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It May Be Time to Offer Annuity Options to 401(k) Plan Participants

02.01.16

In theory, allowing 401(k) plan participants to convert their accumulated retirement savings into a lifetime income stream through an annuity contract sounds like a win. After all, it allows participants to basically turn their 401(k) plan into a pension, so that they have a predictable income stream during their lifetime. So why haven't annuities been used more?

A Little History

The U.S. Department of Labor (DOL) originally created a safe harbor rule in 2008 regarding the selection of annuity providers, but sponsors didn't use it to incorporate more annuity options into 401(k) plans. For most plan sponsors, worries about fiduciary liability associated with selecting an annuity provider have stood in the way.

A DOL "field assistance bulletin" (FAB) issued last year may turn the tide. The FAB clarifies the fiduciary standard for selecting annuity providers.

A Safety Net

The current annuity selection safe harbor includes five elements and is met if the plan's fiduciary:

- Engages in an objective, thorough and analytical search to identify and select providers from which to purchase annuities,
- Considers information sufficient to assess the annuity provider's ability to make all future payments under the annuity contract,
- Considers the cost (including fees and commissions) of the annuity contract in relation to the provided benefits and administrative services,
- Concludes that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract, and
- Consults with a professional to comply with these provisions if necessary.

According to the FAB, "at the time of selection" means that the DOL will evaluate the prudence of a fiduciary decision using the information available at the time the decision was made. It doesn't consider facts that may come to light at a later date.

In addition, the sponsor's obligation to monitor an annuity provider ends when the sponsor stops offering that provider's products. Thus, if a sponsor stops offering an annuity, the sponsor isn't subject to fiduciary liability if the annuity provider whose annuities are used by some of the sponsor's retirees subsequently goes bust.

A Long Time

The FAB also highlighted ERISA's six-year statute of limitations. Under ERISA, an action for a breach of fiduciary duty may not be brought after the earlier of:

- Six years after the date of the last action that 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
- Three years after the earliest date on which the plaintiff had actual knowledge of the breach.

Thus, if a plaintiff makes a claim based on the imprudent selection of an annuity contract to distribute benefits to a specific participant, the plaintiff has to file the claim within six years of the date on which plan assets were expended to purchase the contract.

A Look Ahead Will this clarification open the door to more employers offering annuities? The DOL expects to issue more guidance in the future to further encourage use of annuities in 401(k) plans.

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