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LAND HO! NAVIGATING THE MURKY WATERS OF GUARANTEED LIFETIME INCOME AND THE ANNUITY SAFE HARBOR FOR 401(K) PLANS

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Due to a collective federal goal of providing Americans with guaranteed sources of lifetime income, namely annuities, as a retirement income strategy, numerous regulations and proposed rules have been issued that allow the use of annuities in defined contribution retirement plans. Despite this goal, annuities are rarely offered to participants in a 401(k) plan. This can be explained, in part, by confusion in properly applying these rules to 401(k) plans. Because of the widespread belief that the "Annuity Safe Harbor" lacks well-defined and measurable standards, many retirement plan fiduciaries simply refuse to expose themselves to the greater risk of liability associated with annuities.

This article provides a compass to guide advisers and 401(k) plan fiduciaries safely into the Annuity Safe Harbor, specifically when selecting and monitoring annuity providers and products. First, the background of using annuities for retirement income is explored. Next, the article identifies obstacles to the selection and monitoring of annuity providers and products and provides an overview of recently issued federal regulations and proposed rules expanding the use of annuities in 401(k) plans. In light of impediments to guaranteed lifetime income for 401(k) participants, federal legislative and regulatory actions are proposed. Lastly, guidance is offered from industry experts and recent cases involving the breach of fiduciary duties.

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INTRODUCTION

Will I outlive my savings? Many Americans are asking this question as they approach retirement.[1] An estimated 77 million "baby boomers" will reach retirement age in less than 15 years.[2] To further complicate matters, the average life span of Americans is increasing[3] and the cost of living is rising, spurring fears of outliving one's retirement savings.[4] While approximately half of all employers provide a retirement plan for their employees, few of these plans offer products that guarantee a steady, lifetime source of income.[5] Why is this? A principal reason—employers and other fiduciaries of these plans are concerned with the additional risk of liability that accompanies guaranteed lifetime income products.[6] Gone are the days of pension plans ruling the world of retirement income, allowing retirees to receive steady, guaranteed income for life; instead, pensions have been replaced by 401(k) plans and individual retirement accounts (IRAs).[7]

Guaranteed lifetime income products in employer-sponsored retirement plans are available in the retirement marketplace.[8] Moreover, the Employee Retirement Security Act of 1974 (ERISA)[9] provides a safe harbor for 401(k) fiduciaries when carrying out their duties of care and prudence in the selection or monitoring of guaranteed lifetime income providers and products.[10] Nonetheless, this safe harbor is accompanied by a number of unanswered questions in its application.[11]

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[1] *See* METLIFE, 10TH ANNUAL STUDY OF EMPLOYEE BENEFITS TRENDS: SEEING OPPORTUNITY IN SHIFTING TIDES 48, 75 (2012), http://benefitcommunications.com/-upload/downloads/MetLife_10-Annual-EBTS.pdf (Fifty percent of employee participants were concerned about outliving their retirement savings).

[2] ROBERT J. TOTH, JR. & EVAN GILLER, 2013-13 N.Y.U. REV. EMP. BENEFITS, at 13-2 (2015).

[3] Based on 2012 social security tables, the life expectancy of Americans who were 65 in 2013 was 18.9 years for men and 20.9 years for females. LIFETIME INCOME RISK JOINT TASK FORCE, RISKY BUSINESS: LIVING LONGER WITHOUT INCOME FOR LIFE, AM. ACAD. OF ACTUARIES 5 (Jun. 2013), https://www.actuary.org/files/Risky-Business_Discussion-Paper_June_2013.pdf [hereinafter JOINT TASK FORCE].

[4] METLIFE, *supra* note 1, at 48. In 2009, the U.S. Government Accountability Office published a study identifying that "longevity, inflation, and investment risks" are the primary risks to participants of defined contribution plans." TOTH & GILLER, *supra* note 2, at 13-2; *see* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-642, PRIVATE PENSIONS: ALTERNATIVE APPROACHES COULD ADDRESS RETIREMENT RISKS FACED BY WORKERS BUT POSE TRADE-OFFS, at 18–19 (2009).

[5] BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, NEWS RELEASE, EMPLOYEE BENEFITS IN THE UNITED STATES—MARCH 2015 (July 24, 2015), http://www.bls.gov/news.release/pdf/ebs2.pdf; *see* discussion *infra* Section II(A).

[6] *See* discussion *infra* Section II(A).

[7] *See* discussion *infra* Section I(A).

[8] TOTH & GILLER, *supra* note 2, at 13-3.

[9] 29 U.S.C. §§ 1104-1114 (2012).

[10] The annuity safe harbor is codified at 29 C.F.R. § 2550.404a–4 (2016) and applies to the prudent man standard of care in 29 U.S.C. § 1104(a)(1)(B). The full discussion of the Annuity Safe Harbor is located *infra* Section II(C).

[11] *See* discussion *infra* Section II(A).

This article serves as a guide for navigating the murky waters of guaranteed lifetime income products in 401(k) plans. Section I surveys the background of employer-sponsored retirement plans and guaranteed lifetime income products by spotlighting the societal landscape and underlying policies that have sparked the evolution of retirement plans and their governance. Section II examines concerns related to the inclusion of guaranteed lifetime income products in 401(k) plans and the confusion resulting from a collective federal push to modify existing employer-sponsored plans. Moreover, this section highlights the need for a well-defined and measurable standard to evaluate an annuity provider. Taking into consideration the obstacles blocking the provision of guaranteed lifetime income to 401(k) participants, Section III proposes federal legislative and regulatory action to mitigate these obstacles. Finally, Section IV offers guidance to better navigate the complexities of the selection and monitoring of annuity providers and products. Pragmatic advice and best practices from industry experts, as well as recent case law, provide a sense of direction as to the actions employers and other 401(k) fiduciaries must take in order to demonstrate that they have satisfied their required duties under ERISA.

I. BACKGROUND OF EMPLOYER-SPONSORED RETIREMENT PLANS AND GUARANTEED LIFETIME INCOME

A. *Why is Guaranteed Lifetime Income Important?*

As a result of the shift from traditional pension plans to defined contribution plans such as 401(k) plans, Americans face greater responsibility for managing their retirement assets.[12] In a traditional pension plan, also known as a defined benefit plan, the employee typically receives fixed monthly payments for his or her lifetime.[13] In a pension plan, the employer or an insurance company is responsible for the investment of assets and assumes the risk of any resulting investment losses due to changes in stock and equity markets,[14] whereas in a defined contribution plan, such as a 401(k), the success of the employee's retirement savings is dependent on the employee's own direction of his or her investments.[15] Upon retirement, employees often take their retirement

[12] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LABOR, FACT SHEET—WHITE HOUSE CONFERENCE ON AGING (Jul. 13, 2015), *available at* http://www.dol.gov/ebsa/-newsroom/fswhconferenceonaging.html [hereinafter CONFERENCE ON AGING]. In 1975, nearly 70 percent of all private retirement plan participants were covered by defined benefit plans, also known as traditional pension plans. TOTH & GILLER, *supra* note 2, at 13-2. By 2010, only 27 percent of all private retirement plan participants were covered by traditional pension plans, whereas 73 percent were covered by defined contribution plans, such as 401(k)s. *Id.*

[13] CONFERENCE ON AGING, *supra* note 12.

[14] *Id.*

[15] *Id.*; *see* Bradley P. Rothman, *401(k) Plans in the Wake of the Enron Debacle*, 54 FLA. L. REV. 921, 923 (2002) (footnotes omitted) ("Absent an effective retirement plan, however, many employees lack the means to retire. This is because employees often depend on using private employer-sponsored retirement plans to meet their retirement

savings in a lump sum rather than securing some form of guaranteed lifetime income through an annuity or longevity insurance rider.[16] Although a retiree receives guaranteed lifetime income through social security benefits, these benefits are not enough to fully replace pre-retirement income.[17]

With the rising cost of living and longer predicted life spans, an employee runs the risk of outliving his or her retirement savings.[18] This presents a societal problem: when older Americans have insufficient retirement savings, they may have to skimp on housing, food, healthcare or other necessities, depend on their adult children or other family members for financial support, or apply for means-tested benefits, putting a strain on the already deficient annual federal budget.[19]

B. *Guaranteed Lifetime Income Options and Their Inherent Risks*

Guaranteed lifetime income products provide guaranteed, regular income payouts to an individual for his or her lifetime.[20] The most well-known form of guaranteed lifetime income during retirement is social security. At its inception, social security was intended to protect retirees from poverty but was not meant to replace a retiree's entire pre-retirement income.[21] Two unique features of social security are that it provides lifetime income protection and survivors' benefits.[22] Thus, social security has been especially important for elderly women,[23] lower-wage workers, and those who did not have the opportunity or ability to save on their own.[24] Social security benefits, however, fall short of fully replacing a retiree's income prior to retirement.[25] According to one study, the median share of income from social security in the retiree's first or second year of retirement was only 23.1 percent of the retiree's pre-retirement income.[26]

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income needs. In this situation, an employee's comfortable retirement hinges on the financial success of the employee's retirement plan.").

[16] CONFERENCE ON AGING, *supra* note 12.

[17] More than half of social security recipients aged 65 or over receive benefits that provide more than half of their household income. *Seniors & Social Security*, THE WHITE HOUSE, https://www.whitehouse.gov/issues/seniors-and-social-security (last visited Oct. 24, 2015).

