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BENEFIT NEWS BRIEFS

IRS Releases Guidance Package of Proposed Regulations and Revenue Rulings on Providing Lifetime Income

The IRS released two proposed regulations and two *Revenue Rulings* designed to make it easier for pension plans to offer workers a wider range of choices to receive their retirement benefits by removing regulatory barriers to possible "lifetime income" pension offerings. The goal of the new options is mostly to encourage flexibility in payouts by making annuities more easily available in defined contribution plans and removing some barriers to lump sum payments in defined benefit plans.

The proposed regulations and *Revenue Rulings* are summarized below and reflect comments from the IRS press release of this lifetime income initiative. See, *http://www.treasury.gov/press-center/press-releases/Documents/020212%20Retirement%20Security%20Factsheet.pdf*.

Proposed Regulations

- *Longevity Annuity Contracts*
  Longevity annuities, or "deeply deferred annuities", would be permitted in defined contribution plans and IRAs subject to certain restrictions through new regulations related to IRC 401(a)(9) – minimum distributions. The proposed regulations are available by *"clicking here."*

- *Modifications to Minimum Present Value Requirements for Partial Annuity Distribution Options Under Defined Benefit Pension Plans*
  Partial lump sums and partial annuities would be simplified through proposed regulations to IRC 417(e). The proposed regulations are available by *"clicking here."*

A public hearing on the proposed regulations is scheduled on June 1. Comments are due by May 3. Requests to testify should be filed by May 11.

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Revenue Rulings

- *Application of Survivor Annuity Requirements to Deferred Annuity Contracts Under a Defined Contribution Plan*
  Revenue Ruling 2012-3 provides guidance to the Qualified Joint and Survivor Annuities and Qualified Pre-Retirement Survivor Annuity rules for deferred annuities provided through a defined contribution plan. The guidance is available by *"clicking here."*

- *Rollover from Qualified Defined Contribution Plan to Qualified Defined Benefit Plan to Obtain Additional Annuity*
  Revenue Ruling 2012-4 provides guidance regarding rollovers from a defined contribution plan to a defined benefit plan to obtain additional annuity. The guidance is available by *"clicking here."*

According to the IRS, the result of these changes would be:

➢ Making it easier for retirement plans to offer combination options that avoid an "all-or-nothing" choice, such as the option to take a portion of an individual's plan benefit as a stream of regular monthly income payable for life, while perhaps taking the remainder in a single lump-sum cash payment;

➢ Enabling employer retirement plans and IRAs to offer an additional option in the form of "longevity annuities" – which permit employees to use a limited portion of their account balance to provide lifelong retirement income beginning at age 80 or 85, protecting those who live beyond average life expectancy from running out of savings;

➢ Making clear that employees receiving lump-sum cash payouts from their employer's defined contribution plan can transfer some or all of those amounts to the employer's defined benefit pension plan (*if the employer has one and is willing to allow this*) in order to receive an annuity from that plan (giving employees access to the defined benefit plans' relatively low-cost annuity purchase rates); and

➢ Resolving uncertainty as to how the profit-sharing plan spousal protection rules apply when employees choose deferred annuities (including longevity annuities) from their plans.

These changes are discussed in more detail below.

Making It Easier to Offer the Option of Partial Annuities In Defined Benefit Plans

One possible benefit combination under the **proposed regulations** would allow paying some of the benefit as a *stream of income for life* (to provide protection against the risk of outliving one's savings) and *the rest of the benefit as a lump sum* which provides liquidity. The proposed regulations would make it simpler and therefore easier for pension plans to offer retiring workers more choices.

This option is not currently prevalent in multiemployer plans. The proposed regulation does lower the pension plan's cost to provide this partial annuity option. The option would not be allowed for a plan currently in critical status. Trustees may also have philosophical reasons for not adding this benefit which provides added short term flexibility at the expense of lower long term lifetime benefits.

The regulatory barrier: Where an optional form of benefit consists of a split – *partial lump sum and partial annuity* – current regulations require the use of the statutorily prescribed actuarial assumptions (interest rates and mortality assumptions) for both portions. This means that the plan is unable to use its regular conversion factors to determine the amount of the partial annuity.

The solution: The proposed regulations would streamline the calculation of partial annuities. The statutorily prescribed actuarial assumptions would only be required to apply to the portion of the distribution being paid as a lump sum. Plans would be allowed to determine the remainder of the benefit – the partial annuity – using the plan's regular conversion factors.

> **Example:** If an employee elects to take 75% of his benefit as a partial annuity and 25% as a lump sum, the dollar amount of the partial annuity would simply be 75% of the previously-calculated dollar amount of the full annuity, and the partial lump sum would simply be 25% of the previously-calculated dollar amount of the full lump sum.

