

**MEMO# 31743**

May 2, 2019

## **ERISA Advisory Council Releases 2018 Reports to the Department of Labor**

[31743]

May 2, 2019 TO: ICI Members

Pension Committee

Pension Operations Advisory Committee SUBJECTS: Pension RE: ERISA Advisory Council Releases 2018 Reports to the Department of Labor

The 2018 Advisory Council on Employee Welfare and Pension Benefit Plans, commonly known as the ERISA Advisory Council,[\[1\]](#) issued two reports to the Department of Labor (DOL), which are now publicly available. The first report, entitled “Lifetime Income Solutions as a Qualified Default Investment Alternative (QDIA) – Focus on Decumulation and Rollovers,” examines lifetime income in defined contribution (DC) plans.[\[2\]](#) The second report, entitled “Evaluating the Department’s Regulations and Guidance on ERISA Bonding Requirements and Exploring Reform Considerations,” examines the effectiveness of DOL regulations and sub-regulatory guidance under section 412 of ERISA, which generally requires that an employee benefit plan purchase a fidelity bond to protect against losses caused by acts of fraud or dishonesty.[\[3\]](#)

### **Lifetime Income Report**

According to the lifetime income report, “[t]he 2018 Council’s objective was to focus recommendations on promoting lifetime income (LTI) within [DC] plans through changes to the annuity selection safe harbor and modifying the [QDIA] rule to focus on asset accumulation and decumulation issues in the context of LTI needs and solutions.” ICI presented testimony to the Council in August 2018 intended to (1) call into question the Council’s apparent underlying premise that Americans are under-annuitized and that promoting annuities in DC plans is a necessary policy initiative and (2) explain how implementing two regulatory changes proposed by proponents of increased annuitization—amending the QDIA regulation to allow restrictions on transferability and requiring lifetime income estimates based on annuity calculations—would not serve the interests of plan participants and beneficiaries.[\[4\]](#)

The report makes several observations and recommendations, based on the testimony received during two days of hearings and supplemental written submissions from interested parties. The observations and recommendations generally are consistent with ICI’s testimony.

The report includes the following observations:

- No single product or plan design is likely to address decumulation needs for all DC plan participants. This issue arises from differences in general financial circumstances, account sizes, assets held outside of plans, health profiles, age, gender and marital status. To meet these variable needs, plans may need different solutions.
- Plan sponsors may be deterred from incorporating LTI features within QDIA options because QDIA regulations remain ambiguous in several areas, including liquidity requirements and the ability to limit participation to particular demographic groups, e.g., participants of a specific age or length of service.
- Plan sponsors remain challenged in incorporating LTI options due to fiduciary concerns around selecting and monitoring an annuity issuer. Plan sponsors generally seek an objective and uniformly applied safe harbor. No witnesses before the 2018 Council suggested standards for such a safe harbor. Several witnesses broadly supported potential and pending legislative proposals that would materially modify the fiduciary framework; however, this legislation is beyond the 2018 Council's scope and remit.
- Inconsistencies and disparities across LTI products and administrative platforms hinder LTI utilization.
- As discussed in prior Councils' reports, participants would benefit from clear and unbiased education and information related to DC plan asset decumulation strategies. Plan sponsors may be more inclined to provide this information if they were certain that providing such information would not constitute investment advice.
- The complexity of the LTI topic masks the fact that plan design offerings, such as a social security bridge option or installment payout, could be accommodated today on most recordkeeping platforms at limited cost.

The Council made the following recommendations to DOL:

1. Amend the QDIA regulations to address using LTI in a QDIA. More specifically, the Council recommends changes that:
  - a. Address the permissibility of including fixed annuities, living benefits and other LTI approaches in a QDIA;
  - b. Address the importance of tailoring QDIA options to affected participants, similar to rules applicable to QDIA balanced funds. In this regard, the Council recommends that DOL clarify that sponsors may default participants into different options based on participant demographics because plan populations may not be sufficiently similar for a single default to be universally appropriate;
  - c. Maintain the QDIA rule's current transferability and liquidity requirements (as recommended by ICI's testimony),[\[5\]](#) but clarify whether living benefits satisfy these requirements;
  - d. Address the extent to which surrender charges may be imposed (after the initial 90-day investment period) if they have the effect of limiting liquidity and/or transferability.
2. Publish guidance confirming that a named plan fiduciary may appoint an ERISA section 3(38) investment manager to select and monitor annuity and other LTI providers for DC plan decumulation, as well as accumulation.
3. Encourage plan sponsors to adopt plan design features that facilitate LTI, including, but not limited to: allowing participants to take ad hoc distributions, enabling installment payments, providing social security bridge options and allowing for payment of required minimum distributions.