[18] JOINT TASK FORCE, *supra* note 3, at 4–5.

[19] CONFERENCE ON AGING, *supra* note 12; JOINT TASK FORCE, *supra* note 3, at 3; Patrick J. Purcell, *Income Replacement Ratios in the Health and Retirement Study*, 72 SOC. SECURITY BULL. 37, 37 (2012), https://www.ssa.gov/policy/docs/ssb/v72n3/-v72n3p37.html.

[20] CONFERENCE ON AGING, *supra* note 12.

[21] JOINT TASK FORCE, *supra* note 3, at 3.

[22] *Seniors & Social Security*, *supra* note 17.

[23] *Id.*

[24] JOINT TASK FORCE, *supra* note 3, at 3.

[25] *See* Purcell, *supra* note 19, at 37–38.

[26] The data used to determine the median share of income from social security was collected as part of the Health and Retirement Study, with a sample cohort of 2,194 members, who were born between 1931 and 1941 and interviewed in 2008. *Id.* at 38, 48.

Another way an individual may receive guaranteed lifetime income in retirement is through an annuity.[27] Historically, annuities have been offered to American workers in the form of pension plans.[28] Essentially, an annuity is a contract with an insurance company that gives the purchaser the right to receive guaranteed, periodic income payouts, [29] which are either paid over the lifetime of the purchaser or the lifetimes of the purchaser and his or her spouse.[30] Typically, in exchange for a single lump-sum payment,[31] also known as a premium, the insurance company that offers an annuity is required to make future payments to the purchaser under the terms specified in the annuity contract.[32] The lump sum or premium is determined by the life expectancy of the purchaser calculated through actuarial predictions.[33]

For example, if a 65-year-old male purchased an annuity in 2011 with Insurance Company *X*, he may pay an initial premium of $100,000 from his retirement savings and receive guaranteed monthly payouts of $598 for the remainder of his life.[34] Other options include spousal guarantees, in which case the monthly payouts would be $501 if the same 65-year-old man chooses guaranteed monthly payments for the remainder of his life and the life of his spouse.[35] Alternatively, if the 65-year-old-man chooses the spousal guaranteed annuity, with an additional guarantee that upon his death and the death of his spouse, their beneficiaries would receive any remaining cash under the annuity contract, his monthly payouts would drop to $484.[36] Payout rates, as of December 2012, for traditional annuities purchased in 2012, averaged between 6 to 7 percent of the premium payment (but this payout rate reflects historically low interest rates).[37]

Once an individual pays a premium to an insurer in exchange for an annuity contract, the individual no longer has control over the money paid as a premium.[38] Instead, the insurer has control over these assets.[39]

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[27] CONFERENCE ON AGING, *supra* note 12.
[28] JOINT TASK FORCE, *supra* note 3, at 3.
[29] 4 AM. JUR. 2D *Annuities* § 1 (2015).
[30] ADVISORY COUNCIL ON EMP. WELFARE & PENSION BENEFIT PLANS, EXAMINING INCOME REPLACEMENT DURING RETIREMENT YEARS IN A DEFINED CONTRIBUTION PLAN SYSTEM 21 (Dec. 2012), http://www.dol.gov/ebsa/publications/2012ACreport3.html [hereinafter ADVISORY COUNCIL].
[31] 4 AM. JUR. 2D *Annuities* § 2 (2015).
[32] *Id.* § 1 (2015).
[33] *Id.* § 2 (2015).
[34] John Waggoner, *Would an Immediate Annuity Work for You?* USA TODAY, Nov. 25, 2011, http://usatoday30.usatoday.com/money/perfi/columnist/waggon/story/2011-11-23/-annuities-retirement/51386018/1.
[35] *Id.*
[36] *Id.*
[37] ADVISORY COUNCIL, *supra* note 30, at 21.
[38] 4 AM. JUR. 2D *Annuities* § 1 (2015).
[39] *Id.*

Annuitants retain only an interest in their contractually promised payouts from the insurer each month.[40]

Many varieties of annuities are currently offered in the marketplace, but annuities can be classified into two basic types: deferred and immediate annuities. Income payouts from deferred annuities, also known as longevity insurance, occur at a later date, allowing for accumulation and growth of the underlying assets prior to payout, while the income payouts from immediate annuities start immediately after the purchase of the annuity.[41]

Payouts to the purchaser of deferred or immediate annuities can be fixed, variable, or a combination of the two.[42] In a fixed annuity, the payout is a fixed amount, whereas the payout in a variable annuity is tied to the performance of the underlying investment portfolio.[43] An indexed annuity combines a fixed and variable payout model, including a guaranteed minimum return with the potential for higher returns if the stock market rises, since the returns are connected to the performance of the underlying investment portfolio under a benchmark index, such as the S&P 500.[44]

Hybrid products, such as Guaranteed Lifetime Withdrawal Benefits (GLWB) and Guaranteed Minimum Income Benefits (GMIB), are also available in the marketplace, and are typically offered in the form of a rider to a variable annuity.[45] GLWBs provide a guaranteed withdrawal amount, usually around 5 percent for an individual who is 65 years old, from a deferred annuity account.[46] Even if the deferred annuity account is fully liquidated, the annuitant will receive the same guaranteed withdrawal amount for life.[47] A GMIB is also a rider to a variable annuity, but provides a guaranteed payout to the annuitant, the amount of which is based on each $1,000 of the accumulated value in the underlying annuity account.[48] The accumulated value in the annuity account is guaranteed by the insurer to increase, regardless of the actual investment performance.[49]

While annuities may help Americans to not outlive their retirement savings, annuities have certain inherent risks to the purchaser.[50] First,

[40] *Id.*
[41] STEVEN PLITT, DANIEL MALDONADO, JOSHUA D. ROGERS & JORDAN R. PLITT, COUCH ON INSURANCE § 1:22 (3d ed. 2015); JOINT TASK FORCE, *supra* note 3, at 10–11.
[42] *Fast Answers: Annuities*, http://www.sec.gov/answers/annuity.htm (last modified Apr. 6, 2011) (last visited Jan. 24, 2016).
[43] *Id.*
[44] *Id.*
[45] ADVISORY COUNCIL, *supra* note 30, at 21.
[46] *Id.*
[47] *Id.*
[48] *Id.*
[49] *Id.*
[50] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-642, ANNUITIES WITH GUARANTEED LIFETIME WITHDRAWALS HAVE BOTH BENEFITS AND RISKS, BUT REGULATION VARIES ACROSS STATES, at 2 (2012); Rami Hanegbi, *Security in Uncertain*

certain annuities have high purchase prices, requiring a large initial investment to cover the annuity provider's administrative, investment and selling costs.[51] Moreover, inflation can erode the promised annuity benefits.[52] For example, at the time of purchase, the annuity's fixed rate of return may seem as if it will provide sufficient income to the annuitant, but even a moderate increase in inflation may result in the decreased purchasing power of the payouts made to the annuitant.[53] Additionally, purchasing an annuity leads to the loss of liquidity in the underlying capital used to purchase the annuity, as well as precludes the individual from later investing this capital in equities, which could generate higher returns to the individual than the promised payouts of the annuity.[54] Lastly, there is a risk that an annuity provider could become insolvent before an annuitant receives his or her benefits.[55]

C. *Employer-Sponsored Retirement Plans: The Shift from Defined Benefit Plans to Defined Contribution Plans*

Generally, there are two types of retirement plans offered by an employer to its employees—either a defined benefit plan or a defined contribution plan.[56] Over the past 30 years, employers have shifted from defined benefit plans, otherwise known as pension plans, to defined contribution plans, such as 401(k) plans.[57] Because most employers have moved to defined contribution plans, employees today have greater responsibility for managing their retirement assets, both during their working years and retirement years.[58]

A defined benefit or pension plan consists of a general pool of assets, rather than an individual account for each employee, from which the employee is entitled to fixed periodic payouts for life.[59] The benefits are specified in advance, often as a percentage of the employee's salary, tied to his or her years of service for the employer.[60] The employer, employee, or a combination of the two, may fund the asset pool.[61] However, the *employer* shoulders the risk of investment losses in the pool

Times: Policies for Increasing the Popularity of Life Annuities Among Retirees, 20 VA. J. SOC. POL'Y & L. 473, 482–84 (2013).

[51] Hanegbi, *supra* note 50, at 484–85.

[52] *Disadvantages to Consider in Choosing Commercial Annuities in an Estate Planning Situation*, in § 26,106 RIA ESTATE PLANNING COLLECTION, 20XX WL 730997 at *1 (2016).

[53] *Id.*

[54] Hanegbi, *supra* note 50, at 482–83.

[55] U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 50, at 14.

[56] JOINT TASK FORCE, *supra* note 3, at 9–10.

[57] JOINT TASK FORCE, *supra* note 3, at 3.

[58] CONFERENCE ON AGING, *supra* note 12.

[59] 70 C.J.S. *Pensions* § 25 (2015).

