HAMILTON SMITH ASSOCIATES

Welcome News – US Treasury Provides Clarity for Longevity Annuities within Retirement Plans

The most common defined contribution retirement plan offered today in the US to employees is the 401k plan. This popular plan type allows portability for a mobile workforce and employee choice of plan funds in which to invest. Employee responsibility, however, also means the employee must manage funds to ensure they last through retirement. A promising solution for this challenge is the use of annuities within the defined contribution plan. Purchasing a deferred income annuity (DIA) while still working allows the 'time value of money' to produce bigger guaranteed benefits far in the future.

Employees may use up to 25% of the account balance or $125,000 whichever is less to fund the deferred income annuity.

In recent years, embedding participant DIAs within qualified defined contribution plans has been explored in a minority of plans. One of the reasons for lack of adoption has been lack of practical government guidelines to manage DIAs co-existence within an employee's account. In early July, Treasury finally provided guidelines to pave the way for this exciting change.

New Treasury rules qualifying longevity annuities or QLACs include:

Employees may use up to 25% of the account balance or $125,000 whichever is less to fund the deferred income annuity. These limits will be adjusted by Treasury for cost of living over time.

- Any monies directed into purchase of deferred income annuities will be exempt from required minimum distribution calculations (which begins at age 70 and 1⁄2)
- DIAs may have a return of premium benefit
- Remedy procedures will be outlined for repair of accounts where an employee exceeds the 25%/125,000 max rule

Given this recent clarity, there is ample work to do in enhancing recordkeeping systems that manage defined contribution plans in order to accommodate DIAs. Discussion points should include:

- How will the employer plan rules be marked that DIAs are allowed? Just because Treasury states maximums to be allowed does not mean the plan will necessarily allow these maximum limits.
- Since employer contributions are subject to vesting, how will incoming contributions for DIA purchase be limited to employee money only? Or will purchases be allowed for any vested funds as well?
- Will DIA purchases be a continuous recurring concept occurring with routine payroll deposits or will purchases be offered as a specific request by a participant?
- How will plan and government maximums be managed? If the 25%/$125,000 max rule is exceeded, what form of alert will be produced to the plan administrator? How will the remedy be processed? If an over-contribution is released, into which fund or funds will be excess be directed?
- How will the DIA value be represented on the periodic employee statements?
- When an employee quits, how will the DIA be ported?

As with any new process, the 'devil is in the details' and it is time to start thinking about the details now.

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