Clarifying How Defined Contribution Participants Can Be Offered The Option Of Purchasing An Annuity From Their Defined Benefit Plan

According to the IRS, although the number of employees covered by private-sector defined benefit pension plans has been declining, many employers still sponsor defined benefit plans in addition to their 401(k) plans. This option provides an alternative to offering lifetime income options to participants within the 401(k) plan. A multiemployer defined benefit plan could adopt such an option in regard to a paired 401(k) plan. Although in the current funding environment we think this is not likely to be of much interest to multiemployer pension plans.

The regulatory barrier: A multiemployer defined benefit plan sponsor that wishes to offer this beneficial option to participants is faced with uncertainty as to whether it is permissible and what rules apply.

The solution: Revenue Ruling 2012-4 makes clear how this annuity purchase can be done under the qualified plan rules **if** the multiemployer plan sponsor is interested in offering it. The guidance is available by *"clicking here."*

Making It Easier to Offer the Option of Longevity Annuities In Defined Contribution Plans

The proposed regulations would make it easier for defined contribution plans and IRAs to offer “longevity annuity” options.

A longevity annuity (sometimes referred to as “longevity insurance” or a “deeply deferred annuity”) is an income stream that *begins at an advanced age, such as age 85*, and continues as long as the individual lives. These annuities can provide a cost-effective solution for retirees who are willing to use part of their savings to protect against outliving the rest of their savings and feel reasonably confident that they can manage the rest of their savings until a fixed target date such as age 85.

The regulatory barrier: Current law generally requires individuals to begin taking payouts from their retirement plan soon after reaching age 70½. The person’s entire interest in the plan must be paid over the lives of the individual and his or her designated beneficiary. Current regulations require defined contribution plans to determine the required minimum distribution by dividing the employee’s entire account balance in the plan by the employee’s life expectancy (or that of the employee and a designated beneficiary).

Current regulations would require that the value of that annuity be counted in calculating the required minimum distribution each year before the annuity begins. This could pose a problem if a retiree’s spending from the remaining balance in his account does not leave enough to make minimum required distributions before his annuity commences at age 85. In that case, the current rules would require the retiree to pay required minimum distributions based on the value of the annuity, but he might not be in a position to access that value to make a required distribution.

The solution: The proposed regulations would help open up the defined contribution market, especially the 401k market, to longevity annuities by giving special relief from the minimum distribution requirements. Under the proposal, an annuity that costs no more than 25% of the account balance or (if less) $100,000 and that will begin by age 85 is disregarded in determining required minimum distributions before the annuity begins.

> **Example**: Bill decides to use $30,000 from his $200,000 DC/401(k) account to buy a longevity annuity available under the plan that begins at age 85 and continues making regular payments of about $17,000 per year as long as he lives.
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> Accordingly, Bill will satisfy the minimum distribution requirements from age 70 to age 85 from the remaining balance in his DC/401(k) account and will not be forced to start the annuity early as a result of those requirements.

Clarifying How Profit-Sharing/401(K) Participants Can Be Offered The Option Of A Deferred Annuity Under The Plan Consistent With The Plan Qualification Rules

According to the IRS, one factor that has made some other defined contribution or 401(k) plan sponsors hesitant to include lifetime income options in their plans has been uncertainty as to how certain plan qualification rules would apply to deferred annuities (including longevity annuities). This guidance removes that uncertainty by identifying plan and annuity terms that will automatically protect spousal rights without requiring spousal consent before the annuity begins. At the time the annuity begins, the IRS indicated that the insurance company issuing the annuity would assure compliance with the spousal consent rules.

The regulatory barrier: Retirement plan rules require that an employee who elects certain optional forms of benefit obtain the written, notarized consent of the participant's spouse to that election. Questions have been raised as to how and when that requirement applies if an employee elects lifetime income that will begin in the future.

The solution: *Revenue Ruling 2012-03* makes it easier to offer deferred annuity options by resolving uncertainty as to how and when the spousal consent provisions apply with respect to pre-retirement and post-retirement survivor benefits. The ruling describes various arrangements permitting employees who are not yet ready to retire to invest their account balances in lifetime income benefits – either on a one-time basis or incrementally over a period of years – under deferred annuity contracts that will begin payments at retirement or later (including longevity annuities). The guidance is available by *"clicking here."*

Summary

The two proposed pieces of guidance that apply only to defined contribution plans act to allow new types of "deeply deferred" annuities and clarify how spousal consent rules apply to such an option. This would have no cost to the plan but trustees would have a fiduciary obligation to review the basis on which the option is made available by their vendor.

The two proposed defined benefit options (if approved) will require more careful consideration. For example, payment of lump sums in a defined benefit plan is more costly than providing an annuity. The annuity purchase option also has possible funding implications. Therefore, before instituting new benefit options, most trustees are probably focused on how to improve the Plan's funding and stability.

As these new options take root in the marketplace, multiemployer pension plans can learn what works and what doesn't before venturing into this arena.

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