[60] *Id.*

[61] *Id.*

of assets and must cover any underfunding of assets resulting from investment losses.[62]

Moreover, in the event that an employer becomes insolvent, certain defined benefit plans are guaranteed in part by the Pension Benefit Guaranty Corporation (PBGC) in order to protect the participants of these plans.[63] The PBGC insures that the promised defined benefits, or income payouts, to the participants will be made up to a maximum insurable limit.[64] Another advantage of defined benefit plans is that employees do not run the risk of exhausting their retirement savings during their lifetime,[65] unless they opt to forgo the fixed periodic payments for a lump-sum payment, which they could roll over to an IRA.[66]

On the other hand, in a defined contribution plan, with 401(k)s being the most common, an employee has an individual account to which the employee, employer, or both contributes.[67] In such a plan, each employee is entitled to the vested account balance held in his or her individual account.[68] A key feature in certain defined contribution plans, and often in 401(k) plans, is that these plans allow the participant to direct his or her own investments by choosing from a variety of investment options within the plan.[69] The success of the defined contribution plan correlates with how well the participant's assets are invested; thus, the *participant* shoulders the risk of failing to accumulate sufficient retirement savings.[70] Under a defined contribution plan, employees often receive their accumulated savings in a lump sum upon retirement, although there are other options available.[71]

An employer-sponsored plan may also have both a defined contribution and a defined benefit portion, but the benefits attributable to each portion must maintain their distinct character.[72] Some employers provide access to annuities through a plan with separate defined contribution and defined benefit portions during the time that an employee's funds are accumulating by using target date funds with an optional longevity insurance rider.[73] These types of retirement plans are

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[62] *Id.*
[63] Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, 611 (2000).
[64] *Id.*
[65] CONFERENCE ON AGING, *supra* note 12.
[66] JOINT TASK FORCE, *supra* note 3, at 9–10.
[67] 70 C.J.S. *Pensions* § 24 (2015); JOINT TASK FORCE, *supra* note 3, at 10.
[68] 70 C.J.S. *Pensions* § 24 (2015).
[69] INTERNAL REVENUE SERV., *Retirement Topics: Participant-Directed Accounts*, https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-participant-directed-accounts (page last reviewed or updated Oct. 7, 2015) (last visited July 13, 2016); INTERNAL REVENUE SERV., *Definitions*, https://www.irs.gov/retirement-plans/plan-participant-employee/definitions (page last reviewed or updated May 20, 2016) (last visited July 16, 2016).
[70] Jefferson, *supra* note 63, at 611.
[71] CONFERENCE ON AGING, *supra* note 12.
[72] 70 C.J.S. *Pensions* § 24 (2015).
[73] JOINT TASK FORCE, *supra* note 3, at 9–10.

generally referred to as hybrid plans because of their dual features.[74] Nevertheless, technically speaking, a plan is either a defined contribution plan or a defined benefit plan.[75]

D. *Governance of Guaranteed Lifetime Income Products in Employer-Sponsored Retirement Plans*

ERISA was enacted to address concerns that private pension plan funds were being abused and mismanaged.[76] ERISA governs all employer-sponsored retirement plans, including defined benefit plans, defined contribution plans, and welfare benefit plans.[77] In general, ERISA protects employees against risks to their retirement savings, such as poor investments, employer insolvency, and retirement plan fiduciary breach.[78] Employers, also called plan sponsors, must design and administer their retirement plans in accordance with the provisions of ERISA.[79] Additionally, standards issued under ERISA must be met by employer-sponsored retirement plans in order for these plans to qualify for favorable tax treatment by the Internal Revenue Service (IRS).[80]

The governance of employer-sponsored retirement plans under ERISA is generally administered among the U.S. Department of Labor (DOL), the IRS under the U.S. Department of the Treasury (Treasury Department), and the PBGC.[81] The Employee Benefits Security Administration (EBSA), on behalf of the DOL, administers the reporting, disclosure and fiduciary requirements of ERISA.[82] The IRS is primarily responsible for any participation, vesting, and funding issues.[83] The PBGC, on the other hand, was established to insure an employee's retirement savings from the insolvency of his or her employer.[84] The PBGC protections apply only to defined benefit plans, whereas 401(k) plans, a form of defined contribution plan, are not protected by the PBGC.[85] However, the DOL may intervene in any matters *materially*

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[74] STAFF OF J. COMM. ON TAX'N, 114TH CONG., 2D SESS., PRESENT LAW AND BACKGROUND RELATING TO TAX-FAVORED RETIREMENT SAVING AND CERTAIN RELATED LEGISLATIVE PROPOSALS: SCHEDULED FOR A PUBLIC HEARING BEFORE THE SENATE COMMITTEE ON FINANCE ON JANUARY 28, 2016, at 11 (2016) [hereinafter JOINT COMMITTEE ON TAXATION].
[75] *Id.* "Under section 414(k) and ERISA section 3(35), a defined benefit plan that provides a benefit based partly on the balance of a separate account for a participant is treated as a defined contribution plan for certain purposes." *Id.*, n. 16.
[76] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LABOR, *History of EBSA and ERISA*, http://www.dol.gov/ebsa/aboutebsa/history.html (last visited Oct. 24, 2015) [hereinafter *History of EBSA and ERISA*].
[77] *Id.*
[78] Rothman, *supra* note 15, at 928–29.
[79] *History of EBSA and ERISA*, *supra* note 76.
[80] *Id.*
[81] *Id.*
[82] *Id.*
[83] *Id.*
[84] Rothman, *supra* note 15, at 928.
[85] *Id.* at 931.

affecting the rights of participants, regardless of which department is primarily responsible.[86]

The Securities and Exchange Commission (SEC), established by Congress to enforce securities laws to protect investors and promote stability in the markets, regulates securities.[87] Variable annuities are a type of security and as such, are regulated by the SEC.[88] However, fixed annuities are not securities and are not regulated by the SEC.[89] An indexed annuity may or may not be considered a security, but if the indexed annuity utilizes some form of securities in its design, it will be regulated by the SEC.[90]

While ERISA governs all employer-sponsored retirement plans for employees, because annuities are an insurance product (and the insurance industry is regulated by the states), annuities themselves fall under the ambit of state governance.[91] Nevertheless, there are two exceptions to this general rule: (1) if the annuity utilizes a form of securities in its design, it will trigger SEC regulation of the securities portion, and (2) if the annuity is part of certain defined benefit plans, the PBGC offers federal protection by insuring these pensions, up to the legal limit set by Congress, in the event the plan ends without sufficient money to pay all the benefits promised to participants.[92] Conversely, if participants of a 401(k) plan have purchased an annuity through their plan, or if individuals purchase an annuity outside of an employer-provided retirement plan, such individuals have limited protection, in the event of the annuity provider's insolvency, through their state's guaranty fund.[93] Importantly, the protections provided under state guaranty funds vary depending on the individual's state of residence.[94] Some states may not insure annuities, whereas other states do.[95] Even if annuities are insurable by the state's guaranty funds, the maximum protected amount varies by state.[96] For example, in 2013, an annuitant in New Jersey was protected by state guaranty funds up to

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[86] *Id.*
[87] SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, http://www.sec.gov/about/whatwedo.shtml (last modified Jun. 10, 2013) (last visited Oct. 24, 2015).
[88] *Fast Answers: Annuities*, *supra* note 42.
[89] *Id.*
[90] *Id.*
[91] *History of EBSA and ERISA*, *supra* note 76; FED. INS. OFFICE, U.S. DEP'T OF THE TREASURY, HOW TO MODERNIZE AND IMPROVE THE SYSTEM OF INSURANCE REGULATION IN THE UNITED STATES 1 (Dec. 2013), https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/How%20to%20Modernize%20and%20Improve%20the%20-System%20of%20Insurance%20Regulation%20in%20the%20United%20States.pdf.
[92] *History of EBSA and ERISA*, *supra* note 76; *General Facts About PBGC*, PENSION BENEFIT GUAR. CORP., http://www.pbgc.gov/about/faq/pg/general-faqs-about-pbgc.html (last visited Feb. 6, 2016).
[93] James Epstein, Note, *Protecting Pension Annuities When Insurance Companies Fail: The ERISA Fiduciary Standards*, 44 FLA. L. REV. 107, 109–10 (Jan. 1992).
[94] *Id.* at 110.
[95] *Id.*
[96] *Id.*

$500,000, whereas an annuitant in Indiana holding the identical annuity, was only protected by state guaranty funds up to $100,000.[97]

II. CONCERNS RELATED TO GUARANTEED LIFETIME INCOME PRODUCTS AND THE FEDERAL PUSH FOR CHANGE

A. *Why the Hesitation?*

Employers have been reluctant to offer guaranteed lifetime income products, or annuities, in their defined contribution plans. A survey by Deloitte in 2015 reveals that only 5 percent of defined contribution plans offer annuity options, down from 6 percent in 2013-14.[98] At the time of the survey, only 11 percent of plan sponsors were looking into adding a lifetime income product to their current plan, while 74 percent were not considering it at that time.[99] While there may be multiple explanations for this reluctance, such as the inherent risk in annuity products themselves and the potential for annuity provider insolvency,[100] plan sponsors have indicated that one of the top three reasons they are unwilling to add these products to their plans is concerns regarding the attendant fiduciary responsibilities of such products.[101] Selecting an annuity provider is a fiduciary process that triggers significant responsibility and related risks, and few fiduciaries are willing to expose themselves to increased liability.[102] Because of this, plan sponsors feel they cannot afford the risk of making an in-plan annuity product available to their employees.[103]

Not only are employers as plan sponsors reluctant to offer annuities in their defined contribution plans, but other 401(k) fiduciaries, such as investment advisers and managers, are often hesitant to recommend annuities as an option to plan sponsors.[104] For example, Erik Gronvold, Chartered Financial Analyst (CFA) and Senior Investment Consultant for The Newport Group, has been a fiduciary for numerous defined contribution plans for the last 20 years. His role as a fiduciary

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[97] FED. INS. OFFICE, *supra* note 91, at 45.

