FIELD ASSISTANCE BULLETIN NO. 2015-02

DATE: July 13, 2015

MEMORANDUM FOR: MABEL CAPOLONGO, DIRECTOR OF ENFORCEMENT
REGIONAL DIRECTORS

FROM: JOHN J. CANARY
DIRECTOR OF REGULATIONS & INTERPRETATIONS

SUBJECT: SELECTION AND MONITORING UNDER THE ANNUITY SELECTION SAFE HARBOR REGULATION FOR DEFINED CONTRIBUTION PLANS

Issue

A regulation issued by the Department in 2008 at 29 CFR 2550.404a-4 regarding the selection of annuity providers under defined contribution plans (Safe Harbor Rule) provides plan fiduciaries with safe harbor conditions for the selection and monitoring of annuity providers and annuity contracts for benefit distributions. However, a recurring comment on the Safe Harbor rule is that employers remain unclear about the scope of their fiduciary obligations with respect to annuity selection under defined contribution plans. In particular, questions continue to be raised about how to reconcile the "time of selection" standard in the Safe Harbor Rule -- which embodies the general principle that the prudence of a fiduciary decision is evaluated under ERISA based on the information available at the time the decision was made -- with ERISA's duty to monitor and review certain fiduciary decisions.

Confusion or lack of clarity regarding the nature and scope of fiduciary responsibilities to act prudently in making, monitoring and reviewing annuity selections under a defined contribution plan could lead plan sponsors or their advisors in some instances to overestimate or otherwise misunderstand the duration or extent of those fiduciary responsibilities. This, in turn, could create or reinforce disincentives for plan sponsors to offer their employees an annuity as a lifetime income distribution. This Field Assistance Bulletin (Bulletin) is intended to provide guidance regarding these issues (including the application of ERISA's statute of limitations to claims relating to annuity selection) and assist the Employee Benefits Security Administration's national and regional offices in responding to questions from employers and other interested parties.

Background

The current Safe Harbor Rule describes actions that defined contribution plan fiduciaries can take to satisfy their ERISA fiduciary responsibilities in selecting an annuity provider for benefit distributions (29 CFR 2550.404a-4).[1] Similar to selecting plan investments, choosing an annuity

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[1] The Pension Protection Act of 2006 directed the Department to issue regulations clarifying that the selection of an annuity contract as an optional form of distribution from a defined contribution plan is not subject to the safest available annuity standard under Interpretive Bulletin 95-1 (IB 95-1) and is subject to all otherwise applicable *(footnote continued on next page)*

provider for this purpose is a fiduciary function, subject to ERISA's standards of prudence and loyalty. The Safe Harbor Rule requirements are satisfied if the plan's fiduciary:

- Engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities. This process must avoid self-dealing, conflicts of interest or other improper influence and should, to the extent possible, involve consideration of competing annuity providers;
- Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;
- Appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract;
- Appropriately concludes that, at the *time of the selection* [emphasis added], the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and
- If necessary, consults with an appropriate expert or experts for purposes of compliance with these provisions.

For this purpose the Safe Harbor Rule provides that "the time of selection" means:

(1) the time that the annuity provider and contract are selected for distribution of benefits to a specific participant or beneficiary; or
(2) the time that the annuity provider is selected to provide annuities as a distribution option for participants or beneficiaries to choose at future dates.

The Safe Harbor Rule also provides that when an annuity provider is selected to offer annuities that participants may later choose as a distribution option, the fiduciary must periodically review the continuing appropriateness of the conclusion that the annuity provider is financially able to make all future payments under the annuity contract, as well as the reasonableness of the cost of the contract in relation to the benefits and services to be provided. The fiduciary is not, however, required to review the appropriateness of its conclusions with respect to an annuity contract purchased for any specific participant or beneficiary.[2]

<u>Discussion</u>

ERISA's Prudence Standard Applied to the Selection and Monitoring of Annuities

Section 404(a)(1)(B) of ERISA provides that a fiduciary must discharge his duties with respect to a plan –

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fiduciary standards. On October 7, 2008, the Department issued a final rule amending IB 95-1 to clarify that it applies only to defined benefit plans. The Department published on the same day the final regulation establishing the annuity provider selection safe harbor for distributions from defined contribution plans (29 CFR 2550.404a-4).

[2] *See* 29 CFR 2550.404a-4(c)(2).

