

DOL Issues Interim Final Rule on Lifetime Income Illustrations

A Practical Guidance® Practice Article by Matthew H. Hawes, R. Randall Tracht, Hengyang (Yonggo) Ding, and William J. Marx, Morgan, Lewis & Bockius, LLP



Matthew H. Hawes
Morgan, Lewis & Bockius LLP



R. Randall Tracht
Morgan, Lewis & Bockius LLP

This article discusses the U.S. Department of Labor's recent issuance of an interim final rule to implement "lifetime income illustrations," which must be provided to defined contribution plan participants pursuant to the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act). Pub. L. No. 116-94. 85 Fed. Reg. 59,132 (Sept. 18, 2020); [DOL News Release \(Aug. 18, 2020\)](#).

Background

Enacted in December 2019, the SECURE Act requires defined contribution plans to provide "lifetime income illustrations" to participants. The purpose of this requirement is to help participants understand how their defined contribution plan accounts may translate into an income stream in retirement. The SECURE Act tasked the U.S. Department of Labor (DOL) with issuing rules and model disclosures within one year of the SECURE Act that

will guide plans in preparing and providing these lifetime income illustrations to participants.

Accordingly, the DOL issued an Interim Final Rule (Rule) on August 18, 2020 that sets forth the parameters and disclosures required to implement the lifetime income illustrations. As a threshold point, we note that the Rule only applies to defined contribution retirement plans (401(k) plans, 403(b) plans, etc.) and not to defined benefit pension plans. As such, all references herein to "plans" and "participants" pertain solely to defined contributions retirement plans and their participants.

A Primer to the Lifetime Income Illustration Rule

The concept of lifetime income illustrations for plans is not a new one. By way of example, the DOL published an advanced notice of proposed rulemaking in 2013 (2013 Notice) soliciting comments regarding a possible requirement to include lifetime income illustrations in quarterly participant benefit statements. 78 Fed. Reg. 26,727 (May 8, 2013); ERISA § 105 (29 U.S.C. § 1025). The DOL received 125 comment letters in response to the 2013 Notice, but ultimately did not issue regulations or take any other formal action.

Against this background, the SECURE Act was signed into law in late 2019 and amended Section 105 of the Employee Retirement Income Security Act of 1974 (ERISA) to require that plans provide lifetime income illustrations to participants at least annually as part of participant benefit statements. SECURE Act, § 203. In addition, as required by the SECURE Act, the Rule sets forth a detailed roadmap

for calculating the required lifetime income illustrations, identifies specific assumptions for calculating lifetime income amounts, includes model disclosure language, and provides certain liability protections to plans that provide lifetime income illustrations in accordance with the Rule.

What is a Lifetime Income Illustration?

As contemplated by the Rule, a lifetime income illustration is an illustration of the stream of monthly income payments that a participant could receive if he or she were to retire and begin drawing income in the form of a fixed-income life annuity—meaning that the monthly amounts would not change during the lifetime of the recipient—from his or her plan account. Under the Rule, a lifetime income illustration must be provided to participants at least **annually** as part of their benefit statements. As described in more detail below, the Rule provides that the lifetime income illustration must be based on:

- The current value of a participant's account at the time the illustration is prepared (without any projection for future earnings or contributions) –and–
- The assumption that:
 - Payments start to be paid immediately (even though a participant may not be close to retirement age)
 - The participant has reached at least age 67 –and–
 - Be expressed as both a lifetime stream of payments to the participant and a lifetime stream of payments for the joint lives of the participant and a spouse

DOL Assumptions for Preparing Lifetime Income Illustrations

The preparation of any hypothetical lifetime income illustration is impacted by a variety of factors and inputs, including:

- The size of the participant's account balance
- The date that the participant retires and begins receiving payments
- The age and life expectancy of the participant at retirement
- Whether the participant is married (and if so, the spouse's age and life expectancy)

- The investment return or interest rate that a participant or spouse might receive on assets held in the retirement account –and–
- The availability of commercial annuities to provide a stream of income and the cost of such annuities; etc.

OBSERVATION. The seemingly simple question that many participants might ask – What sort of retirement income will my plan account provide to me (and, if applicable, my spouse) in retirement? – is a hard one to answer and depends on a number of factors and inputs. Without specific rules and guidelines to fix and establish these factors and inputs, plans tasked with calculating lifetime income illustrations could use a variety of different approaches that result in dramatically different outcomes. The difficulty in establishing specific rules for setting these factors and inputs may have stalled the DOL's earlier efforts in attempting to issue lifetime income guidance. However, the SECURE Act forced the issue by requiring the DOL to work through these considerations and issue guidance and model disclosures for lifetime income illustrations within one year of the date of enactment of the SECURE Act.