[98] DELOITTE DEV., ANNUAL DEFINED CONTRIBUTION BENCHMARKING SURVEY: EASE OF USE DRIVES ENGAGEMENT IN SAVING FOR RETIREMENT 31 Exhibit 5.1 (2015), http://www2.deloitte.com/content/dam/Deloitte/us/Documents/human-capital/us-hc-annual-defined-benchmarking-survey-2015.pdf. [hereinafter BENCHMARKING SURVEY].

[99] *Id.* Exhibit 5.13, at 37.

[100] *See* discussion *supra* Sections I(B) and I(D).

[101] BENCHMARKING SURVEY, supra note 98, exhibit 5.16, at 37. The top three reasons expressed by those not considering adding this product to their offerings are lack of interest among participants (29 percent), administrative complexity (20 percent), and concerns about fiduciary responsibility (14 percent). *Id.* at 37.

[102] MATTHEW J. EICKMAN, LIFETIME INCOME FOR DEFINED CONTRIBUTION PLAN PARTICIPANTS: IRS AND DOL GUIDANCE LIKELY TO STIMULATE AND ACCELERATE PRODUCT DEVELOPMENT (Jan. 30, 2015), 2015 WL 1207656; *see also* Shlomo Benartzi, Alessandro Previtero, and Richard H. Thaler, *Annuitization Puzzles*, 25 J. ECON. PERSP. 143, 160–61 (2011) (discussing that employers are hesitant to include lifetime income options within their 401(k) plans due to the vagueness of the Annuity Safe Harbor and the uncertainty of meeting their legal fiduciary responsibilities to plan participants).

[103] Benartzi, *supra* note 102, at 160–61.

[104] TOTH & GILLER, *supra* note 2, at 13-17.

includes providing investment advice to plan sponsors and investment committees, prudently selecting investment products that may be offered to participants of the plan, and regularly monitoring the in-plan investment products, ensuring the continued prudence of these investment products as investment choices within the plan. When asked his opinion as to whether he recommends the inclusion of annuities in a 401(k) plan, he stated:

> Annuity-based income strategies, if imprudently structured, can lead to unfavorable outcomes for both participants and fiduciaries. From a plan sponsor/fiduciary perspective, there is a lack of clarity on how the DOL will interpret ERISA as it relates to a fiduciary's obligations for selecting and monitoring annuity providers it offers to plan participants. On the one hand, there is no obligation under ERISA to provide participants with insurance-based products, which expand the potential scope and duration of the prudent oversight of plan investments (i.e., fiduciary liability exposure) since annuities are intended to be held well beyond the typical retirement age. On the other hand, providing safe-harbor protection to these products would make the risk/reward ratio attractive . . . it would be the same concept the DOL applies to target-date funds . . . under the Pension Protection Act of 2006—which is to limit the liability of fiduciaries for participant losses in those funds. So, offering annuities to 401(k) participants can add fiduciary risk/expense but is not required under ERISA. If participant demand remains low, there will be little to no incentive for plan sponsors to offer such features, especially if they cannot rely on third party expertise or safe harbor protection.[105]

Because fiduciaries must comply with a prescribed standard of conduct under ERISA, two significant concerns have arisen among fiduciaries when contemplating the addition of an annuity product to a 401(k) plan.[106] First, there is a perceived lack of a usable standard for fiduciaries to rely on when selecting or monitoring an annuity provider.[107] Secondly, the design and terms of the annuity product itself are subject to an appropriate fiduciary review, and there is confusion among fiduciaries as to what constitutes a prudent annuity product.[108]

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[105] E-mail from Erik Gronvold, CFA and Senior Investment Consultant, The Newport Group, to author (Jan. 1, 2016, 18:40 EST) (on file with author).
[106] *See* 29 U.S.C. § 1109 (2012); TOTH & GILLER, *supra* note 2, at 13-17.
[107] TOTH & GILLER, *supra* note 2, at 13-17.
[108] *Id.*; 29 C.F.R. § 2550.404a-4(b) (2016).

B. *The Fiduciary Standard of Conduct in Defined Contribution Plans*

ERISA sets the standard of conduct for fiduciaries of an employer-sponsored retirement plan.[109] Under ERISA, one is considered a fiduciary to the extent that such person (1) exercises discretionary authority or control over the management or disposition of plan assets; (2) renders, or has the authority to render, plan investment advice for a fee; or (3) exercises discretionary authority or responsibility in the administration of a plan.[110] Further, one is a fiduciary if the individual or entity is a named fiduciary within the plan instrument.[111]

The key element in determining whether an individual or entity is a fiduciary (if not a named fiduciary in the plan instrument) is whether the individual or entity exercises discretion or control over the management or administration of the plan.[112] A plan's fiduciaries typically include the trustee, investment advisers, and any individual or committee exercising discretion in the administration or management of the plan, such as recordkeepers, plan administrators, and third-party service providers.[113] Additionally, an individual or entity is a fiduciary if involved in the selection of a fiduciary to the plan.[114]

Fiduciary duties attach to the actions of employers or plan sponsors when and to the extent that they function as plan administrators.[115] When an employer is contemplating the establishment of a retirement plan, the plan's benefits, or the amendment or termination of an existing plan, an employer is *not* a fiduciary because it is acting on behalf of its business and not on behalf of the plan.[116] However, when an employer takes steps to implement any of its business decisions related to the establishment, benefits, termination, or amendment of a retirement plan, the person acting on behalf of the plan in carrying out these decisions may be a fiduciary.[117] Often, an employer will hire a third-party service provider, such as a bank, insurance company, or registered investment adviser, or use an internal committee or human resources department to act as a fiduciary in administrating and managing its retirement plan.[118] For example, if an employer designates a third-party service provider to administrate its plan, *the employer acts as a fiduciary in its selection of the third-party service provider*, but is not liable for the investment decisions made by the service

[109] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LABOR, *ERISA Fiduciary Advisor: Introduction*, http://www.dol.gov/elaws/ebsa/fiduciary/introduction.html (last visited Oct. 24, 2015) [hereinafter *ERISA Fiduciary Advisor*].
[110] 29 U.S.C. § 1002(21)(A) (2012).
[111] 29 U.S.C. § 1102(a)(2) (2012).
[112] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LABOR, MEETING YOUR FIDUCIARY RESPONSIBILITIES 2 (Feb. 2012), *available at* http://www.dol.gov/ebsa/publications/-fiduciaryresponsibility.html [hereinafter MEETING YOUR FIDUCIARY RESPONSIBILITIES].
[113] *Id.*
[114] *Id.*
[115] 67A C.J.S. *Pensions* § 38 (2015).
[116] MEETING YOUR FIDUCIARY RESPONSIBILITIES, *supra* note 112, at 2.
[117] *Id.*
[118] *ERISA Fiduciary Advisor*, *supra* note 109.

provider.[119] Nonetheless, an employer is required to periodically monitor the service provider to confirm it is prudently handling the plan's assets in accord with the service provider's appointment under the plan documents.[120]

Fiduciaries of an employer-sponsored retirement plan are subject to the prudent man standard of care under ERISA.[121] A fiduciary must act solely in the interest of plan participants and their beneficiaries (1) for the exclusive purpose of providing benefits to them and paying only reasonable expenses to administer the plan; (2) by carrying out the fiduciary's duties with the same care, skill, prudence, and diligence as a prudent man would in a similar capacity under the circumstances then prevailing; (3) by prudently diversifying the plan investments in order to minimize the risk of large losses; and (4) in accordance with the documents governing the plan, unless and to the extent the plan documents are inconsistent with ERISA.[122]

ERISA's requirements may be enforced through administrative actions by the DOL or a lawsuit may be brought against a fiduciary for breach of the fiduciary duties set out in ERISA.[123] The DOL, plan participants, and beneficiaries may bring a lawsuit against plan fiduciaries.[124] Certain violations of ERISA may also result in the imposition of a civil penalty.[125] Moreover, if a fiduciary is found to have breached his or her duties under ERISA, the fiduciary will be *personally liable* for restoring any loss in value of the plan assets or any profits earned through the fiduciary's improper use of the plan assets.[126] However, a fiduciary may be protected from liability under the safe harbor of ERISA Section 404(c),[127] which operates as a defense for fiduciaries of defined contribution plans, such as 401(k) and profit sharing plans.[128] Under this safe harbor, a fiduciary is not liable for the *specific investment decisions made by a participant or beneficiary* of a plan.[129] Nevertheless, a fiduciary has a duty to properly select and monitor the investment alternatives made available to plan participants.[130]

Those bringing an action for a breach of fiduciary duties are barred from raising such a claim after the statutory time period established in

[119] MEETING YOUR FIDUCIARY RESPONSIBILITIES, *supra* note 112, at 3.
[120] *Id.*
[121] 29 U.S.C. § 1104(a) (2012).
[122] *Id.*
[123] 29 U.S.C. § 1109 (2012); 29 U.S.C. § 1132 (2012); JOINT COMMITTEE ON TAXATION, *supra* note 74, at 18.
[124] 29 U.S.C. § 1132 (2012).
[125] *Id.*
[126] 29 U.S.C. § 1109 (2012); 29 U.S.C. § 1132 (2012).
[127] 29 U.S.C. § 1104(c) (2012).
[128] MEETING YOUR FIDUCIARY RESPONSIBILITIES, *supra* note 112, at 3.
[129] 29 U.S.C. § 1104(c) (2012); MEETING YOUR FIDUCIARY RESPONSIBILITIES, *supra* note 112, at 3.
[130] 29 U.S.C. § 1104(c) (2012); MEETING YOUR FIDUCIARY RESPONSIBILITIES, *supra* note 112, at 3.

