2012 Annuity Guidance

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Agenda

- General update
- Background
- Revenue Ruling 2012-3
- Proposed QLAC regulations
- Revenue Ruling 2012-4
- Proposed 417(e) regulations

General update

- MAP-21!
- Other funding projects
  - Final regulations, § 430
  - Proposed regulations, §§ 430 and 436
- Hybrid plan regulations
- Final 417(e) regulations
- Form 5500 updates

Counsel of Economic Advisers Report – February 2, 2012

- Social Security benefits can be expected to provide only 55% of lifetime average earnings.
- One third of individuals over age 80 receive more than 90% of their income from Social Security. An additional 30% of individuals over age 80 receive 50 to 90% of their income from Social Security.
- The share of private-sector workers covered by DB pension plans fell from 38% in 1980 to 20 percent in 2008.
- In 1980, 71 percent of private employer-sponsored retirement plans were held in DB plans, in 2008, 60 percent of these assets were held in DC plans.

The issue

- Many Americans have most of their pension assets in DC accounts
- Difficult to manage account to last a lifetime
- Lifetime annuities provide more retirement security
  - Provide future income payments for the life of the retiree
  - May also cover income payments for the spouse or other beneficiary after the retiree's death

The response

- The Administration recognized challenges to retirement security
- Wished to find ways to encourage employers to offer annuities to their employees
- Four pieces of guidance issued February, 2012:
  - RR 2012-3 – Survivor annuity contracts, DC plans
  - Proposed QLAC regulations
  - RR 2012-4 – DC-to-DB rollovers
  - Proposed 417(e) regulations

Annuitization

- Refers to using liquid assets to buy schedule of future income payments, often guaranteed for life
- Types of annuities
  - Immediate – beginning at date of retirement
  - Deferred – beginning at future date
  - Longevity annuities – beginning at advanced age
- ADVANTAGE – protects retirees against the risk of outliving assets

Benefit of Annuitization

- Annuitization protects retirees against the risk of outliving assets.
- Annuitization is "insurance" against living too long. In contrast, life insurance is insurance against premature death.

The "Annuity Puzzle"

- Very few retirees elect to purchase immediate or longevity annuities.
- Why?
  - Irrevocability
  - The desire to retain liquid assets in case of unexpected medical costs or as a bequest to heirs
  - Concerns over the long-term financial soundness of annuity providers
  - Lack of understanding of longevity risk and how lifetime income products can help manage it
  - Price
  - Complexity (i.e., how the products themselves work and how the law applies to annuities)

Rev. Rul. 2012-3

- Purpose – to clarify how QJSA and QPSA rules apply in situations in which a profit sharing plan offers deferred annuities.
- Three situations are covered each of which involve the purchase of deferred annuities with differing features:
  - Plain vanilla annuity
  - Annuitization automatic at later of age 65 or retirement
  - Annuitization automatic at later of age 65 or retirement AND amounts attributable to matching contributions are forfeited upon death of participant.

Rev. Rul. 2011-3 Holdings

- In situations in which a participant has the opportunity <u>not</u> to annuitize, a plan is not subject to the QJSA and QPSA requirements until the annuity starting date.
- In situations in which a participant <u>must</u> annuitize at a later date, a plan is subject to the QJSA and QPSA requirements when the participant first invests in the annuity.
- In situations in which a plan separately accounts for deferred annuity contracts, the remainder of the plan is not subject to QJSA and QPSA requirements.

Future QJSA/QPSA guidance

- Rev. Rul. 2012-3 is “first step” guidance.
- Future guidance necessary to cover “gray areas” such as situations in which participants have the opportunity to adjust payments after annuitization (e.g., stop, increase, decrease).

Proposed QLAC Regulations

- Technically, amendments to the 1.401(a)(9) regulations and conforming amendments to certain other regulations.
- Purpose is to remove the minimum distribution rules as an impediment to the utilization of longevity annuities by excluding the value of the QLAC from the account balance.

Definition of a QLAC

- Limitation on premiums
- Maximum age at commencement
- Benefits payable after death of an employee
- Other QLAC requirements

Other QLAC Reg. Provisions

- IRAs
- Section 403(b) plans
- Section 457(b) plans
- Defined benefit plans
- Disclosure and annual reporting requirements.

Comments - QLAC regulations

- $100,000 and 25% limits
- Return of premium feature
- Correction program
- Consequence of excess premiums
- Requirement that a contract must state that it is a QLAC
- Variable and participating contracts
- Unisex mortality requirements
- Guaranteed minimum death benefits and cash surrender values
- Alternative death benefits

Rev. Rul. 2012-4 -- Rollovers

- Concept – participants may be more likely to choose an annuity if they can "purchase" it from their DB plan
  - Potentially less costly
  - More convenient/ less confusing
- § 408 already provides for rollovers between qualified plans
- Rev. Rul. 2012-4 clarifies for DC->DB rollovers to provide additional DB benefits

Rev. Rul. 2012-4 -- Rollovers

- Some obstacles
  - Fewer DB plans
  - Employer reluctance to increasing DB exposure
  - Employee concerns about benefit security

Rev. Rul. 2012-4 -- Rollovers

- Key holdings
- If convert rollover to DB amount using
  - Assumptions that apply to mandatory employee contributions – does not violate § 411 or § 415
  - Less generous assumptions – violates § 411
  - More generous assumptions – subsidized portion of the benefit counts as employer-provided benefit for § 411, § 415

Rev. Rul. 2012-4 -- Rollovers

- FAQ
  - Limited fact pattern is not intended to restrict rollovers
  - Rollovers not permitted if AFTAP is under 60%
  - Does not apply to § 414(k) accounts – only if rollover used to buy additional DB benefits

Proposed regulations – 417(e)

- Concept – employees may be more willing to take annuity if avoid “all or nothing” choice
- 417(e) sets minimum present values for certain types of distributions
- Longstanding rule – if any portion of a distribution is subject to 417(e), the entire distribution is subject to 417(e)
- Changing rule may encourage employers to offer partial lump sums

Proposed regulations – 417(e)

- Proposed regulation would apply 417(e) only to a portion of the benefit in 3 cases:
  - Plan with two separate benefits, determined separately with different options (cash balance conversion)
  - Proportional split (allow employee to take % as lump sum and remaining % as an annuity)
  - Fixed dollar amount (employee contributions payable as a lump sum)

Proposed regulations – 417(e)

- FAQ
  - Effective date – some would like to apply retroactively
  - § 411(d)(6) issues if plan already offers partial lump sum
  - § 436 "bifurcation" rule was exception to general rule

Questions?

E-mail RetirementPlanQuestions@irs.gov