

TYPES NOT MAPPED YET November 02, 2020 | TTR not mapped yet | Lori W. Jones

What employers should know about lifetime income disclosure requirements for defined contribution plans

A version of this article was originally published in the November/December 2020 edition of Employee Benefit Plan Review.

Section 203 of the Setting Every Community Up for Retirement Enhancement Act ("SECURE Act")¹ amends the disclosure rules under Section 105 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), to add an annual lifetime income disclosure requirement for all defined contribution plans subject to ERISA. According to the legislative history of the SECURE Act, the purpose of the new requirement is to help a defined contribution plan participant understand how his or her plan account balance correlates into a lifetime income stream.² The SECURE Act also requires the Department of Labor ("DOL"), within one year after enactment of the SECURE Act, to issue model lifetime income disclosure language and assumptions to be used by plan administrators in complying with the lifetime income disclosure requirement.³

On August 18, 2020, the Department of Labor released an Interim Final Rule, entitled "Pension Benefit Statements - Lifetime income illustrations."⁴ As directed by Congress, the Interim Final Rule provides assumptions to be used by plan administrators in converting a defined contributions plan participant's account balance to an equivalent single life annuity and a qualified joint and survivor annuity. The Interim Final Rule also includes model language designed to explain the lifetime income illustrations to plan participants and beneficiaries.

The following is a summary of key elements of the new lifetime income disclosure requirement as clarified by the Interim Final Rule.

Two lifetime illustrations must be provided at least annually

ERISA Section 105(a)(1) requires a plan administrator to provide benefits statements to participants. Such statements must be provided quarterly in the case of plans under which a participant can self-direct the investment of his or her account and annually in all other cases. As amended by the SECURE Act, Section 105(a)(2) requires the benefit statement to include two illustrations of the monthly benefit payments that would result if a participant's total accrued benefit were used to purchase a lifetime income stream. The first illustration assumes the purchase of a single life annuity. The second illustration assumes the purchase of a qualified joint and survivor annuity ("QJSA") that provides a survivor benefit equal to 100 percent of the participant's benefit during life.

Contents of a benefit statement that includes a lifetime income illustration

A benefit statement that includes a lifetime income illustration must include the following information:

- The beginning and ending date of the benefit statement period;
- The value of the participant's account balance as of the last day of the benefit statement period;
- A lifetime income illustration expressed as a single life annuity; and
- A lifetime income illustration expressed as a QJSA with a 100 percent survivor annuity.⁵

Assumptions in calculating lifetime income illustrations

The Interim Final Rule specifies the assumptions a plan administrator must use in calculating lifetime income illustrations. These assumptions are summarized in a Fact Sheet issued by the DOL ("DOL Fact Sheet").⁶ The assumptions are as follows:⁷

- **Assumed commencement date** - Each lifetime income illustration must assume a benefit commencement date that is the last date of the period reflected in the benefit statement that includes the illustration.
- **Assumed age** - Each lifetime income illustration must assume that the participant is age 67 unless the participant is older, in which case the participant's actual age is used in calculating the illustration. Age 67 is the age at which most participants can commence full Social Security benefits.
- **QJSA assumptions** - A QJSA lifetime income illustration must be provided to all participants, even if unmarried, and must assume the spouse is the same age as the participant.
- **Assumed interest rate** - In calculating monthly payments for each lifetime income illustration, the plan administrator must use the 10-year constant maturity Treasury rate as of the first business day of the last month of the benefit statement period. According to the DOL Fact Sheet, this interest rates approximates the rate used by insurance companies in pricing immediate annuity contracts.⁸
- **Assumed mortality table** - For each lifetime income illustration, the plan administrator must use the gender neutral mortality table in Section 417(e)(3)(B) of the Internal Revenue Code.
- **Plan loans** - Plan loans are included in a participant's account balance for purposes of calculating a lifetime income illustration unless the participant has defaulted on the loan.
- **Vesting** - For purposes of calculating a lifetime income illustration, a participant is assumed to be 100percent vested in his or her plan account.⁹

Assumptions for defined contribution plans with annuity distribution options

In the case of defined contribution plans offering an annuity distribution option through a licensed insurer, the plan administrator may substitute the assumptions in the terms of the plan's insurance contract in lieu of the assumptions listed in the Interim Final Rule. However, a lifetime income illustration must still assume that (1) benefit payments commence on the last day of the benefit statement period, (2) the participant is age 67 (unless older), and (3) the participant has a spouse of the same age.¹⁰

Deferred annuities purchased by participants are excluded from lifetime income illustrations

If a portion of a participant's account includes a deferred lifetime annuity contract purchased by the participant from a licensed insurer, the amounts payable under such contract are excluded from the Lifetime income illustration.

