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# Encouraging Annuitization

Government debuts lifetime income initiatives

**THE OBAMA ADMINISTRATION** considers the wise use of retirement savings to be an important policy goal. Of particular concern is the risk that extended life expectancies will cause retirees to outlive their retirement assets. One way of guarding against this outcome and its potentially devastating social consequences would be to promote defined benefit (DB) pension plans, which provide a predictable stream of lifetime income. However, bowing to the reality that 401(k) and other defined contribution (DC) plans are the prevalent means of retirement savings and that even DB plans allow benefits to be received as a lump sum, the administration wishes to counteract the shift to single-sum cash payments and facilitate, if not encourage, the annuitization of DC plan account-balances.

The first step in implementing this policy was seen on February 2, 2010, when the Department of Labor (DOL), Internal Revenue Service (IRS) and U.S. Department of the Treasury issued a joint release, requesting information regarding lifetime income options for participants in retirement plans. In the release, these agencies announced that they were currently reviewing the rules under the Employee Retirement Income Security Act (ERISA), and the related rules under the Internal Revenue Code (IRC), to determine whether and how they could enhance the retirement security of participants by facilitating access to lifetime-income arrangements. The three government agencies then held a two-day joint hearing that September to consider the specific issues raised in the nearly 800 comments submitted by the public in response to the information request.

After reviewing the comments, the IRS released a package of proposed regulations and immediately-effective revenue rulings on February 2, 2012 that, according to a Treasury Fact Sheet, are "intended to remove impediments and otherwise ease the offering of lifetime income choices that can help retirees manage their savings."

**Longevity Annuities.** The centerpiece of the administration's regulatory package is the effort to encourage the use of longevity annuities (also known as deeply deferred annuities)—products with an income stream that begins at an age later than normal retirement, such as age 80 or 85, and lasts until death. It is anticipated that an employee

would use the bulk of his plan account, along with Social Security and any other resources, as retirement income until the delayed annuity starting date.

The problem with longevity annuities is that current law requires plan participants and IRA owners to begin receiving payouts soon after they reach age 70.5. The regulations now in effect require DC plans and IRAs to determine required minimum distributions on an annual basis by dividing the participant's or IRA owner's entire account balance, including the value of any deferred annuity, by his or her life expectancy (or the joint life expectancies of the participant/owner and a designated beneficiary). Thus, a participant could be required to take a distribution based on the value of the annuity without being able to access that value, since it would have been paid to the insurance company as premium.

Under the proposed regulations, however, a participant would be permitted to exclude the value of a qualifying longevity annuity contract (QLAC) from the account balance used to determine required minimum distributions. To qualify as a QLAC, the annuity starting date could be no later than age 85 and the annuity premium would have to be limited to the lesser of \$100,000 or 25% of a participant's account balance on the date a premium payment is made. The Treasury Department estimates that a premium of \$100,000 paid at age 70 will purchase an annuity beginning at age 85 that provides an annual income from \$26,000 to \$42,000. This calculation uses an interest rate assumption of 3%, and, if this assumption is raised to 4%, the Treasury estimates that the annual payout could be as much as \$50,000. Paying premiums at a date or dates before age 70 would also boost payouts.

The market for longevity annuities is currently very limited, but the administration hopes that relaxation of the required minimum distribution rules will encourage expansion of the products' use. Since the Treasury has indicated that the proposed regulations will be followed by continued dialogue and further guidance, it is likely the government's next steps will include efforts to educate employees about the importance of guaranteed retirement income.

In the next column, I will address the rest of the regulation and revenue rulings.