Legislative and regulatory bulletin

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Understanding the SECURE Act Annuity Safe Harbor

Fear of potential liability drives many of the decisions defined contribution (DC) plan fiduciaries make. And fear has been a key reason DC plan sponsors have resisted including guaranteed retirement income options in their 401(k) or other plans. One of the things they have been concerned about is the possibility – however remote – that the insurer they select to issue annuities to provide guaranteed income to their retired participants will become insolvent and unable to make the promised payments.

A 2008 Department of Labor (DOL) rule set out what was intended to be a safe harbor for selecting annuity providers for DC plan payments, but most plan sponsors didn't feel the rule gave them enough protection. Among other things, it required them to conclude that "the annuity provider is financially able to make all future payments under the annuity contract."[1] To many plan sponsors, making such a determination seemed extremely difficult, if not impossible. They reasoned that while the insurer might be financially strong today, they couldn't predict whether the company would be able to make "all future payments" possibly decades from now, when many retirees would be expecting to receive monthly annuity checks.

The SECURE Act creates a "safer" safe harbor

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, enacted in December 2019, included provisions that could help encourage the inclusion of retirement income payout options in DC plans.[2] The most significant was a safe harbor that would protect plan fiduciaries who select insurers to provide guaranteed retirement income contracts. Specifically, the safe harbor would shield fiduciaries from liability in the event that the insurers they selected were unable to meet their obligations under the contracts, provided certain requirements were met.[3] Most observers believe that this statutory safe harbor will be much more useful than the one outlined in the DOL rule because it sets forth a clear process that fiduciaries can follow.

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[1] ERISA Regulation Section 2550.404a-4.
[2] See our 4Q 2021 Legislative and Regulatory Bulletin for a description of these and other policy initiatives related to retirement income in DC plans.
[3] Setting Every Community Up for Retirement Enhancement Act (H.R. 1865) Section 204, and ERISA Section 404(e).

It's important to note that the safe harbor applies to the selection of the insurance *company*, not the insurance *contract* issued by the company. Therefore, fiduciaries still must conduct the appropriate due diligence process on the annuity contract itself, considering, among other things, the contract's terms, conditions and fees.

The requirements of the safe harbor

Newly added Section 404(e) of the Employee Retirement Income Security Act (ERISA) provides that a fiduciary who satisfies the following requirements will not be liable for any losses to participants or beneficiaries due to the insurer's inability to satisfy its obligations under the contract.

- The fiduciary engages in an objective, thorough and analytical search to identify insurers from which to purchase guaranteed income contracts.
- The fiduciary considers the cost of the contracts in relation to their benefits and features and the services to be provided, and concludes that the costs are reasonable. Importantly, the provision notes that there is no requirement for a fiduciary to select the lowest cost contract.
- The fiduciary considers the financial capability of each insurer and concludes that the insurer is capable of satisfying its obligations under the contracts. But see below as to how a fiduciary will be *deemed* to satisfy this requirement.

Obtaining written representations from the insurer

The fiduciary will be deemed to have satisfied the requirement regarding the financial capability of the insurer if:

- Each year, the fiduciary obtains written representations from the insurer that:
    - The insurer is licensed to offer guaranteed retirement income contracts.
    - The insurer currently and for the immediately preceding seven years (1) has operated under a certificate of authority from its state's insurance commissioner, (2) has filed audited financial statements and maintained the reserves as required by the state, and (3) is not operating under an order of supervision, rehabilitation or liquidation.
    - The insurer undergoes an examination by its state's insurance commissioner at least every five years.
    - The insurer will notify the fiduciary of any change in circumstances that would preclude it from making the above representations.
- In addition, the fiduciary must not have received any information that would cause the fiduciary to question the insurer's representations.

A clearer path to fiduciary protection

By following a straightforward, defined process that includes obtaining representations from the insurer, ERISA fiduciaries who select insurers to provide annuity payout options for their DC plans should be protected in the event that the insurer can't make payments as required by the annuity contracts due to its insolvency or other condition. Policymakers hope that this clearer path to protection will prompt more fiduciaries to consider adding retirement income options to their DC plans. It is important that fiduciaries work with their counsel and other advisors to be sure that they are meeting all of the requirements of the safe harbor.

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