The Rule addresses these many variables as follows.

Assumptions for a Participant's Plan Account

The lifetime income illustration must be calculated on the basis of the participant's current account balance as of the last day of the applicable "statement period." For these purposes, the statement period is the calendar quarter benefit statement period that is being used for the lifetime income illustration. Notably, this account balance is fixed and there is no projection for future contributions to the participant's account (either by the participant or the employer) and no projection for the account's future investment experience. The plan must assume that a participant is 100% vested in his or her plan account and that the account value includes the balance of any outstanding plan loan (meaning that the loan is assumed to be paid off and included in the calculation of the lifetime income stream of payments).

OBSERVATIONS. Confronted with the difficulty of establishing assumptions or defaults for rates of future contributions and investment earnings (or, perhaps, requiring plans to show multiple lifetime income illustrations assuming different levels of future contributions or earnings), the DOL opted for a simpler approach of assuming no future contributions or investment earnings. While plans likely will appreciate this administratively friendly approach, some participants may perceive the resulting lifetime income illustrations as providing limited

insight regarding their likely retirement income. In the preamble to the DOL, the DOL appeared to recognize this dynamic and noted that many plans and recordkeepers currently make lifetime income calculators available that are more "interactive, stochastic, and tailored to the individual plan and plan participant," and the DOL "encourages the continuation of these practices." 85 Fed. Reg. 59,141.

Commencement Date for Payments and Participant Age

The lifetime income illustration must assume that payments start as the last day of the applicable benefit statement period. Similarly, the lifetime income illustration must assume that a participant is age 67 at the time that payments commence (except that if the participant is older than 67, the participant's actual age must be used). In the Preamble to the Rule, the DOL indicated that age 67 was selected "because this age aligns with full or normal retirement age under Social Security for most workers." The DOL also requested comments on whether multiple illustrations should be required, in order to give a snapshot of potential retirement incomes streams across various retirement ages (e.g., age 60, 62, 65, 67, and 72).

OBSERVATION. As with the plan account assumptions above that do not project future contributions or investment earnings, these assumptions—deeming payments to start immediately and participant to be of retirement age—may result in lifetime income illustrations that provide limited value to some participants, particularly those participants who are not close to the deemed retirement age.

Marital Status and Survivor Benefit

The Rule requires plans to assume that a participant is married and to provide two lifetime illustrations, one based on a lifetime stream of payments to just the participant (i.e., a "single life annuity") and another based on a lifetime stream of payments to the participant and then to the participant's spouse following the participant's death (i.e., a "qualified joint and survivor annuity" or QJSA). The survivor percentage for the QJSA must be 100%, which means that the payment amounts made to the participant during his or her lifetime must continue without reduction to the participant's spouse following the participant's death. For purposes of the 100% QJSA illustration, the participant and (hypothetical) spouse are assumed to be the same age at retirement.

OBSERVATION. While other QJSA percentages are common (for example, defined benefit pension plans are required to offer a QJSA of no less than 50% to married

participants), the DOL noted that the 100% survivor benefit would be the most helpful to participants because it would show the largest reduction to the participant's monthly income amount if the maximum benefit for a surviving spouse were to be selected at retirement. However, considering that it is unlikely the participant and spouse are the same age, the illustrated value of the 100% QJSA may be of only limited use to a married participant.

Interest Rate and Mortality Table

For purposes of converting the participant's account balance into a single life annuity and 100% QJSA, the Rule requires plans to use:

- **The 10-year constant maturity (CMT) securities yield rate** as of the first business day of the last month of the applicable statement period. In the preamble to the Rule, the DOL noted that this is a well-known rate reflective of the actual pricing of commercial annuities (that implicitly includes the insurance load, which the cost applied by the insurance company to provide a lifetime income). However, in its request for comments on the Rule, the DOL expressed a willingness to consider other rates, including the "applicable federal rate" often used as a universal estimated interest rate or the 10-year Treasury Inflation Protected Securities (TIPS) rate, and inclusion of an explicit insurance load.
- **The mortality tables under Section 417(e)(3)(B) of the Internal Revenue Code** (the same interest rate that must be used to calculate lump sum distribution in a defined benefit plan). In the preamble to the Rule, the DOL noted that this mortality table is periodically updated, well known, publicly available, and gender-neutral. However, the DOL again expressed a willingness to consider other mortality table alternatives in its request for comments on the Rule.
 - **OBSERVATION.** With respect to the mortality table, the DOL indicated that the 2013 Notice prompted many comments regarding the use of gender-specific rather than gender-neutral factors for mortality. Many of the comments noted that commercial annuities factor in gender, and thus, the lifetime income illustration would be more precise if the mortality table factored in gender, particularly for married couples. The DOL chose to apply unisex mortality assumptions, however, because this approach is consistent with the requirement that lifetime annuities offered under ERISA plans must be priced on a gender neutral basis, and because administrators may not have information regarding participants' gender readily available.