> with the care, skill, prudence, and diligence *under the circumstances then prevailing* [emphasis added] that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

Consistent with this statutory language, the prudence of a fiduciary decision is evaluated with respect to the information available at the time the decision was made – and not based on facts that come to light only with the benefit of hindsight.[3] The conditions of the Safe Harbor Rule embody this general principle of fiduciary prudence. A fiduciary's selection and monitoring of an annuity provider is judged based on the information available at the time of the selection, and at each periodic review, and not in light of subsequent events.[4]

The periodic review requirement in the Safe Harbor Rule does not mean that a fiduciary must review the prudence of retaining an annuity provider each time a participant or beneficiary elects an annuity from the provider as a distribution option. The frequency of periodic reviews to comply with the Safe Harbor Rule depends on the facts and circumstances. For example, if a "red flag" about the provider or contract comes to the fiduciary's attention between reviews (e.g., a major insurance rating service downgrades the financial health rating of the provider or several annuitants submit complaints about a pattern of untimely payments under the contract), the fiduciary would need to examine the information to determine whether an immediate review is necessary, or, depending on the facts and circumstances, the fiduciary may need to conduct an immediate review.

The guidance in this Bulletin is limited to the selection and monitoring of annuity providers for benefit distributions from defined contribution plans.[5] The Department and the Department of the Treasury are engaged in a joint initiative to encourage the prudent consideration, offering, and use of lifetime income alternatives, including annuities, in retirement plans.[6] Accordingly, the Departments have issued separate regulations and other guidance clarifying applicable rules and facilitating the offering and selection of lifetime income under retirement plans.[7] The

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[3] *Bunch v. W.R. Grace & Co*., 555 F.3d 1, 10 (1st Cir. 2009) ("Although hindsight is 20/20, as we have already stated, that is not the lens by which we view a fiduciary's actions under ERISA"); *DiFelice v. U.S. Airways Inc.*, 497 F.3d 410, 424 (4th Cir. 2007) ("First and foremost, whether a fiduciary's actions are prudent cannot be measured in hindsight, whether this hindsight would accrue to the fiduciary's detriment or benefit."); *Donovan v. Mazzola*, 716 F.2d 1226, 1231 (9th Cir.1983) ("The Court's task is to inquire 'whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment.'").

[4] *See Tibble v. Edison Intern.*, 135 S.Ct. 1823 (2015) (trustee's continuing duty to monitor trust investments and remove imprudent ones exists separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset). *See also* 3 Restatement (Third) of the Law of Trusts §90 cmt. b, at 294-296 (2007) ("[A] trustee's duties apply not only in making investments, but also in monitoring and reviewing investments.").

[5] This guidance does not address any issues regarding plan or fiduciary communications to participants regarding annuity contracts held by participants still covered under a plan.

[6] *See* Joint Request for Information published at 75 FR 5253 (Feb. 2, 2010). Comments on the RFI are available at www.dol.gov/ebsa/regs/cmt-1210-AB33.html.

[7] *See* Pension Benefit Statements, Advance Notice of Proposed Rulemaking, 78 FR 26727 (May 8, 2013); DOL Information Letter from Phyllis C. Borzi to J. Mark Iwry (Oct. 23, 2014) (guidance under 29 CFR 2550.404c-5 and 2550.404a-4 with respect to a series of target date funds that seek to provide lifetime income through the use of unallocated deferred annuity contracts described in Internal Revenue Service Notice 2014-66 -- available at www.dol.gov/ebsa/pdf/il102314.pdf); Final Treasury Regulations on Longevity Annuity Contracts, 79 FR 37633
(footnote continued on next page)

Department is considering guidance on fiduciary selection and monitoring of annuity providers and contracts that are offered as investment options under defined contribution plans as part of its project on the Department's regulatory agenda to evaluate possible amendments to the Safe Harbor Rule. Information regarding the project is available at www.reginfo.gov/public/do/eAgendaViewRule?pubId=201504&RIN=1210-AB58.

Examples

The examples below illustrate the selection and monitoring of an annuity provider under the Safe Harbor Rule. The following assumptions apply to each of the examples: (1) the fiduciary prudently concludes that, at the time of its selection, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the annuity contract; (2) each product or product feature is an annuity contract; and (3) each annuity provider is appropriately licensed to issue annuity contracts under state insurance laws.

The annuity products or features used in the examples are (1) an immediate annuity which provides for fixed monthly payments that start immediately and continue for the life of the retiree (or beneficiary if a joint life annuity is elected); and (2) a longevity annuity, which is a deferred fixed income annuity purchased at retirement, but income payments start at an advanced age, such as 80 or 85.