In regard to the permissibility of including fixed annuities, living benefits and other LTI approaches in a QDIA (item 1.a. above), the report observes that the QDIA regulations only tangentially address the incorporation of annuity contracts in a QDIA, by indicating that an investment otherwise meeting the requirements for the QDIA safe harbor will not fail to be a QDIA simply because it is offered through a variable annuity (or similar) contract or because it offers ancillary features common to annuities, such as guarantees or death benefits. The Council agreed with certain witnesses that additional clarification around annuities within QDIAs would be helpful, including confirmation that an investment can qualify for the QDIA safe harbor even if a percentage is allocated to an annuity, guaranteed income benefit, or similar feature, and confirmation that different QDIAs could be used for different participant groups, e.g., based on the age of the participant.

With respect to calls from some witnesses for DOL to relax the QDIA rule's liquidity and transferability requirements (item 1.c. above), the Council disagreed and explained that "[u]nderlying the QDIA regulations is the notion that participants with a meaningful opportunity to opt out of a default investment have effectively made an affirmative election for the QDIA. In practice, many participants are likely invested in QDIAs with little awareness and without consent. In such a circumstance, the ability to opt out after the default investment is critical and a short window, such as the 90-day window contemplated in the QDIA regulations for certain fees, does not adequately address this issue." The report concluded that: "notwithstanding some commentator requests to relax existing transferability and liquidity requirements to permit illiquid fixed annuities in a QDIA, the 2018 Council does not recommend such action. Rather, the Department should retain the existing transferability and liquidity requirements. These transferability and liquidity restrictions should not foreclose using fixed annuities in QDIAs; rather, they provide important participant protections . . . [and] liquid, transferable fixed annuity contracts in a QDIA are available in the marketplace."

## **Bonding Report**

In preparing the bonding report, the Council examined whether changes to the regulations and sub-regulatory guidance implementing section 412 of ERISA could improve compliance and thereby enhance the safeguarding of plan funds or other property from acts of fraud or dishonesty. In light of data showing significant non-compliance with the fidelity bond requirements, particularly among small plans, the report recommends that DOL publish new guidance directed to plan officials, plan sponsors, and plan service providers:

1. A new Interpretive Bulletin, incorporating much of the content of Field Assistance Bulletin 2008-04.
2. A summary of the requirements for securing a fidelity bond. The report includes a sample summary (drafted by the Council) in an appendix.

The report notes that because the instances of noncompliance are concentrated in the small plan market, the Council assumes there is "a general underdeveloped awareness and misunderstanding of the fidelity bond rules by sponsors of small plans and the commercial service providers who serve the small plan market." To address this lack of awareness, the Council believes DOL should "relaunch" its updated rules (as published in FAB 2008-04) in the form of an Interpretive Bulletin, which would be published in the Code of Federal Regulations, but not require a full notice and comment rulemaking. In regard to the recommended fidelity bond summary, the report explains that "[s]uch a summary would serve to demystify fidelity bonds for purchasers, by explaining the basic requirements, and by helping them to distinguish among the various insurance products that are typically sold

in conjunction with fidelity bonds.”

## **2019 ERISA Advisory Council Topics**

We understand that the 2019 Council will examine two topics: (1) the transfer of uncashed retirement plan benefits to state unclaimed property funds and (2) helping plan sponsors make better use of plan audits. The Council has not yet posted issue statements for these topics.

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### **endnotes**

[1] For more detail about the ERISA Advisory Council, see <https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council>.

[2] The lifetime income report is available here: <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2018-lifetime-income-solutions-as-a-qdia.pdf>.

[3] The bonding report is available here: <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2018-evaluating-the-departments-regulations-and-guidance-on-erisa-bonding-requirements-and-exploring-reform-considerations.pdf>.

[4] For a description of ICI’s testimony, see ICI Memorandum No. 31338, dated August 16, 2018, available here: [https://www.ici.org/my\\_ici/memorandum/memo31338](https://www.ici.org/my_ici/memorandum/memo31338).

[5] The proposal to modify the QDIA rule’s transferability requirement (i.e., that defaulted participants must have the opportunity to direct investments out of a QDIA as frequently as a participant or beneficiary who affirmatively elects to invest in the QDIA, but not less frequently than once in any three-month period) is intended to accommodate annuity products that do not allow transfers out, or do not allow transfers out as frequently as required by the current rule.