Required and Model Disclosure Language

The Rule requires that lifetime income illustrations must include brief and understandable explanations of the assumptions that are used to develop the illustrations. The Rule then includes model disclosures that can be used to satisfy this obligation. As described in more detail in the following section below, plans that use the model disclosure language (or language that is substantially similar) qualify for certain relief from liability under ERISA.

Lifetime income illustrations must reflect the following points and assumptions:

- The assumed annuity payment commencement date and age
- An explanation of a single life annuity
- An explanation of a 100% QJSA, the availability of other survivor percentage annuities, and the impact of choosing a lower survivor percentage
- An explanation of the marital status and age of spouse assumptions
- An explanation of the interest rate assumptions (including how interest rates fluctuate based on market conditions and how they affect the monthly benefit amount)
- An explanation of the mortality assumptions
- An explanation that the monthly payment amounts are illustrations only and are not guaranteed
- An explanation that the actual monthly income stream will depend on numerous factors and may vary substantially from the illustrations
- An explanation that the illustrated monthly payment amounts are fixed amounts that would not increase for inflation
- An explanation of the assumption that a participant is assumed to be 100% vested in his or her plan account (regardless of whether that's actually the case) –and–
- An explanation that the account balance includes the outstanding balance of any participant loan and assumes the loan will be repaid

See [DOL, Pension Benefit Statement – Lifetime Income Illustrations, "Overview of the IFR."](#)

OBSERVATION. While using the model disclosures is not mandatory, plans are strongly incentivized to stick with the model disclosures both for administrative ease and to

qualify for the liability relief as described in more detail below. As such, there would seem to be few circumstances in which a plan would wish or need to use language in lieu of the model disclosures. However, we note that the Rule does not prohibit plans from including additional disclosure that is not otherwise inconsistent with the Rule. As such, plans may want to consider whether supplemental language or disclosures may be desirable (for example, a disclosure noting that the plan is required by law to provide the lifetime income illustrations, or a statement about how to access a lifetime income calculator made available by the plan or the plan's recordkeeper that might provide a more tailored illustration). Of course, care should be taken to ensure that any such disclosures do not conflict with the model disclosures or undermine the liability relief described below.

Special Disclosures for In-Plan Annuities

In accordance with the SECURE Act, the Rule contains special assumptions and model disclosure language for plans that offer distribution annuities, deferred income annuities, or both.

Distribution Annuities

In general, a distribution annuity is an annuity form of distribution (e.g., single life annuity, QJSA at 50%, 75%, or 100%, etc.) that a plan may make available to participants as an optional distribution form. Distribution annuities typically are provided pursuant to a contract with an insurance company. With this background, the Rule permits – but does not require – plans to provide illustrations based on annuities that participants may actually elect under the terms of the insurance contract. However, illustrations based on these annuities and contract terms must still follow many of the standard disclosure terms described above, including that the illustration must:

- Show two lifetime income streams (a single life annuity and a QJSA);
- Assume that the first payment is made on the last day of the statement period;
- Assume that the participant is age 67 on such date (unless the participant is older, in which case the participant's actual age is used); and
- Assume that the participant is married with a spouse of the same age.

Treatment of Deferred Income Annuities

In general, deferred income annuities (DIA) allow participants to purchase, or to make ongoing contributions toward the current purchase of, a future annuity provided by an insurance company at a select retirement age (or later in the case of certain DIAs, such as qualifying longevity annuity contracts). For any portion of a participant's account used to purchase a DIA, the Rule requires disclosure of the following (in lieu of the general illustration and disclosure requirements summarized above):

- The date payments are scheduled to commence and the participant's actual age on such date (reflecting the fact that a participant selects the commencement date of a DIA)
- The frequency and amount of deferred annuity payments under the DIA as of the commencement date, in current dollars
- A description of any survivor benefits, period certain commitment or similar feature
- A statement on whether the deferred annuity payments are fixed or will adjust with inflation or in some other way during retirement, and a general explanation of how any such adjustment is determined –and–
- For any portion of a participant's account not used to purchase a DIA, the general illustration and disclosure requirements summarized above continue to apply

OBSERVATION. The SECURE Act contains provisions intended to break down barriers to providing more lifetime income opportunities in defined contribution plans. Although distribution annuities and DIAs are not yet common in 401(k) plans (these features are more common in 403(b) plans), legislative and [regulatory changes](#)—including the lifetime income illustrations required by the Rule—are likely to increase demand for, and the availability of, guaranteed income products. As such, the special disclosures concerning these types of in-plan annuities presents an opportunity for participants to receive a more customized lifetime income illustration than is otherwise available using the general assumptions otherwise required by the Rule.