ERISA.[131] If the plaintiff had actual knowledge of the breach, the claim must be brought within three years of the earliest date the plaintiff actually knew of the breach.[132] If the plaintiff had only constructive knowledge of the breach, the claim must be brought within six years of the last action by the fiduciary that constituted a breach, or in the event of an omission, "the latest date on which the fiduciary could have cured the breach . . . ."[133] In the case of fraud or concealment, the action must be brought within six years after the date the breach is discovered.[134]

C. *The Annuity Safe Harbor*

In response to significant losses arising from the bankruptcy of Executive Life Insurance Company of California (ELIC), an insurer that offered annuities for pension plans,[135] the DOL issued fiduciary guidance in Interpretive Bulletin 95-1 related to the purchase of annuities in connection with terminating a defined benefit or pension plan.[136] Under this Bulletin, the DOL established that fiduciaries who select an annuity provider for purposes of benefit distribution upon the termination of an existing pension plan must take steps "to obtain the *safest annuity available*, unless under the circumstances it would be in the interests of participants and beneficiaries to do otherwise."[137] Subsequently, in 2002, the DOL extended this safest available annuity standard to fiduciaries selecting annuities in connection with defined contribution plans, such as 401(k)s.[138]

Responding to concerns that this safest available annuity standard set too high of a standard for fiduciaries of defined contribution plans, Congress enacted Section 625 in the Pension Protection Act of 2006, requiring the DOL to "issue final regulations clarifying that the selection of an annuity contract as an optional form of distribution from an individual account plan to a participant or beneficiary . . . is *not subject* to the safest available annuity standard under Interpretive Bulletin 95-1."[139]

Thus, in 2008, in accordance with the congressional requirement, the DOL issued an annuity safe harbor specifically for fiduciaries of

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131 29 U.S.C. § 1113 (2012).
132 29 U.S.C. § 1113(2) (2012).
133 29 U.S.C. § 1113(1) (2012); CRAIG C. MARTIN, MICHAEL A. DOORNWEERD, AMANDA S. AMERT & DOUGLAS A. SONDGEROTH, ERISA LITIG. HANDBOOK, JENNER & BLOCK PRACTICE SERIES 290 (5th ed. 2012), *available at* https://jenner.com/system/assets/-assets/6849/original/ERISA_20Litigation_20Handbook_205th_20Ed_20FINAL.pdf (last visited Oct. 24, 2015).
134 29 U.S.C. § 1113(2) (2012).
135 ELIC went bankrupt due to its use of high-paying, high-risk junk bonds to fund its annuity obligations. When these junk bonds ultimately failed, many pension plans utilizing ELIC's annuities suffered losses. TOTH & GILLER, *supra* note 2, at 13-17.
136 TOTH & GILLER, *supra* note 2, at 13-17; *see* 29 C.F.R. § 2509.95–1 (2016).
137 29 C.F.R. § 2509.95–1(c) (2016) (emphasis added).
138 U.S. Dep't of Labor, Advisory Opinion Letter 2002-14A (Dec. 18, 2002).
139 TOTH & GILLER, *supra* note 2, at 13-18; *see* Pension Protection Act of 2006, PL 109–280, 120 Stat 780 (Aug. 17, 2006).

defined contribution plans (the Annuity Safe Harbor).[140] This Annuity Safe Harbor acts as a defense for fiduciaries selecting an annuity provider for benefit distributions from a defined contribution plan, such as a 401(k).[141] When a fiduciary selects an annuity provider or contract, the Annuity Safe Harbor provides that a fiduciary satisfies his or her fiduciary duties under Section 404(a)(1)(B) of ERISA,[142] so long as the fiduciary:

> (1) Engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities;
>
> (2) Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;
>
> (3) Appropriately considers the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under such contract;
>
> (4) Appropriately concludes that, at the *time of the selection*, the annuity provider is financially able to make all future payments under the annuity contract and the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract; and
>
> (5) If necessary, consults with an appropriate expert or experts . . . .[143]

This "time of selection" under subsection (4) of the Annuity Safe Harbor may be either:

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[140] 29 C.F.R. § 2550.404a–4 (2016); TOTH & GILLER, *supra* note 2, at 13-18.

[141] TOTH & GILLER, *supra* note 2, at 13-18.

[142] The fiduciary shall discharge his duties under ERISA § 404(a)(1)(B) "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims . . ." 29 U.S.C. § 1104(a)(1)(B) (2012). This is a modified version of the prudent person standard under the common law of trusts. Epstein, *supra* note 93, at 112–13. The version created by Congress in ERISA § 1104, has been characterized by some as a prudent expert standard, with its language of a "prudent man acting in a like capacity . . . would use in the conduct of an enterprise of a like character." Dana M. Muir & Cindy A. Schipani, *Fiduciary Constraints: Correlating Obligation with Liability*, 42 WAKE FOREST L. REV. 697, 708–09 (2007). Congress intended more flexibility with ERISA § 1104 than existed under the common law prudent man standard, specifying that it should be interpreted in light of the size and scope of the plan. Epstein, *supra* note 93, at 112.

[143] 29 C.F.R. § 2550.404a–4(b) (2016) (emphasis added).

> (1) The time that the annuity provider and contract are selected for distribution of benefits to a specific participant or beneficiary; or
>
> (2) The time that the annuity provider is selected to provide annuity contracts at future dates to participants or beneficiaries, provided that the selecting fiduciary periodically reviews the continuing appropriateness of the conclusion described in paragraph . . . (4) . . . taking into account the factors described in paragraphs . . . (2), (3) and (5) . . . .[144]

Furthermore, "a fiduciary is not required to review the appropriateness of" the fiduciary's conclusion, made at the time the annuity provider is selected to provide annuity contracts at future dates to participants or beneficiaries, "with respect to any annuity contract purchased for any *specific participant or beneficiary*."[145]

D. *The Changing Tide: Recent Developments in the Federal Push for Guaranteed Lifetime Income Products*

In 2010, the Obama Administration announced that it is "[p]romoting the availability of annuities and other forms of guaranteed lifetime income, which transform savings into guaranteed future income, reducing the risks that retirees will outlive their savings or that their living standards will be eroded by investment losses or inflation."[146] Particularly, the Administration noted that it is "critical that the 401(k) system be safe, transparent, and well-regulated," indicating that 401(k) regulations would be updated to meet these goals.[147] Thus, since 2010, federal agencies overseeing defined contribution plans and the sale of annuities have engaged in a joint effort to address the systemic weaknesses in the provision of sufficient retirement income through employer-sponsored retirement plans.[148]

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[144] 29 C.F.R. § 2550.404a–4(c) (2016).

[145] 29 C.F.R. § 2550.404a–4(c)(2) (2016) (emphasis added). This specific provision of the Annuity Safe Harbor may seem unclear or confusing. The DOL, in guidance issued in 2015, clarified the meaning of this provision. *See* discussion *infra* Section II(D)(iv).

[146] INSURED RET. INST., *President Obama Calls for All Americans to Have Access to Retirement Accounts* (Jan. 27, 2010), http://www.myirionline.org/docs/default-source/news-releases/president-obama-calls-for-all-americans-to-have-access-to-retirement-accounts.pdf?sfvrsn=0; WHITE HOUSE TASK FORCE ON THE MIDDLE CLASS, FACT SHEET: SUPPORTING MIDDLE CLASS FAMILIES, 1, 3, https://www.whitehouse.gov/-sites/default/files/Fact_Sheet-Middle_Class_Task_Force.pdf (last visited July 13, 2016) [hereinafter FACT SHEET: SUPPORTING MIDDLE CLASS].

[147] FACT SHEET: SUPPORTING MIDDLE CLASS, *supra* note 146, at 3.

