The ERISA Industry Committee

May 2, 2012

Submitted through the Federal eRulemaking Portal:
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Internal Revenue Service
CC:PA:LPD:PR (Reg-115809-11) Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Comments on Longevity Annuity Contract Regulations

Ladies and Gentlemen:

The ERISA Industry Committee ("ERIC") is pleased to submit these comments on the proposed regulations related to qualifying longevity annuity contracts ("QLACs"). The proposed regulations were published in the *Federal Register* on February 3, 2012.

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive retirement, health care, and other economic security benefits directly to tens of millions of active and retired workers and their families. ERIC has a strong interest in proposals affecting its members' ability to deliver effective and secure retirement benefits.

ERIC supports efforts to "reduce regulatory barriers in order to increase interest in lifetime income, encourage innovation among stakeholders, and expand choices for individuals with a view to promoting greater retirement security."[1] To that end, we welcome the proposal to modify existing minimum required distribution rules to accommodate deferred annuities. We believe that additional flexibility will make lifetime income options more attractive, promoting greater retirement security.

We respectfully request that the proposal be improved in the following ways:

1. The value of a deferred annuity should be disregarded "to the extent" that the requirements for a QLAC are satisfied. If the amount set aside for a QLAC exceeds the maximum permitted by the regulation (proposed to be $100,000 or 25% of the account balance), minimum required distribution calculations should take into account only the value attributable to excess premiums.

2. The final regulations should allow the intent to be a QLAC to be stated in the required QLAC disclosure or an insurance certificate, rather than in the contract itself.

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[1] U.S. DEP'T OF THE TREASURY, TREASURY FACT SHEET: HELPING AMERICAN FAMILIES ACHIEVE RETIREMENT SECURITY BY EXPANDING LIFETIME INCOME CHOICES 2 (Feb. 2, 2012).

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3. QLAC relief should be available for defined benefit plans.

4. Treasury and the Service should address the consequences of requiring unisex mortality assumptions for QLACs provided through employer plans.

In addition to these changes to the QLAC regulations, we respectfully request that existing minimum required distribution regulations be revised to allow accelerated payment of an annuity in pay status. This request is discussed at the end of this letter.

Discussion

1. The value of a deferred annuity should be disregarded "to the extent" that the requirements for a QLAC are satisfied.

Under the proposal, the value of any QLAC is disregarded for purposes of calculating minimum required distributions under a defined contribution plan. Prop. Treas. Reg. § 1.401(a)(9)-5, A-3(d). If one of the QLAC requirements is not satisfied, however--for example, the amount set aside exceeds a limit--the full value of the annuity contract must be taken into account. Prop. Treas. Reg. § 1.401(a)(9)-6, A-17(d)(2). The proposal further states that if too much is set aside, any subsequent increase to the limit will not cause the contract to become a QLAC. *Id.*, A-17(d)(3)(iii).

This all-or-nothing approach is unduly draconian. It is inevitable that some individuals will inadvertently set aside too much for a longevity annuity contract. If this happens, there is no reason to treat the amount set aside up to the limit differently than if excess amounts had not been set aside. The risk of such harsh consequences will make plan sponsors and participants hesitate to offer or purchase QLACs. In addition, the all-or-nothing approach is not intuitive, and will be difficult for plan sponsors to administer; difficult for participants to understand; and difficult for the Service to police.

Accordingly, the final regulations should state that the value of a deferred annuity will be disregarded "to the extent" that the QLAC requirements are satisfied. Only the portion of the contract that is attributable to excess premiums should be taken into account for purposes of the minimum required distribution calculations. The portion that can be disregarded should be calculated by applying a simple ratio based on the premiums paid relative to the limit: the value treated as a QLAC equals the value of the contract times the ratio of (a) the maximum premium that may be set aside in a QLAC (*e.g.*, $100,000 or 25% of the participant's account balance), to (b) the total premium invested in the annuity contract.

Specifically, the regulatory language should be changed as follows:

- The first sentence of Prop. Treas. Reg. § 1.401(a)(9)-5, A-3(d) should state "The account balance does not include the value of any longevity annuity contract held under the plan ***to the extent*** that the contract satisfies the requirements to be a qualifying longevity annuity contract under A-17 of § 1.401(a)(9)-6."