EXAMPLE #1 — *Monitoring and Review Until Annuity Provider is Replaced*
IMMEDIATE ANNUITY

Facts: Employer G offers a 401(k) plan under which participants with vested account balances may elect among various benefit distribution options, including an immediate annuity. Employer G prudently selects an annuity provider, H, to issue immediate annuities directly to participants who from time to time thereafter elect this option when they retire.

Employer G periodically reviews Annuity Provider H for as long as the plan offers Annuity Provider H's annuities. At some point, Employer G determines that it can obtain more competitive annuities from another annuity provider. Accordingly, Employer G stops offering annuities from Annuity Provider H as a benefit distribution option. Some years later, Annuity Provider H becomes unable to pay its annuity holders.

Conclusion: Under the Safe Harbor Rule, Employer G's obligation to periodically review Annuity Provider H ended when Employer G stopped offering annuities from Annuity Provider H as a distribution option to participants or their beneficiaries.

(July 2, 2014); Proposed Treasury Regulations on Modifications to Minimum Present Value Requirements for Partial Annuity Distribution Options Under Defined Benefit Pension Plans, 77 FR 5454 (Feb. 3, 2012); Rev. Rul. 2012-3, 2012-8 IRB 383 (Application of Survivor Annuity Requirements to Deferred Annuity Contracts Under a Defined Contribution Plan); Rev. Rul. 2012-4, 2012-8 IRB 386 (Rollover from Qualified Defined Contribution Plan to Qualified Defined Benefit Plan to Obtain Additional Annuity); Notice 2014-66, IRB 2014-46 (Lifetime Income Provided Through Target Date Funds in Section 401(k) Plans and Other Qualified Defined Contribution Plans).

EXAMPLE #2 — *Monitoring and Review Until Annuity is No Longer a Distribution Option*
DEFERRED ANNUITY

<u>Facts</u>: Employer C's 401(k) plan includes, as a distribution option, a qualifying longevity annuity contract (*see* Treas. Regulations, 79 FR 37633 (July 2, 2014)). This type of deferred annuity provides a stream of payments that do not begin until a specified number of years (for example, 10 to 15) after the participant retires, or when the participant reaches age 80 or 85. Employer C prudently selects Annuity Provider D under the Safe Harbor Rule to provide the longevity annuity option to plan participants. Under the terms of the plan, participants can make single premium payments from their accounts to purchase a qualifying longevity annuity at retirement. If a participant purchases a qualifying longevity annuity, the participant's premium payment cannot be withdrawn or converted to a lump sum, except for a return of premium benefit upon the death of the participant. Participants who purchase a qualifying longevity annuity receive a certificate at retirement evidencing their rights under the annuity. Neither Employer C nor the plan has any legal rights or interests in the purchased annuities.

<u>Conclusion</u>: As long as the plan continues to offer participants the option to purchase a qualifying longevity annuity at retirement from Annuity Provider D, compliance with the Safe Harbor Rule requires Employer C to periodically review Annuity Provider D. Under the facts of this example, this duty to monitor ends when qualifying longevity annuities from Annuity Provider D are no longer offered as a distribution option.

ERISA's Statute of Limitations on Fiduciary Liability for the Selection of Annuity Providers and Annuity Contracts

Actions by participants and beneficiaries against plan fiduciaries under ERISA for breaches of duty in connection with the purchase of annuities,[8] including the imprudent selection and monitoring of annuity providers, are subject to the applicable limitations periods in ERISA section 413. This section provides that an action for a breach of fiduciary duty may not be brought after the earlier of (a) six years after the date of the last action which constituted a part of the violation or, in the case of an omission, the latest date on which the fiduciary could have cured the violation, or (b) three years after the earliest date on which the plaintiff had actual knowledge of the breach. In the case of fraud or concealment of a breach, an action may not be brought later than six years after the breach was discovered. Absent fraud or concealment, these provisions mean that a plaintiff must base his or her claims on actions or omissions that occurred within the six years preceding the lawsuit. Thus, for example, if the plaintiff bases his or her claim on the imprudent selection of an annuity contract to distribute benefits to a specific participant, the claim would have to be brought within six years of the date on which plan assets were expended to purchase the contract.

Questions concerning the information contained in this memorandum may be directed to Stephanie Cibinic of the Office of Regulations and Interpretations, 202-693-8500.

[8] *See* ERISA section 502(a)(9).