[148] TOTH & GILLER, *supra* note 2, at 13-3.

i. QLACS

In 2014, the Treasury Department published final regulations instituting "Qualified Longevity Annuity Contracts" (QLACs).[149] Under this rule, as long as a longevity annuity contract meets certain requirements, it will be classified as a QLAC and automatically satisfy the required minimum distribution rules of the Internal Revenue Code.[150] The QLAC is a form of deferred annuity in which employees may buy annuity contracts before or after retirement with funds from their 401(k) plans, thereby securing future income payouts under the contracts.[151] The QLAC is designed for purchase by any defined contribution plan, whether the plan is "funded with trust-held equity investments or in group annuity contracts."[152] Essentially, the QLAC is treated as an in-kind investment of the plan and an asset of a participant's individual account, not as a benefit structure.[153] Further, the QLAC is a nontaxable distribution from a qualified defined contribution plan or IRA, and can be rolled over between plans and IRAs, in accordance with applicable rollover rules.[154] A QLAC must provide for the commencement of benefit payments to the participant no later than the first day of the month following the participant's eighty-fifth birthday.[155] Participants are permitted to use up to *the lesser of* 25 percent of their retirement account balance, or $125,000, to buy a QLAC.[156] Despite the enactment of QLACs, insurance companies have been slow to offer them, and those QLACs that are offered are only for IRAs.[157] But, in December 2015, the first approved QLAC for a 401(k) plan was introduced.[158]

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[149] Treas. Reg. § 1.401(a)(9)–6 (as amended Aug. 6, 2014); W. Waldan Lloyd, *Living with Qualified Longevity Annuity Contracts*, A.L.I. CONTINUING LEGAL EDUC. 1, 2 (Apr. 22-24, 2015), SW026 ALI-CLE 323.

[150] Lloyd, *supra* note 149, at 2. Under the Internal Revenue Code, an employee must take the required minimum distribution from his or her 401(k) plan, among other types of retirement plans, equal to the employee's full interest in the plan (e.g., the entire account balance) by April 1 of the year following the later of either the year the employee retires or reaches the age of 70½. I.R.C. § 401(a)(9)(C). For a detailed listing of the requirements necessary to establish a QLAC, see Treas. Reg. § 1.401(a)(9)–6 (as amended Aug. 6, 2014). For the DOL's fiduciary requirements for disclosure in participant-directed individual account plans, see 29 C.F.R. § 2550.404a–5 (2016). For a model comparison of investment options under a retirement plan, see *Model Comparative Chart*, 29 C.F.R. app. § 2550.404a–5 (2016).

[151] Lloyd, *supra* note 149, at 2.

[152] TOTH & GILLER, *supra* note 2, at 13-15, 13-16.

[153] *Id.* at 13-17.

[154] *Id.*

[155] Treas. Reg. § 1.401(a)(9)–6, Q&A (17)(a)(2); Lloyd, *supra* note 149, at 3.

[156] Treas. Reg. § 1.401(a)(9)–6, Q&A (17)(b)(2). The dollar and percentage limitations are subject to later adjustment by the Treasury Department. Treas. Reg. § 1.401(a)(9)–6, Q&A (17)(d)(1)(iii); Treas. Reg. § 1.401(a)(9)–6, Q&A (17)(d)(2)(i).

[157] Greg Iacurci, *Insurers Slow to Introduce QLACs for 401(k) Market*, INV. NEWS (Dec. 4, 2015), http://www.investmentnews.com/article/20151204/FREE/151209949/insurers-slow-to-introduce-qlacs-for-401-k-market. For a discussion of some of the administrative hurdles facing insurance providers and broker-dealers in offering QLACs, see Darla Mercado, *Broker-Dealers Face Administrative Hurdles in Rollout of QLAC Annuity*, INV.

ii. Bundling Deferred Annuities with Target Date Funds

On October 24, 2014, the IRS issued Notice 2014-66, allowing unallocated deferred annuities, including QLACs, to be bundled into target date fund assets (TDF), "even if only some of the TDFs within the series are available only to older participants."[159] Expressing the policy behind this Notice, J. Mark Iwry, Senior Advisor to the Secretary of the Treasury and Deputy Assistant Secretary for Retirement and Health Policy, stated that "Treasury is working to expand the availability of retirement income options for working families. By encouraging the use of income annuities, today's guidance can help retirees protect themselves from outliving their savings."[160] The Notice provides that "if certain conditions are satisfied,[161] a series of TDFs in a defined contribution plan is treated as a single right or feature for purposes of the nondiscrimination requirements of § 401(a)(4) of the Internal Revenue Code."[162] Therefore, these TDFs will be permitted "to satisfy those nondiscrimination requirements as they apply to rights or features even if one or more of the TDFs considered on its own would not satisfy those requirements."[163]

Many employers offer TDFs as a default investment option in their 401(k) plans, providing employees who do not otherwise affirmatively elect an investment option, to have their retirement account savings automatically invested in the plan's selected target date fund by default.[164] As such, on the same day that IRS Notice 2014-66 was issued, the DOL confirmed in an Information Letter to the Treasury Department that these types of unallocated deferred annuity contracts allowed under the Notice, including QLACS, could also be used by employers as a qualified default investment alternative under the ERISA Qualified Default Investment Alternative (QDIA) safe harbor,[165] provided that the conditions and

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NEWS (May 13, 2015), http://www.investmentnews.com/article/20150513/FREE/-150519962/broker-dealers-face-administrative-hurdles-in-rollout-of-qlac-annuity.

[158] Iacurci, *supra* note 157. The first approved QLAC for a 401(k) plan, called "Retirement Income Insurance," was provided by MetLife. *Id.*

[159] I.R.S. Notice 2014-66, 2014-46 I.R.B. 820; *see* U.S. DEP'T OF THE TREASURY PRESS RELEASE, *Treasury Issues Guidance to Encourage Annuities in 401(k) Plans*, (Oct. 24, 2014), http://www.treasury.gov/press-center/press-releases/Pages/jl2673.aspx [hereinafter *Treasury Issues Guidance*].

[160] *Treasury Issues Guidance*, *supra* note 159.

[161] For a complete listing of conditions and requirements under the Notice, see I.R.S. Notice 2014-66, 2014-46 I.R.B. 820 and Michael L. Hadley, *Summary of Guidance on Use of Annuities in Target Date Funds*, A.L.I. CONTINUING LEGAL EDUC. (Nov. 12-14, 2014), SW003 ALI-CLE 1013 (2014).

[162] I.R.S. Notice 2014-66, 2014-46 I.R.B. 820.

[163] *Id.*

[164] *Treasury Issues Guidance*, *supra* note 159.

[165] In 2007, the DOL provided a safe harbor under ERISA for a QDIA, codified at 29 C.F.R. § 2550.404c–5(e)(4)(i) (2016). Scott Fisher, Eric Friedman & Kevin Vandolder, *Selecting and Monitoring Target Date Funds: Issues to Consider*, Practical Law Practice Note 1-610-0031, at 2 (law stated as of Dec. 8, 2015) (last viewed Jan. 17, 2016). Under this QDIA safe harbor, a participant or beneficiary is deemed to exercise investment control over the assets in his or her account if, in the absence of an affirmative investment

requirements in the Notice are satisfied.[166] The DOL confirmed that, "the distribution of annuity certificates as each Fund dissolves on its target date is consistent" with the ERISA QDIA safe harbor.[167] Additionally, the fiduciary standards under ERISA § 404(a)(1)(B)[168] can be satisfied if the designated investment manager satisfies the conditions of the Annuity Safe Harbor and the plan sponsor prudently selects the investment manager and monitors the investment manager "at reasonable intervals, in such manner as may be reasonably expected to ensure that the investment manager's performance has been in compliance with the terms of the Plan and statutory standards, and satisfies the needs of the Plan."[169] The DOL further explained that, "[a]ssuming the plan sponsor appropriately discharges its duties as the appointing fiduciary, it will not be liable for any acts or omissions of the investment manager, except for potential co-fiduciary liability under ERISA Section 405(a)."[170]

iii. Banning the Use of Lump-Sum Payments to Replace Annuity Payouts

On July 9, 2015, the IRS issued Notice 2015-49, effectively banning a plan sponsor or other fiduciary of a defined benefit pension plan from using a lump-sum payment or accelerated form of distribution to replace the existing annuity payments to participants of a defined benefit pension plan.[171] The IRS explained its rationale, stating that allowing lump-sum payments to replace a participant's right to regular, lifetime annuity payments undermines the intent of the minimum required distribution rules under the Internal Revenue Code.[172]

iv. DOL's Guidance on the Annuity Safe Harbor for Defined Contribution Plans

On July 13, 2015, the DOL issued Field Assistance Bulletin 2015-02 (FAB 2015-02), providing guidance on the Annuity Safe Harbor for

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election, the plan invests the assets and meets the notice requirements under the QDIA safe harbor. *Id.* If the requirements of the safe harbor are met, the plan's fiduciaries are not liable for losses that are the direct and necessary result of either investing all or part of the participant's or beneficiary's account in a QDIA or investment decisions made by an investment manager or other entity regarding the management of a QDIA. *Id.*

[166] Letter from Phyllis C. Borzi, Assistant Secretary for Employee Benefits Security Administration, U.S. DEP'T OF LABOR to J. Mark Iwry, Senior Advisor to the Secretary and Deputy Assistant Secretary for Retirement and Health Policy, U.S. DEP'T OF THE TREASURY at 1 (Oct. 23, 2014), http://www.dol.gov/ebsa/regs/ils.

[167] Letter from Phyllis C. Borzi, *supra* note 166, at 3.

[168] Also known as ERISA's standard of prudence, codified at 29 U.S.C. § 1104 (2012).

[169] Letter from Phyllis C. Borzi, *supra* note 166, at 4 (emphasis added).

[170] *Lifetime Income Guidance on Target-date Funds (TDFs) Issued by IRS and DOL*, PRAC. LAW EMP. BENEFITS & EXEC. COMP. (Oct. 24, 2015), Prac. Law Legal Update 5-585-8145.

[171] I.R.S. Notice 2015-49, 2015-30 I.R.B. 79.