¹¹ This rule applies whether the deferred annuity contract is in the form of a life annuity or a qualified joint and survivor annuity. However, the Lifetime income illustration statement must include the following information with respect to the deferred annuity:

- The date payments are scheduled to commence and the age of the participant on such date;
- The frequency and amount of payments as of the commencement date, expressed in current dollars;
- A description of any survivor benefit, term certain, or other similar feature; and
- A statement whether payments are fixed, adjust with inflation, or adjust in some other way and how such adjustment is determined.¹²

Interim Final Rule includes model explanatory language

The Interim Final Rule requires that benefit statements include explanations of the assumptions used in calculating the monthly payments in the illustration and provides optional model language for the explanations. According to the DOL Fact Sheet, the explanations are designed to help participants and beneficiaries understand the method of calculating the estimated monthly payments and that the estimates are only illustrations and not guarantees with respect to future benefits. For example, the model language includes a description of the assumptions relating to the benefit commencement date, participant's marital status, interest rates and mortality tables used in making calculations. The model language also defines the terms single life annuity and qualified joint and survivor annuity for participants and beneficiaries who may be less familiar with these concepts.¹³

The Interim Final Rule requires an explicit cautionary note to participants that the monthly payments shown in the benefit statement are not guaranteed.

Special model language is provided for defined contribution plans that offer annuity distributions or if participants have purchased deferred annuities.

No liability by reason of providing illustrations if model explanatory language is used

The Interim Final Rule provides that no liability will be imposed on plan fiduciaries and plan sponsors solely as a result of providing lifetime income illustrations.¹⁴ To qualify for this relief, the lifetime income illustration must be based on the required assumptions in the Interim Final Rule. In addition, the lifetime income illustration statement must include the explanatory language provided in the Interim Final Rule or language that is substantially similar in all material respects.¹⁵

Effective date

The effective date of the Interim Final Rule is one year after its publication in the Federal Register.¹⁶ Although not required to do so, the DOL has invited public comment with respect to the Interim Final Rule for 60 days after publication. The DOL has further stated its intent to adopt a Final Rule prior to the effective date of the Interim Final Rule that takes into account comments on the Interim Final Rule.¹⁷ The DOL has indicated that the adoption date of the Final Rule will be sufficiently in advance of the effective date of the Interim Final Rule to minimize compliance burdens for plan administrators.¹⁸

Conclusion

The lifetime income disclosure requirement has potential to enhance a participant's understanding of the impact of his or her existing retirement savings and the need to continue or increase future retirement savings. However, the lifetime income illustrations are based on many assumptions that could be misleading to participants. For example, the assumptions that a participant is 100 percent vested, married, and that the participant's spouse is the same age, and the inclusion of plan loans in the calculation of the account balance, could significantly skew the lifetime income illustrations. In addition, some participants may not fully grasp that the illustrations are estimates only and not guarantees of future benefits. It will be important for plan administrators to ensure that communications to plan participants are clear with respect to the true nature of the lifetime income illustrations.

Lori Jones is the chair of Thompson Coburn's Employee Benefits practice.

1. The Setting Every Community Up for Retirement Enhancement Act (Division O of the Further Consolidated Appropriations Act, 2020, P.L. 116-94), <https://www.congress.gov/116/plaws/publ94/PLAW-116publ94.pdf> ↗
2. <https://www.congress.gov/116/crpt/hrpt65/CRPT-116hrpt65.pdf> ↗
3. P.L. 116-94, Division O, Section 203(b). ↗
4. <https://www.dol.gov/sites/dolgov/files/ebsa/temporary-postings/pension-benefit-statements-lifetime-income-illustrations.pdf> ↗
5. IFR §2520.105-3(b). ↗
6. <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/pension-benefit-statements-lifetime-income-illustrations.pdf> ↗
7. IFR §2520.105-3(c). ↗
8. Id. ↗
9. IFR §2520.105-3(d)(10). ↗
10. IFR §2520.105-3(e)(1). ↗
11. IFR §2520.105-3(e)(2). ↗
12. Id. ↗
13. Labor Regulation §2520.105-3(d). ↗
14. Labor Regulation §2520.105-3(g). ↗
15. Id. ↗
16. Labor Regulation §2520.105-3(i). ↗
17. <https://www.dol.gov/sites/dolgov/files/ebsa/temporary-postings/pension-benefit-statements-lifetime-income-illustrations.pdf> at page 40. ↗
18. Id. ↗



authorsTest

lori

Lori W. Jones