periodically review the original annuity provider has ended, as annuities from the original provider are no longer offered to participants or their beneficiaries.

Example 2 – Monitoring and Review Until Annuity Is No Longer a Distribution Option: In the example for a longevity annuity, the employer offers a qualifying longevity annuity contract (QLAC) as a distribution option at retirement from a particular annuity provider. According to the DOL, as long as the employer continues to offer participants the option to purchase a QLAC at retirement from that particular annuity provider, it is obligated to periodically review the provider; its duty to monitor the provider only ends when QLACs from that provider are no longer offered as a distribution option.

The DOL notes that certain assumptions apply to each of the examples, provided that: “(1) the fiduciary prudently concludes that, at the time of its 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 annuity contract; (2) each product or product feature is an annuity contract; and (3) each annuity provider is appropriately licensed to issue annuity contracts under state insurance laws.”

STATUTE OF LIMITATIONS EXPLAINED

FAB 2015-02 also explains ERISA’s statute of limitations on fiduciary liability for the selection of annuity providers and annuity contracts, which holds that an action may not be brought after the earlier of “(a) six years after the date of the last action which constituted a part of the violation or, in the case of an omission, the latest date on which the fiduciary could have cured the violation, or (b) three years after the earliest date on which the plaintiff had actual knowledge of the breach.” FAB 2015-02 further explains that in the case of an annuity provider selection, the limitation period begins on “the date on which plan assets were expended to purchase the [group] contract.”

IMPLICATIONS FOR DC PLAN SPONSORS AND THEIR PARTICIPANTS

With FAB 2015-02, we believe the current Administration has taken another important step forward to encourage plan sponsors to consider offering income annuities to their DC plan participants. By offering income annuities, plan sponsors can play an important role in helping to ensure successful retirement outcomes for their participants.

An income annuity can be added to a DC plan in five simple steps:

1. Select the provider
2. Amend the plan
3. Notify plan participants and beneficiaries
4. Modify the summary plan description and the election benefit form
5. Establish procedures for administration and 5500 filing

For more information, consider reading the following MetLife “Topics In” whitepapers: Defined Contribution Plan Design: Why Income Should Be the Outcome and Defined Contribution Plan Design: Facilitating Income Replacement in Retirement.
2. DOL Regulation Identification Number 1210-AB58
3. Treasury Regulation 79 FR 37633, issued July 2, 2014, provided final rules regarding qualifying longevity annuity contracts (QLACs). For more information, see MetLife’s “Special Commentary” Meet the QLAC - Initial Considerations for Defined Contribution (DC) Plan Sponsors.