[172] *Id.*

fiduciaries of defined contribution plans.[173] In FAB 2015-02, the DOL attempted to address "a recurring comment on the [Annuity] Safe Harbor . . . that employers remain unclear about the scope of their fiduciary obligations with respect to annuity selection under defined contribution plans," particularly as it relates to the fiduciary's selection and monitoring of annuity providers.[174] Notably, the DOL pointed out that the guidance provided in FAB 2015-02 "is limited to the selection and monitoring of annuity providers for *benefit distributions* from defined contribution plans."[175] Put another way, FAB 2015-02 applies when a 401(k) plan offers an annuity as a means for a participant to take distributions from his or her accumulated retirement savings. However, the DOL, in conjunction with the Treasury Department, "is considering guidance on fiduciary selection and monitoring of annuity providers and contracts that are offered as *investment options* under defined contribution plans."[176]

The Annuity Safe Harbor requires that a fiduciary not only use prudence at the time of selection of the annuity provider and contract, but also at the time the fiduciary periodically reviews the annuity provider and annuity contract.[177] Specifically, the fiduciary must evaluate the costs of the annuity contract, including fees and commissions, relative to the annuity contract's benefits and services provided, and evaluate the financial ability of the annuity provider to make all future payments under the annuity contract.[178] The DOL clarified in FAB 2015-02 that "the prudence of a fiduciary decision is evaluated with respect to the information available at the time the decision was made—and not based on facts that come to light only with the benefit of hindsight."[179] Thus, the prudence of "a fiduciary's *selection and monitoring of an annuity provider* is judged based on information available at the time of the selection, and at each periodic review, and not in light of subsequent events."[180] Moreover, the periodic review under the Annuity Safe Harbor "does not mean that a fiduciary must review the prudence of retaining an annuity provider each time a participant or beneficiary elects an annuity from the provider as a

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[173] EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LABOR, FIELD ASSISTANCE BULL. NO. 2015-02 (July 13, 2015) [hereinafter FAB 2015-02]; *see* 29 C.F.R. § 2550.404a–4 (2016).
[174] FAB 2015-02, *supra* note 173.
[175] *Id.*
[176] *Id.* The DOL, under its regulatory agenda, is evaluating possible amendments to the Safe Harbor Rule for annuities in defined contribution plans. For information on this project, see the website, OFFICE OF MGMT & BUDGET AND GEN. SERVS. ADMIN., EXEC. OFFICE OF THE PRESIDENT, http://www.reginfo.gov/public/do/eAgendaViewRule?-pubId=201504&RIN=1210-AB58 (last visited Jan. 24, 2016).
[177] 29 C.F.R. § 2550.404a–4(c) (2016).
[178] *Id.*
[179] FAB 2015-02, *supra* note 173; *see also* Bunch v. W.R. Grace & Co., 555 F.3d 1, 10 (1st Cir. 2009) ("Although hindsight is 20/20, as we have already stated, that is not the lens by which we view a fiduciary's actions under ERISA").
[180] FAB 2015-02, *supra* note 173 (emphasis added); *see also* Tibble v. Edison Int'l, 135 S. Ct. 1823, 1828 (2015) (trustee's duty to continue to monitor trust investments and remove those trust investments that are imprudent exists separately from the trustee's duty to exercise prudence in selecting investments at the outset).

distribution option."[181] However, "the frequency of periodic review to comply with the [Annuity] Safe Harbor . . . depends on the facts and circumstances."[182] For example, if the fiduciary, between periodic reviews, is aware of a "red flag" event, such as when a major insurance rating service downgrades the rating of the annuity provider, or multiple annuitants submit complaints demonstrating a pattern of untimely payments under the annuity contract, the fiduciary needs "to examine the information to determine," depending on the facts and circumstances, "whether an immediate review is necessary" and, if so, "the fiduciary may need to conduct an immediate review."[183]

Essentially, the DOL clarified that a plan fiduciary's responsibility to monitor and periodically review an annuity provider ends when the plan fiduciary selects a new annuity provider for the plan, not when the original provider finishes making all promised payments under the annuity contracts it issued on behalf of plan participants and beneficiaries.[184] However, the DOL seems to limit its guidance to immediate annuities and QLACs, by providing two examples—one related to immediate annuities and one related to unallocated deferred annuities, such as QLACs.[185] The first example applies to an immediate annuity, where the employer offers a 401(k) plan, which allows participants to elect various distribution options upon retirement, including an option to elect an immediate annuity.[186] The DOL concluded that under the Annuity Safe Harbor, the employer's "obligation to periodically review Annuity Provider H ended when" the employer "stopped offering annuities from Annuity Provider H as a distribution option to participants or their beneficiaries."[187] The second example involves an employer that includes a QLAC in its 401(k) plan as a distribution option to participants upon retirement.[188] The DOL concludes that "[a]s long as the plan continues to offer participants the option to purchase a [QLAC] at retirement from Annuity Provider D," the Annuity Safe Harbor requires that the employer periodically review Annuity Provider D. "Under the facts of this example, this duty to monitor ends when [QLACs] from Annuity Provider D are no longer offered as a distribution option."[189]

Lastly, FAB 2015-02 clarifies that the statute of limitations under ERISA Section 413 for the breach of fiduciary duties in the selection and

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[181] FAB 2015-02, *supra* note 173.
[182] *Id.*
[183] *Id.*
[184] *Id.*
[185] *Id.*; *DOL Clarifies Safer Harbor on Defined Contribution Annuity Distribution Options*, BENEFITS BRIEF (Groom Law Grp., Washington D.C.), Jul. 14, 2015, at 2, http://www.groom.com/media/publication/1605_DOL_Clarifies_Safe_Harbor_on_Defined_Contribution_Annuity_Distribution_Options.pdf [hereinafter *DOL Clarifies Safer Harbor*].
[186] FAB 2015-02, *supra* note 173.
[187] *Id.*
[188] *Id.*
[189] *Id.*

monitoring of annuity providers begins to run *on the date that plan assets are used to purchase the annuity*.[190] Hence, absent fraud or concealment by a fiduciary of the plan, a claim based "on the imprudent selection of an annuity contract to distribute benefits to a specific participant, the claim would have to be brought within six years of the date on which plan assets were expended to purchase the contract."[191]

v. The Expansion of Fiduciary Duties to Retirement Advisers

On April 6, 2016, the DOL released its final version of the controversial Conflict of Interest Rule intended to ensure that those saving for retirement get investment advice that is in their best interests and free from conflicts of interest.[192] Quite possibly "the most significant regulatory action within the retirement industry in the past 40 years," the DOL's final Conflict of Interest Rule amended the regulatory definition of fiduciary investment advice, replacing a five-part test with a new definition of "fiduciary" that comports with the scope and intent of ERISA and the Internal Revenue Code's statutory definition.[193] Under the new definition of fiduciary, all persons[194] who render investment advice or recommendations for a fee or other compensation with respect to ERISA plan assets or an IRA are treated as fiduciaries.[195]

Finalized on the same day as the Conflict of Interest Rule, the DOL issued multiple related prohibited transaction exemptions, including the Best Interest Contract Exemption (BICE).[196] BICE "permits firms to continue to rely on many current compensation and fee practices, as long as they meet specific conditions intended to ensure that financial institutions mitigate conflicts of interest and that they, and their individual

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[190] *Id.*; 29 U.S.C. § 1113 (2012).

[191] FAB 2015-02, *supra* note 173; *DOL Clarifies Safer Harbor*, *supra* note 185, at 2–3.

[192] Sean Forbes, *DOL Releases Substantially Altered Fiduciary Rule*, 43 BPR 491 (Apr. 12, 2016); Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946-01 (Apr. 8, 2016) (codified at 29 C.F.R. § 2510.3-21 (2016)) [hereinafter Conflict of Interest Rule].

[193] Conflict of Interest Rule, *supra* note 192, at 20,948; *DOL Issues Final Regulations Expanding Definition of "Fiduciary" And Addressing Conflicts of Interest With Respect to Provision of Investment Advice*, COMPENSATION PLANNING JOURNAL (BNA), 44 CPJ 135 (June 3, 2016) [hereinafter *DOL Issues Final Regulations*].

[194] The DOL broadly refers to those rendering investment advice as investment professionals, consultants, and advisers, with the clarification by the DOL that "an adviser can be an individual or entity who is, among other things, a representative of a registered investment adviser, a bank or similar financial institution, an insurance company, or a broker-dealer." Conflict of Interest Rule, *supra* note 192, at n. 1, and accompanying text.

[195] Conflict of Interest Rule, *supra* note 192, at 20,948; *DOL Issues Final Regulations*, *supra* note 193.

