WRMarketplace
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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: Treasury and Department of Labor Guidance Facilitates the Use of Deferred Annuities in Qualified Defined Contribution Retirement Plans Offering Target Date Funds

MARKET TREND: The concern that retirement plan participants will not have sufficient assets in their defined contribution plans to carry them through their retirement has been the subject of much discussion lately. Governmental agencies responsible for regulating the private retirement plan area appear to be looking for ways to improve retirees' financial health through efforts to promote the availability of lifetime income alternatives in defined contribution plans.

SYNOPSIS: The IRS and the DOL recently issued coordinated guidance that addressed the use of a series of target date funds that utilize deferred annuity contracts distributed to plan participants when these funds dissolve at their target dates. Under this coordinated guidance, provided certain requirements are satisfied, the use of this investment arrangement in a tax-qualified defined contribution plan subject to ERISA (1) should not be considered to discriminate in favor of highly compensated individuals, (2) should be able to qualify as the plan's "qualified default investment alternative" (**"QDIA"**) for use in investing assets for which participants have not provided investment direction, and (3) should be covered under the DOL's safe harbor guidance concerning the selection of an annuity provider.

TAKEAWAYS: Advisors to tax-qualified defined contribution plan sponsors can assist their clients in making sponsored plans more valuable by adding lifetime income alternatives. The key to structuring a series of target date funds that incorporate deferred annuity contracts is to ensure that it does not cause the plan to fail nondiscrimination requirements or run afoul of various fiduciary duties under ERISA. Consequently, advisors must be familiar with Notice 2014-66, the QDIA regulations and the annuity selection safe harbor under ERISA.

MAJOR REFERENCES: *IRS Notice 2014-66*; *DOL Information Letter from Phyllis Borzi to J. Mark Iwry, dated October 23, 2014.*

In coordinated guidance issued toward the end of October, the Treasury Department and the Department of Labor ("DOL") have facilitated the use of annuities as a means of providing lifetime income from 401(k) plans. As discussed below, the Treasury guidance ensures that the offering of a series of target date funds (**"TDFs"**) that include deferred annuities as an investment option will not be considered to discriminate in favor of highly compensated employees, even if their availability is limited to older – and, therefore, likely higher paid – participants. The guidance from the DOL indicates that a series of TDFs that includes deferred annuities can be used as a plan's QDIA, as well as confirming that the annuity provider selection safe harbor is available for plans concerning the choice of annuities made available under the TDF.

Treasury Department Guidance

In Notice 2014-66, the IRS concluded that a series of TDFs would be considered a single "benefit, right or feature" subject to applicable nondiscrimination requirements, thereby avoiding the need for each TDF to meet the nondiscrimination requirements separately. Therefore, a series of TDFs will not raise nondiscrimination concerns, provided that four requirements are met:

- First, the series of TDFs must be designed as a single integrated investment program under which the same investment manager manages each TDF and applies the same generally accepted investment theories across the series of TDFs. Accordingly, the only permissible difference among the TDFs is the mix of assets that can be selected by the investment manager, based on the level of risk appropriate for the age-band of individuals participating in each TDF.

- Second, some of the TDFs available to participants in older age-bands include deferred annuities, and none of the deferred annuities provides a guaranteed lifetime withdrawal benefit **("GLWB")** or guaranteed minimum withdrawal benefit **("GMWB")** feature.

- Third, the TDFs do not hold employer securities that are not readily tradable on an established securities market.

- Fourth, other than the mix of assets, the rights and features of each TDF are determined in a consistent manner, and the extent to which the fees and administrative expenses of each TDF are paid from plan assets must be the same.

DOL Guidance

The DOL guidance came in the form of an information letter from Phyllis Borzi, Assistant Secretary for Employee Benefits Security Administration, to J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy at the Treasury Department. The letter analyzed a TDF arrangement and addressed two issues:

1. Qualified Default Investment Alternative. Applicable rules under ERISA provide that a plan fiduciary is not liable for losses incurred by participants whose accounts are invested in the plan's QDIA in the absence of affirmative investment direction from the participant. The information letter indicates that the use of unallocated deferred annuity contracts as fixed income investments in a TDF would not cause the TDF to fail to meet the requirements of the QDIA regulations. Similarly, the DOL concluded that the distribution of annuity certificates as each TDF dissolves on its target date is consistent with the QDIA regulations. Thus, so long as the plan fiduciary complies with certain notice requirements and invests the assets in accordance with DOL regulations governing QDIAs[1], the investment in a series of TDFs that incorporate deferred annuity contracts will not create liability for the Plan fiduciary.

2. Annuity Selection Safe Harbor. When a plan offers an annuity option, the selection of the annuity provider is a fiduciary function. Under a safe harbor established by the DOL, the selection of an annuity provider and contract for benefit distributions will be considered to satisfy the fiduciary responsibility of prudence under ERISA if the fiduciary: (1) engages in an objective, thorough and analytical search of potential providers; (2) considers information sufficient to assess the provider's ability to make all required future payments; (3) considers the cost of the contract vis-à-vis the benefits and administrative services to be provided under the contract; (4) concludes that, at the time of selection, the annuity provider is able to make all required payments and the costs associated with the contract are reasonable; and (5) if necessary, consults with an appropriate expert or experts concerning the other requirements of the safe harbor.

The DOL concluded that the safe harbor is available for the selection of TDFs that incorporate deferred annuity contracts if the investment manager of the TDF actually follows the requirements of the safe harbor and the plan's fiduciary acted prudently in selecting and monitoring the investment manager.

TAKEAWAYS

- Advisors to tax-qualified defined contribution plan sponsors can assist their clients in making sponsored plans more valuable by adding lifetime income alternatives.

- The key to structuring a series of target date funds that incorporate deferred annuity contracts is to ensure that it does not cause the plan to fail nondiscrimination requirements or run afoul of various fiduciary duties under ERISA.

- Consequently, advisors must be familiar with Notice 2014-66, the QDIA regulations and the annuity selection safe harbor under ERISA.

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NOTES

[1] A detailed discussion of the QDIA regulations is beyond the scope of this *Washington Report*, but they impose generally, among other things, criteria concerning the nature and risk characteristics of the investment and requirements concerning the participant's ability to transfer out of the investment and the fees that may be charged in connection with such transfers.

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