Relief from ERISA Liability

Plan fiduciaries have long been concerned that providing lifetime income illustrations may be fraught with fiduciary risks. Participants could mistakenly believe the illustrations to be promises or guarantees of a specific income stream or as a type of investment advice (e.g., that they choose investment options that contain or are offered through an annuity contract).

To address these concerns, the Rule generally provides relief from liability under Title I of ERISA, which includes relief from liability for breaches of fiduciary duties, solely by reason of providing the lifetime income illustrations required by the Rule. This relief is conditioned on providing the disclosures, including all of the DOL's model language or language that is "substantially similar in all material respects" to the model language. This "substantially similar" standard is intended to permit "minimal and substantively immaterial modifications" – e.g., referring to "your statement" instead of "this statement," adding the plan's name, etc. – to the disclosure without losing the liability protection. Deviations from the Rule's required assumptions (e.g., required commencement date, age, rate of interest, mortality), by contrast, almost certainly would void the liability relief.

Exception

The fiduciary liability relief will not apply, however, to the required disclosures with respect to portions of the account used to purchase a DIA. The rationale is that this information is not derived using DOL's prescribed assumptions or disclosed using the DOL's model language, each of which is required by the statute for relief.

Timing and Effective Date

The Rule would apply to participant benefit statements **furnished after September 18, 2021, the date that is 12 months** after the date of the Rule's publication in the Federal Register (i.e., September 18, 2020). It is not entirely clear whether the Rule will be interpreted to require that plans distribute a lifetime income illustration as of (1) the first calendar quarter following the Rule's effective date or (2) whether a plan may be able to choose when to provide the first "annual" lifetime income illustration during the year following the Rule's effective date.

For example, if the plan provides quarterly benefit statements as of the last day of each calendar quarter (e.g., March 31, June 30, September 30, and December 31), the Rule could be interpreted as requiring the September 30, 2021, benefit statement to be the earliest benefit statement period for which the plan would need to provide the lifetime income illustration. Through informal comments, however, the DOL has suggested that the Rule's effective date provisions were intended to be interpreted more generously—and only require that the disclosure be provided at any time during the one-year period following the Rule's effective date rather than the first benefit statement period following September 18, 2020. Hopefully, the DOL will clarify and confirm this interpretation in the final version of the Rule.

OBSERVATION. Under the Rule, the fiduciary liability relief would not cover lifetime income illustrations provided before the effective date of the Rule. That being said, for plans that already provide lifetime income illustrations, the Rule provides guidance that is immediately actionable, particularly regarding disclosure language that may be used to mitigate the practical and associated legal risks of participants mistakenly believing that the existing illustrations guarantee a certain level of benefits or recommend a certain type of annuity investment.

Public Notice and Comment

In addition to comments on the prescribed assumptions described above, the DOL invited comments on many aspects of the Rule, including:

- The impact on plans currently providing lifetime income illustrations
- The costs and other impacts on recordkeepers to develop systems and processes to provide lifetime income illustrations pursuant to the Rule
- Whether the DOL's model disclosure language is substantively appropriate and "written in a manner calculated to be understood by the average plan participant," as is generally required for participant disclosures
- Whether, and how, to incorporate various annuity features – such as terms certain and guaranteed lifetime withdrawal benefits (GLWBs), also referred to as guaranteed minimum withdrawal benefits (GMWBs) – into the Rule's framework for lifetime income illustrations –and–
- Whether the DOL, separately or in conjunction with the adoption of the final Rule, should issue guidance on clarifying the circumstances under which the provision of additional illustrations may constitute the rendering of "investment advice" or "investment education" under ERISA

Written comments were due by November 17, 2020, 60 days following the Rule's September 18, 2020, publication in the Federal Register. 85 Fed. Reg. 59,132.

Conclusion

The Rule is administratively friendly insofar as it provides a fairly straightforward and uniform set of assumptions for calculating lifetime income illustrations and model disclosure language. However, while simplifying the calculation process, the Rule's assumptions may result in lifetime income illustrations that are of limited value to some participants (particularly those who are not close to retirement). That said, as illustrated by the DOL's requests for comments, the Rule's assumptions and model disclosures are not set in stone, and further changes adding more functionality could be adopted in the final Rule. Despite the uncertainty regarding the final provisions of the Rule, given the lead time necessary to program systems and develop processes necessary to prepare and distribute the lifetime income illustrations, plan administrators and recordkeepers will need to start working to satisfy these requirements immediately.

