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REVISITING RETIREMENT PLAN DESIGNS AFTER THE GLOBAL PANDEMIC

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When the year 2020 began, there was much optimism in the business world. Employers set many goals and established initiatives geared toward investing in their human capital in order to best assist their employees to grow and contribute to the performance of the organization. The passage of The Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act"), signed into law on December 20, 2019, also included provisions to expand access to tax-advantaged retirement accounts and secure retirement streams of income. Many plan sponsors were eager to digest and implement the new requirements of the SECURE Act as well as communicate these changes to participants As a result of the outbreak of the global COVID-19 pandemic, the world has undeniably changed in a short time, and many businesses and workers are struggling. Many have endured severe financial harm and significant loss to their retirement savings.

As we move through the pandemic crisis, there is hope that we will eventually be able to resume our normal lives and create better organizations and systems. Financial stressors will remain with all of us for some time, and employers will seek ways to alleviate these stressors for their human capital. Undoubtedly, discussions will also renew regarding ways to protect retirement assets against volatility in order to better secure the prospect of a secure retirement with predictable lifetime income. With the SECURE Act, employers who sponsor defined contribution retirement plans, such as 401(k) plans, now have: (1) new participant disclosure obligations; (2) the ability to adopt certain portability design features related to lifetime income investment options; and (3) guidelines to encourage inclusion of lifetime income investment options in plan investment line-ups. Plan sponsors and fiduciaries should become familiar with the mandatory requirements as well as the optional aspects of these rules and determine how to leverage them to ease employee retirement concerns.

Lifetime Income Disclosures

When the applicable regulations become effective, plan sponsors will need to include in at least one participant benefit statement issued during any 12-month period a lifetime income disclosure. This will be required for participant statements furnished more than one year after the last applicable guidance (including interim final regulations, model disclosures or assumptions) issued by the Department of Labor. This disclosure will be required regardless of whether the employer's plan includes a lifetime income or annuity distribution option. The purpose of the disclosure will be to set forth the lifetime income stream equivalent of the participant's total account balance under the plan (i.e., to provide an estimate of what the participant could receive from the plan if their benefits were paid in the form of a qualified joint and survivor annuity (assuming a spouse of equal age to that of the participant) or single life annuity). Requirements for model disclosures will include (a) provisions that the lifetime income stream is only an illustration, (b) an explanation that actual payments pursuant to a lifetime income stream purchased with the account balance will depend on numerous factors, and (c) an explanation of the assumptions used in the illustration.

When the guidance is issued, plan sponsors and fiduciaries will need to determine if these disclosures necessitate additional communications to plan participants, especially if an annuity is not actually an option for a plan distribution. It remains to be seen whether this disclosure obligation will be useful to participants, and whether it will become a factor which leads to the proliferation of available lifetime income distribution options. At a minimum, they should assist participants in understanding what they will need to do to achieve a certain type of monthly income in their non-working years and perhaps the behaviors they will need to adopt to reach their retirement goals. It seems that it would be prudent to also emphasize in these disclosures the potential adverse impact of severe market volatility on any illustrations.

Portability of Lifetime Income Options

Effective for plan years beginning after 2019, the SECURE Act addresses the issues regarding the removal and replacement of a lifetime income investment as a plan option by providing for certain distribution allowances where a lifetime income investment ceases to be an option under a qualified defined contribution plan, a 403(b) plan or governmental 457(b) plan. In such cases (except as otherwise provided in the SECURE Act guidance), the plan may allow certain qualified distributions to another employer retirement plan or individual retirement account, or may allow distributions of a lifetime income investment in the form of a qualified plan distribution annuity contract, if made within a 90-day period ending the date that the investment is no longer authorized to be held as an investment option under the plan. This flexibility should not only allow participants invested in such de-selected options to avoid certain fees, but should also assist plan fiduciaries responsible for deciding whether to remove or replace lifetime income options. Thus, plan sponsors may want to consider amending their plans to provide for this feature. It may also be a desired feature for employers that undergo many acquisitions and are tasked with merging plans that have different investment line-ups when it comes to lifetime income options.

Fiduciary Safe Harbor for Selection of Lifetime Income Provider

In order to provide plan participants with direct access to lifetime income distribution options, plan fiduciaries should consider adding such options to plan investment lineups. Though existing regulations provide a safe harbor with respect to selection of an annuity provider and a contract for benefits distributions from a defined contribution plan, there remains uncertainty among plan fiduciaries regarding their potential liability in connection with selecting a lifetime income provider such as an insurance company. The SECURE Act specifies optional measures that a plan fiduciary may take in selecting an insurer in order to fulfill its prudence requirements vis à vis assessing the insurer's ability to satisfy its obligations under the contract.

While the new guidance is not definitive in that it neither establishes minimum requirements nor provides the exclusive means for satisfying requirements, it identifies prudent measures that include: engaging in an objective, thorough search for potential insurers, evaluating the financial capacity of the insurers and the costs of the contract, and concluding that at the time of the selection the insurer is financially capable of meeting its obligations and that the costs are reasonable. This diligence will require determining that the insurer: is licensed; at the time of selection (and for each of the preceding seven years) operated under a certificate of authority from its State Insurance Commissioner that was not revoked or suspended; has filed audited financial statements and undergoes requisite exams, maintains applicable reserves, and is not operating under an order of supervision, rehabilitation or liquidation. Plan fiduciaries are not required to select the contract with the lowest cost. The protections do not extend to the terms of the underlying insurance contract, which still requires a separate fiduciary analysis. The new guidance presents an opportunity to weigh the pros and cons of these options with plan investment advisors.

Robust employee benefits and compensation programs have always been utilized by organizations to attract, motivate and retain talent and are a clear sign that the organization invests in its human capital. As we emerge from the pandemic crisis, retirement plan designs will undoubtedly be revisited in order to address the manner in which participants will restore, receive and manage their plan distributions to secure their retirements. New investment products will also emerge and they will warrant consideration. Employers that can alleviate their employees' retirement fears will assist them in focusing on the job at hand.

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