

Retirement Plan Sponsors Must Soon Provide Annual Lifetime Income Illustrations

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Last year, Congress passed the Setting Every Community Up for Retirement Enhancement Act of 2019, often called the “SECURE Act”. One of the SECURE Act’s important provisions amended ERISA Section 105 to require sponsors of defined contribution plans to provide two illustrations of a participant’s account balance converted to a lifetime income equivalent – one as a single life annuity (SLA) and another as a qualified joint and survivor annuity (QJSA) – at least annually. This measure of the SECURE Act required the Department of Labor’s Employee Benefit Security Administration (EBSA) to provide regulatory guidance within one year to establish the actuarial and other assumptions plan sponsors can use to convert a plan participant’s account balance into an SLA and QJSA and also to provide model disclosures plan sponsors can use and rely to provide the required illustration. On August 18, 2020, the EBSA released an interim final rule (IFR) to provide the EBSA’s initial guidance on this new annual requirement for sponsors of tax-qualified defined contribution plans.

EBSA believes that illustrating a participant’s account balance as a stream of estimated lifetime payments will provide two primary benefits for plan participants. First, it will assist workers in defined contribution plans to better understand how their account balance translates into monthly income in retirement. Second, and as a result of the better understanding, workers can better prepare for retirement. The recent guidance will benefit plan administrators by providing a roadmap for them to significantly reduce the potential liability exposure associated with providing lifetime income illustrations (at least for those plan sponsors that follow the new guidance).

GENERAL REGULATORY ASSUMPTIONS

The linchpin of the new rules is the establishment of basic assumptions that plan administrators may use to calculate the monthly payment illustrations of participants’ account balances as SLAs and QJSAs. If the following standard set of assumptions are used for the annual illustrations, the plan sponsors are protected from claims from participants related to the illustrations.

Assumed commencement date: On what date will the annuity payments begin? Plan administrators must calculate monthly payment illustrations as if the payments begin on the last day of the benefit statement period.

Assumed age: How old is the participant on the annuity start date? Plan administrators must assume that a participant is age 67 on the assumed commencement, which is the Social Security full retirement age for most workers, or the participant's actual age, if older than 67.

Assumed Spousal and Survivor Benefits:

- **What is the SLA benefit?** Plan administrators must illustrate a Single Life Annuity, which will pay a fixed monthly amount for the life of the participant, with no survivor benefit after the participant's death.
- **What are the QJSA spousal assumptions?** Plan administrators must assume that all participants have a spouse of equal age, regardless of a participant's actual marital status or the actual age of any spouse.
- **What is the QJSA survivor benefit?** Plan administrators must use a Qualified Joint and 100% Survivor Annuity, which will pay a fixed monthly amount for the life of the participant, and the same fixed monthly amount to the surviving spouse after the participant's death.

Assumed interest rate: Plan administrators must use the 10-year constant maturity Treasury rate (10-year CMT) as of the first business day of the last month of the statement period to calculate the monthly payments. The 10-year CMT approximates the rate used by the insurance industry to price immediate annuities.

Assumed mortality: How should life expectancy be determined? Plan administrators must use the gender neutral mortality table in Internal Revenue Code Section 417(e)(3)(B) – the mortality table generally used to determine lump sum cash-outs from defined benefit plans.

Example: In its August 18, 2020 "Fact Sheet", released in connection with the issuance of the new rules, the EBSA provided this simple example to illustrate the application of these regulatory assumptions:

- Participant X is age 40 and single. Her account balance on December 31, 2022, is \$125,000. The 10-year CMT rate is 1.83% per annum on the first business day of December. The benefit statement of this participant would show:
- Current Account Balance \$125,000
- Single Life Annuity of \$645 per month for life (assuming Participant X is age 67 on December 31, 2022)
- Qualified Joint and 100% Annuity of \$533 per month for participant's life, and \$533 for the life of spouse following participant's death (assuming Participant X and her hypothetical spouse are age 67 on December 31, 2022)

SPECIAL RULES FOR IN-PLAN ANNUITIES

The new rules also provide guidance for those plans that offer in-plan annuities through a contract with a licensed annuity provider. The new rules allow these plans to either provide the illustrations consistent with the rules summarized above or to base the illustrations using the actual terms of the plan's annuity contract (subject to certain limitations). If using the annuity contract for providing the illustrations, the monthly payment illustrations must provide

the SLA and QJSA scenarios and assume that payments commence on the last day of the statement period, the participant is age 67 (unless older) on that date, and the participant has a spouse the same age. In addition, there are special rules for those plans that allow for the purchase of deferred annuities.

MODEL LANGUAGE

The new rules require explanations about the estimated lifetime income payments that plan must provide to participants. These explanations will help participants understand, among other things, how the plan sponsor calculated the estimated monthly payments and, importantly, that these estimates are illustrative only and are not guarantees. The model language provided by the new rules can be used in separate communications (by using the Model Benefit Statement Supplements found in the Appendices to the new rules) or can be separately integrated, as discrete inserts, into existing pension benefit statements.

LIABILITY RELIEF

Very importantly, the new rules provide that no plan fiduciary, plan sponsor, or other person will be liable under ERISA for providing a lifetime income illustration that follows the new guidance. This relief from liability addresses the concern of plan fiduciaries that participants might sue them if actual monthly payments in retirement fall short of illustrations provided prior to retirement. To qualify for this relief, the plan sponsor must derive the lifetime income equivalents (i.e., the SLA and QJSA) using the assumptions provided by the new rules and must use the model language from the new rules (or language substantially similar to the model language) in participants' benefit statements.

WHAT NEXT?

The new interim rules will be effective one year after its publication in the Federal Register. However, in its release the EBSA stated its intent to issue a final rule within the next year, in which case the final rule will be effective upon its issuance. We would expect the EBSA to provide a substantial notice period prior to finalizing these new rules. In the interim, plan sponsors should begin a dialogue with the appropriate plan providers for each defined contribution plan to establish a plan for providing the new required illustrations.