Related Content

Lexis

- Taxation of Executive Compensation § 8.17, "Reporting and Disclosure: Plan Administrator," paragraph 8.17[2][c] (2020)
- ALI-ABA Course of Study Materials (SM079 ALI-ABA 473), Agency Guidance Regarding the Pension Protection Act of 2006
- [DOL Field Assistance Bulletin 2006-03 \(Dec. 20, 2006\)](#)
- [DOL Field Assistance Bulletin 2007-03 \(Oct. 12, 2007\)](#)

Practical Guidance

- [Lifetime Income Benefit Rules for Defined Contribution Plans under the SECURE Act](#)
- [SECURE Act Brings Numerous Retirement Plan Changes](#)
- [ERISA Fiduciary Duties](#)
- [Electronic Disclosure Rules \(ERISA Safe Harbors\)](#)
- [Investment Committee Issues for Defined Contribution Plans](#)
- [401\(k\) Plans: Understanding the Rules](#)
- [403\(b\) Plan Design and Compliance](#)
- [Disclosure Rules for SPDs, Participant-Directed Plans, Employer Securities, and Blackout Notices](#)

Matthew H. Hawes, Partner, Morgan, Lewis & Bockius LLP

Matthew H. Hawes helps clients navigate every aspect of employee benefits, executive compensation, and equity compensation; including the drafting and design of qualified pension and profit-sharing plans, health and welfare arrangements, deferred compensation plans, and employee agreements. He also performs employee benefits due diligence reviews in the mergers and acquisitions context, and he advises companies on regulatory compliance with the US Internal Revenue Code, ERISA, COBRA, and HIPAA.

Previously, Matt was a law clerk for Judge Susan P. Graber of the US Court of Appeals for the Ninth Circuit. He also worked as a tax associate in a New York-based law firm, where he advised clients on US federal tax issues, including the consequences of capital markets transactions, private equity investments, and mergers and acquisitions. In that capacity, he represented clients in tax controversy matters before the IRS and U.S. federal courts.

Before earning his law degree, Matt spent more than four years serving in the United States and abroad as an officer in the United States Navy, earning the rank of lieutenant. His duties included service onboard the USS Inchon (MCS-12) as the weapons officer, assistant first lieutenant, and combat information center officer; service with the 5th Battalion, 10th Marines, 2d Marine Division as a naval gunfire liaison officer assigned to Weapons Company, 1st Battalion, 6th Marines, 24th Marine Expeditionary Unit; and service as an artillery liaison officer.

R. Randall Tracht, Partner, Morgan, Lewis & Bockius LLP

R. Randall "Randy" Tracht advises clients on a broad range of employee benefits and executive compensation issues involving clients' tax-qualified pension and 401(k) plans, health and retiree medical plans, non-qualified deferred compensation plans, equity incentive plans and other executive compensation arrangements, employment agreements, and fringe benefit plans. Randy represents and counsels a wide range of corporate and tax-exempt clients across the United States, including clients in the higher education, healthcare, retail, and energy sectors. His work includes counseling clients on fiduciary issues under the Employee Retirement Income Security Act (ERISA), tax-qualification requirements and other issues under the Internal Revenue Code, the employee benefits aspects of corporate transactions, and other matters.

Randy represents clients before the US Internal Revenue Service (IRS), the US Department of Labor, and the Pension Benefit Guaranty Corporation (PBGC) in a range of proceedings, including remedial correction programs, agency-initiated audits, and transactions and restructuring matters. He counsels clients and plan committees on plan governance and fiduciary risk management issues on matters of plan administration and the investment of plan assets. Randy frequently works with clients on the employee benefits issues arising in the context of workforce changes, including reductions in force, early retirement programs, and other restructurings. He advises pension plan sponsors on "de-risking" initiatives including lump sum windows, annuity purchases, and plan terminations. Randy speaks and publishes frequently on employee benefits issues and has authored numerous LawFlashes, White Papers, and other publications, and has presented at regional and national employee benefits conferences on various issues.

This document from Practical Guidance®, a comprehensive resource providing insight from leading practitioners, is reproduced with the permission of LexisNexis®. Practical Guidance includes coverage of the topics critical to practicing attorneys. For more information or to sign up for a free trial, visit [lexisnexis.com/practical-guidance](https://www.lexisnexis.com/practical-guidance). Reproduction of this material, in any form, is specifically prohibited without written consent from LexisNexis.