- Prop. Treas. Reg. § 1.401(a)(9)-6, A-17(d)(2) should be revised to state as follows:

> (2) Consequences of excess premiums. If a premium for a longevity annuity contract exceeds the limits under paragraph (b) of this A-17, the value of the longevity annuity contract that is attributable to such excess premium shall not be a qualifying longevity annuity contract and shall not be disregarded under § 1.401(a)(9)-5, A-3(d). The portion treated as a qualified longevity annuity contract shall be equal to the value of the longevity annuity multiplied by a fraction, the numerator of which is the maximum premium permitted by paragraphs (b)(2) and (3) of this A-17 and the denominator of which is the total premium invested in the longevity annuity. All remaining value shall be treated as attributable to excess premiums.

- Paragraph (d)(3)(iii) of A-17 should be deleted. If an increase to the premium limit causes a contract to satisfy the QLAC requirements, minimum required distributions for periods after the QLAC requirements are satisfied should be calculated without regard to the value of the QLAC.

2. The final regulations should allow the intent to be a QLAC to be stated in the required QLAC disclosure or an insurance certificate, rather than in the contract itself.

The proposed regulations state that a longevity annuity will not qualify as a QLAC unless "[t]he contract, when issued, states that it is intended to be a QLAC." Prop. Treas. Reg. § 1.409A-6, A-17(a)(6). We do not believe this requirement is necessary. Treatment as a QLAC should be determined based on the characteristics of the annuity contract, without the need for magic words. Moreover, any need to identify a contract as a QLAC will be satisfied by the disclosure requirements set forth in Prop. Treas. Reg. § 1.6047-2.

If Treasury and the IRS nevertheless conclude that the intent to be a QLAC must be stated in the annuity document, the final regulations should provide that this requirement will be satisfied for a group annuity contract if the individual insurance certificate states that it is intended to be a QLAC (and satisfies the other QLAC requirements).

Insurance contracts are generally filed with state insurance regulators. We understand that it would be cumbersome to have to file new contract forms for QLACs. Allowing the requirements to be satisfied in the insurance certificate, rather than in the group annuity contract itself, would ease the burden considerably.

3. QLAC relief should be available for defined benefit plans.

The Preamble to the proposed regulations states that the proposal does not apply to defined benefit plans, because defined benefit plans "offer annuities which provide longevity protection." 77 Fed. Reg. 5443, 5449 (Feb. 3, 2012). Although it is true that defined benefit plans offer annuities, existing minimum required distribution rules interfere with the ability to offer ***deferred*** annuities.

It is well-documented that participants in defined benefit plans with a lump-sum option overwhelmingly choose the lump sum.[2] The anti-cutback rule prohibits addressing this problem by eliminating the lump-sum option. *See* Treas. Reg. § 1.411(d)-3(b).

When a lump sum is available, many participants have very good reasons for choosing the lump sum over an annuity. Although an annuity protects against downside risk, the protection comes at a high cost. For example:

- If the participant dies at a young age, he or she can forfeit significant savings.
- Most annuities are not indexed for inflation and therefore lose significant value over time. Participants can hedge against inflation by receiving a lump sum and investing wisely.
- Participants who elect annuities are forced to rely on a fixed income. There is no flexibility for unexpected financial needs--for example, the need to pay an unexpected medical expense.
- The conservative actuarial assumptions that are required for calculating lump sums make lump-sum payments very attractive--often more valuable on an actuarial basis than an annuity.

An effective way to address the risk of participants outliving their retirement savings (or being overly conservative) is to encourage more distribution options that make downside protection attractive. Split payment options (proposed in regulations published in the *Federal Register* on February 3, 2012) are a step in the right direction. Allowing a lump-sum payment to be combined with a deferred annuity would help to further this objective.

A deferred annuity under a defined benefit plan is no less attractive, and no less important, than under a defined contribution plan. In both cases, a deferred annuity facilitates the best of both worlds: the flexibility and potential for upside that a lump sum offers, and the safety net of a deferred annuity--for a cost that is much less than an immediate annuity.

Moreover, allowing QLACs under defined contribution plans and IRAs, but not defined benefit plans, will encourage many participants to request lump-sum payments and roll them over to a defined contribution plan or an IRA, where they can buy a QLAC. Forcing participants to go this route will result in many participants buying annuities that are less attractive than what could be provided under a defined benefit plan. This result would undercut the efforts described in Revenue Ruling 2012-4 to encourage rollovers from defined contribution plans to defined benefit plans.

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[2] *See, e.g.*, 77 Fed. Reg. 5454, 5456 (Feb. 3, 2012); Gary R. Mottola & Stephen P. Utkus, *Lump Sum or Annuity? An Analysis of Choice in DB Pension Payouts*, Vanguard Center for Retirement Research, Vol. 30 (Nov. 2007) (finding that 73% of participants in a large traditional defined benefit plan and 83% of participants in a large cash balance plan elected a lump sum).

