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Extended Predicted Lifespans May Increase Interest in Lifetime Distribution Options

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On Monday, the Society of Actuaries released new mortality tables which show that life expectancies for women and men have increased and that the average age 65 man will live to age 86.6 years and the average age 65 woman will live to 88.8 years. Since 2000 men's average life expectancies have increased 2 years and women's average life expectancy increased 2.4 years. This hits retirement plans on two fronts. These extended life expectancies were based on data obtained from corporate pensions and so the data was generated from a relevant source.

I*mpact on Defined Benefit Plans and Derisking*

Defined benefit plans will need to pay the retirement benefits for a longer period of time since the annuity benefits they provide are provided over either the participant's life or the participant and surviving spouse's joint lives, so the costs of these plans are likely to increase slightly and the cost to "derisk" defined benefit plans by transferring the liability for all or a portion of the benefits under the plan to an annuity provider are also likely to increase. The Wall Street Journal reported that this increase in life expectancy could eventually increase retirement liabilities by roughly 7% for most pension plans. Such an increase may also impact the plan's funding status and distribution restrictions as well as the premiums the plan will pay to the PBGC. The increase in pension liabilities will also hit corporate financial statements with increased expenses and liabilities.

Impact on Defined Contribution Plans

While defined contribution plans provide a mechanism for accumulating an account balance and most do not have an obligation to pay benefits in the form on lifetime annuities (excepting money purchase pension plans and target benefit plans or some 401(k) profit sharing plans established with qualified joint and survivor annuity distributions as the standard form of distribution (another discussion for another day)), this change in life expectancies will also impact defined contribution plans by potentially exerting pressure on plan sponsors to consider to amend the defined contribution plans to add a mechanism that permits employees to elect a distribution method that will last over the employee's lifetime.

<u>Qualified Longevity Annuity Contract Option</u>

One method recently provided to permit lifetime distributions is the qualified longevity annuity contracts permitted under the final regulations issued by the Internal Revenue Service (the "Service") on July 21, 2014 which permits a plan sponsor to offer a participant the right to elect to use a portion of their account balance in the plan to purchase a longevity annuity contract offered under the plan provided a number of requirements are satisfied. Since this is an option in which participants may be able to invest under a plan offering a qualified longevity annuity contract ("QLAC"), the plan sponsor and plan fiduciaries must consider obtaining a full disclosure of the fees and compensation received by the annuity provider to comply with the fiduciary's obligations to receive fee disclosures and to choose the investment option under ERISA and also must decide how it should disclose the fees related to the QLAC to the participants so that the fee disclosures required to be made to participants are satisfied. There are other considerations related to adding QLACs to a defined contribution plan that should also be considered such as the issues related to selection of an annuity provider or insurer for the contracts. The QLAC rules are **effective** for contracts purchased on or after July 2, 2014.

<u>Target Date Funds with Imbedded Deferred Annuities Option</u>

The Service recently provided another option for 401(k) plans to provide a mechanism to provide lifetime income to participants. The Service issued Notice 2014-66 which permits a plan to provide as an investment option, a series of target date funds that include deferred annuities in the assets of the target date fund and to offer these only to older participants. Normally a plan must satisfy the Service's requirement that all benefits, rights and features under the plan be offered in a manner that does not discriminate in favor of highly compensated employees. For many plans, the employees who are highly compensated employees tend to be the more mature or senior employees so if an investment is offered only to the more mature or senior employees, the plan could run the risk of offering an investment (or a right to invest) in a manner that discriminates in favor of highly compensated employees which would risk the qualification of the 401(k) plan. The Service permits the offer of the Target Date Funds with unallocated deferred annuity contracts as part of the feature as one right or feature collectively, instead of as a separate right or feature for each age banded separate target date fund and with this view of the funds collectively in combination with the satisfaction of a number of additional requirements, the target date funds with the deferred annuity investments will be permitted. The target date funds cannot provide either guaranteed lifetime withdrawal benefits or guaranteed minimum withdrawal benefits at this time. The U.S. Department of Labor also reviewed the series of target date funds with unallocated deferred annuity contracts as one of their investments as to whether the addition of the unallocated deferred annuity contract would cause the target date funds to no longer qualify as a Qualified Default Investment Alternative or "QDIA") and if the target date funds in question meet a number of requirements, including requirements related to the deferred annuity contract, the investment portfolio, and the investment managers for the target date funds, these funds can constitute a QDIA. Plan fiduciaries selecting as a QDIA a target date fund which includes a deferred annuity as a component in its investments, need to review all of the applicable fiduciary concerns when selecting such an investment as a QDIA and make the required disclosures of such investment's fees and investment characteristics and historical performance as required under ERISA's regulations.   The plan fiduciary is also required to appropriately monitor the selection of the investment manager appointed for the target date fund with the deferred annuity investment.

The Service's Notice and the U.S. Department of Labor's letter related to the Target Date Funds with internal deferred annuity contracts are applying/interpreting the law as it currently exists with respect to these particular facts and thus they do not contain an effective date because it is an interpretation of current law. Thus, the target date fund guidance is effective currently for plan sponsors who want to consider such an investment alternative.

Service Updates Retirement Plan Limits

The Service updated retirement plan contribution and benefit limits by issuing the **attached table reflecting the limits applicable** to 2015 as well as quite a few historical years (this is a good table to retain for internal compliance review use and in the event of an audit). The key numbers are that participant elective deferrals permitted per calendar year have increased from $17, 500 in 2014 to $18,000 in 2015 for 401(k) plans, 403(b) plans and most 457 plans and the federal government's Thrift Savings Plan. Catch up contributions for participants age 50 and older for the same types of plans increase from $5,500 to $6,000 for 2015.   The compensation that can be considered by a defined contribution plan when calculating benefits increased from $52,000 to $53,000 for 2015 (not counting catch up contributions). The maximum annual benefit provided by a defined benefit plan remains at $210,000 for 2105. The OASDI taxable wage base for 2015 is $118, 500 instead of $117,000 for 2014. **See the attached for a full listing of all limits by the Service's Code section references.**

Defined Benefit Pension Premiums Increased

The Pension Benefit Guaranty Corporation also announced its increased premiums for 2015 yesterday. The per participant flat rate premium increases to $57 per participant for 2015 from $49 per participant in 2014. The variable rate premium rate increased from $14 per $1,000 of unfunded vested benefits ("UVBs") to $24 per $1,000 of UVBs in 2015 with a per participant cap of $418.

Determination Letter and Plan Amendment Reminder

The Service also issued a reminder that Cycle D determination letters on individually designed retirement plans (plans whose plan sponsor's employer identification number ends in either a 4 or a 9) must submit their application for a determination letter on or before January 31, 2015. This process requires a notice to interested parties and it is not too early to start to think about getting the submission and documents ready for plans required to submit by January 31, 2015. Multi-employer plans are also required to apply or determination letters by January 31, 2015.

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