4. **Treasury and the Service should address the consequences of requiring unisex mortality assumptions for QLACs provided through employer plans.**

Footnote 1 of the Preamble to the proposed regulations states that "if [a QLAC] is provided under an employer plan, unisex mortality assumptions would be required." 77 Fed. Reg. 5443, 5446 (Feb. 3, 2012). We understand that this requirement is based on the holding of *Ariz. Governing Committee for Tax Deferred Annuity and Deferred Comp. Plans v. Norris*, 463 U.S. 1073 (1983).

We are concerned, however, that the requirement to use unisex mortality assumptions can make buying a deferred annuity through an employer plan particularly unattractive for men. Because deferred annuities can start after the life expectancy of the average male, the cost of using unisex mortality assumptions is much more significant for a deferred annuity than for an immediate annuity. As a result, many men will find annuities purchased through an IRA to be more attractive than annuities purchased through an employer plan.

We recommend taking the following steps to address this concern:

i. Treasury and the Service should work with the Department of Labor and the EEOC to establish guidance on what employers and advisers can or should do to help participants procure attractive deferred annuities. For example, the guidance should address the extent to which it would be appropriate--

   - To advise participants to consider annuity options outside the plan, or

   - To negotiate preferred provider relationships with IRA providers that can provide more favorable annuities than are available through the plan.

ii. As discussed above, Treasury and the Service should provide QLAC relief for defined benefit plans. In some cases, the efficiency of providing an annuity through a defined benefit plan can offset the added cost of using unisex mortality tables.

Accelerating Payment of Annuity in Pay Status

Treas. Reg. § 1.401(a)(9)-6 prohibits increasing annuity payments to participants in pay status except in limited circumstances. The regulation can be read to bar accelerating otherwise permissible payments--for example, cashing out a participant's remaining annuity payments in a lump sum. Such a restriction is inconsistent with the policy of Code § 401(a)(9) and contributes to participants shying away from annuity options when they are available. As noted above, requiring annuitants to rely on a fixed income, without flexibility to address unforeseen financial needs, makes annuities unattractive.

Treasury and the Service should address this concern by allowing participants with annuities in pay status to make any changes to their payment terms that result in payment being accelerated.

Existing rules against increasing annuity payments were intended to prevent circumvention of the minimum required distribution rules.[3] For example, if a straight life annuity benefit of $1,000 per month were converted to an actuarially equivalent annuity benefit of $1 per month with a lump-sum payment upon the participant's death, the bulk of the distribution would be delayed past the required beginning date--circumventing the minimum distribution requirements.

However, this concern does not arise when the form of payment initially complies with Code § 401(a)(9) and is modified to accelerate payment. For example, if a participant's benefit commences on or before the required beginning date in the form of a straight life annuity, the amount paid each year will never be less than the minimum required amount. A subsequent election to ***accelerate*** payment will not change the result. To the contrary, the acceleration will result in completion of the distributions ***faster*** than is required by Code § 401(a)(9).

The existing regulations under Code § 401(a)(9) already allow changes to annuities in pay status under specified circumstances. *See* Treas. Reg. § 1.401(a)(9)-6, A-13 and 14. We are not aware of any basis in the statute or legislative history for allowing changes to an annuity under the circumstances listed in the regulation but not allowing ***acceleration*** of payment under an annuity that otherwise satisfies the requirements of Code § 401(a)(9). If the initial payment schedule satisfies the Code § 401(a)(9) requirements, subsequently accelerating payment would actually further Code § 401(a)(9)'s purpose of ensuring that benefits under a qualified plan are "for the primary benefit of an employee, rather than the employee's beneficiaries."[4]

Like the availability of a split-payment option or a deferred annuity, flexibility to request accelerated payments under an annuity will make annuities less risky and more attractive. This is one more example of a regulatory barrier that should be eliminated to promote greater retirement security.

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ERIC appreciates the opportunity to submit these comments. If we can be of further assistance, please let us know.

Sincerely,

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President & CEO

Kathryn Ricard
Senior Vice President, Retirement

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[3] *See, e.g.*, H.R. REP. NO. 98-861, at 1138 (1984) (Conf. Rep.); COMM. ON FINANCE, 98TH CONG., DEFICIT REDUCTION ACT OF 1984: EXPLANATION OF PROVISIONS APPROVED BY THE COMMITTEE ON MARCH 21, 1984 308 (Comm. Print 1984); STAFF OF THE JOINT COMM. ON TAXATION, GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984 811 (1984).

[4] STAFF OF THE JOINT COMM. ON TAXATION, GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982 304 (1982).