[196] Best Interest Contract Exemption, 81 Fed. Reg. 21,002-01 (Apr. 8, 2016) [hereinafter Best Interest Contract Exemption]; EMP. BENEFITS SEC. ADMIN., U.S. DEP'T OF LABOR, FACT SHEET—DEPARTMENT OF LABOR FINALIZES RULE TO ADDRESS CONFLICTS OF INTEREST IN RETIREMENT ADVICE, SAVING MIDDLE CLASS FAMILIES BILLIONS OF DOLLARS EVERY YEAR (2016), https://www.dol.gov/ebsa/newsroom/fs-conflict-of-interest.html [hereinafter CONFLICTS OF INTEREST].

advisers, provide investment advice that is in the best interests of their customers."[197] To rely on BICE, the financial institution must acknowledge fiduciary status for itself and its advisers.[198] Moreover, firms or individuals rendering investment advice to IRA owners or owners of other non-ERISA plans, also known as individual retail investors, must enter into an enforceable contract with the individual retail investor.[199] This contract holds the adviser to "basic fiduciary standards aimed at ensuring that their advice is in the best interest of their customers and take certain steps to minimize the impact of conflicts of interest," providing a way for individual retail investors to directly enforce their rights to prudent fiduciary conduct.[200] As for ERISA plan investors, they will be able to rely on their advisers' acknowledgements of fiduciary status to assert their statutory rights under ERISA.[201] As a result, individuals will have a way to hold advisers accountable for improper fiduciary conduct by way of a breach of contract claim (for IRAs and other non-ERISA plans) or through the statutory protections of ERISA (for ERISA plans, such as defined benefit plans and 401(k) plans).[202]

Complying with the finalized Conflict of Interest Rule may be quite an undertaking for an entity whose advisers or representatives fall under the new definition of fiduciary, involving such steps as identifying the relationships and compensation structures of those subject to the rule, training advisers and customer service representatives to comply with the new rule, and instituting procedures for documentation and record retention.[203] Because of the sweeping changes to the definition of fiduciary, the new rule will become effective on April 10, 2017, with a full-compliance date of January 1, 2018, allowing time for affected plans and service providers to adjust to their new status as fiduciaries.[204]

As to the new Conflict of Interest Rule's impact on guaranteed lifetime income products, the effect of the rule may take some time to surface.[205] According to attorney Bruce Ashton of Drinker Biddle & Reath, the final rule and exemptions will not have a huge impact on in-plan lifetime income products, but "a sale in connection with a rollover or just a sale in an IRA, that's now all going to be subject to these new rules and probably the BICE. It's going to have a material impact on all product

[197] CONFLICTS OF INTEREST, *supra* note 196.
[198] *Id.*
[199] *Id.*
[200] *Id.*
[201] *Id.*
[202] *Id.*
[203] Jacklyn Wille, *Labor Department Faces Five Lawsuits Over Fiduciary Rule*, PENSION & BENEFITS REPORTER (BNA), 43 BPR 747 (Jun. 14, 2016).
[204] Conflict of Interest Rule, *supra* note 192, at 20,946; Sean Forbes, *DOL Promises Answers to Welter of Fiduciary Rule Questions*, PENSION & BENEFITS REPORTER (BNA), 43 BPR 648 (May 17, 2016).
[205] Kristen Ricaurte Knebel, *Fiduciary Rule's Impact on Lifetime Income is Unclear*, PENSION & BENEFITS REPORTER (BNA), 43 BPR 561 (Apr. 26, 2016).

sales in the distribution and IRA context."[206] As for the impact on sales of variable annuities, registered investment adviser Andrew D.W. Hill expressed that the new Conflict of Interest Rule will make it virtually impossible for advisers to continue selling certain variable annuities because such products are almost never in a client's best interest, offering no additional value beyond the underlying mutual funds yet carrying high commissions.[207]

E. *The Disconcerting Selection of an Annuity Provider and the Problem with Insurance Company Credit Ratings*

The Annuity Safe Harbor for defined contribution plans has been and continues to be controversial.[208] If a plan sponsor desires to include an annuity in its 401(k) plan, fiduciaries of the plan are required to prudently select and monitor the annuity provider, i.e., the insurance company, from which the annuity contracts are purchased.[209] To accomplish this, financial data of the insurer must be accessed and considered by plan sponsors or other fiduciaries to the plan.[210] One of the key elements for the fiduciary to determine is whether the insurer is financially able to make all future payments guaranteed under the annuity contracts it sells.[211]

The Annuity Safe Harbor provides that plan sponsors, in their financial assessment of an insurance company, may retain specialized experts.[212] But, the Annuity Safe Harbor does not expressly provide for the use of insurer credit ratings issued by commercial rating services in order to assess insurers.[213] Rather, according to the preamble to the Annuity Safe Harbor, "[a]n annuity provider's ratings . . . are not part of the final safe harbor," though they are encouraged to be used, "particularly if the ratings raise questions regarding the provider's ability to make future payments under the annuity contract."[214] The Preamble also notes that fiduciaries are encouraged to evaluate the protections that may be available through "state insurance guaranty associations for an annuity provider."[215] In addressing some of the shortcomings of the existing Annuity Safe Harbor, attorney Bruce Ashton of Drinker Biddle & Reath, LLP, in a hearing before the DOL, testified that the Annuity Safe Harbor "does not provide sufficient detail to be a valuable tool for the average

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[206] *Id.*
[207] *Id.*
[208] TOTH & GILLER, *supra* note 2, at 13-18.
[209] 29 U.S.C. § 1104(a)(1)(B) (2012); *see* 29 C.F.R. § 2550.404a–4 (2016).
[210] TOTH & GILLER, *supra* note 2, at 13-18.
[211] *Id.* at 13-17.
[212] 29 C.F.R. § 2550.404a–4(b)(5) (2016).
[213] TOTH & GILLER, *supra* note 2, at 13-18.
[214] Selection of Annuity Providers—Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58,447-01, 58,448 pmbl. (Oct. 7, 2008) (codified at 29 C.F.R. § 2550.404a–4 (2016)); TOTH & GILLER, *supra* note 2, at 13-19.
[215] Selection of Annuity Providers—Safe Harbor for Individual Account Plans, 73 Fed. Reg. 58,447-01, 58,448 pmbl. (Oct. 7, 2008) (codified at 29 C.F.R. § 2550.404a–4 (2016)).

plan fiduciary."[216] Moreover, it does not clearly address the type of information that should be considered in assessing the ability of an annuity provider to make future payments.[217]

Credit rating agencies are important institutions in the global capital markets, but these agencies have been highly criticized for providing inaccurate ratings.[218] Credit ratings are directly linked to the regulation of bond investors, including insurance companies, and impact the price at which bonds and annuities are issued.[219] An insurance company can effectively "buy a high rating" by making sure its risk-based capital ratio is high.[220] The bottom line is that credit ratings do not necessarily guarantee the solvency of an insurance company.[221] Expressing the frustration of other fiduciaries in a hearing before the DOL, Michael Hadley testified, "it is not, and should not be, the law that offering an annuity distribution turns plan fiduciaries into stop-loss guarantors of insurers whose financial condition unexpectedly deteriorates despite the watchful eyes of state insurance commissioners."[222]

Scholars have proposed various ways to reform the credit rating industry, such as imposing greater civil liability on credit rating agencies and establishing "a mandatory pay-for-performance compensation scheme in which a fixed percentage of accrued revenue is ceded to fund a performance bonus."[223] Nevertheless, reform may soon be on the way, not directly related to credit ratings, but in the form of a new standard being crafted by the Federal Reserve regarding the amount of capital required to be held by insurance companies under its supervision.[224] Additionally, global regulators, spearheaded by the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS), are developing a global insurance capital standard that will apply to "global systemically important insurers" (insurers identified by the FSB as a potential threat to global financial stability) and other insurers in the international marketplace.[225] If the global insurance capital rule is finalized, it will replace the current capital requirements of the IAIS and

[216] ADVISORY COUNCIL, *supra* note 30, at 14.
[217] *Id.*
[218] Robert J. Rhee, *On Duopoly and Compensation Games in the Credit Rating Industry*, 108 NW. U. L. REV. 85, 86–87 (2013).
[219] *Id.* at 86.
[220] Robert Toth, Jr., *Overreliance on Insurers' Ratings Could Lead to Breach in Buying Lifetime Income Products*, 23 No. 12 THOMPSON'S 401(K) HANDBOOK NEWSL. 6 (Nov. 2014) [hereinafter *Overreliance on Insurers' Ratings*].
[221] *Overreliance on Insurers' Ratings*, *supra* note 220, at 6.
[222] ADVISORY COUNCIL, *supra* note 30, at 15.
[223] Rhee, *supra* note 218, at 87–89.
[224] Jeff Sistrunk, *Insurance Legislation And Regulation to Watch in 2016*, LAW360 at 1 (Dec. 24, 2015, 20:38 EST) (LexisNexis). The development of this capital standard began soon after the passage of the Collins Amendment to the Dodd-Frank Act in 2014, eliminating Dodd-Frank's requirement that the Federal Reserve apply the same leverage capital and risk-based capital rules to insurers that apply to banks and certain other nonbank financial institutions. *Id.*
[225] *Id.*

impact certain large U.S. insurance companies, such as American International Group, MetLife, and Prudential Financial.[226]

III. A PROPOSAL OF FEDERAL LEGISLATIVE AND REGULATORY ACTION

In order to extend the PBGC's protections to employer-sponsored defined contribution plans, Congress should amend ERISA to allow all annuity purchases, through any form of employer-sponsored plan and not just defined benefit plans, to be insured by the PBGC.[227] Allowing all annuities to be insured under the PBGC follows the spirit of its purpose, that is, "to encourage the continuation and maintenance of private-sector defined benefit pension plans, *provide timely and uninterrupted payment of pension benefits*, and *keep pension insurance premiums at a minimum*."[228] At the time the PBGC was instituted, defined contribution plans were not the primary form of retirement plan offered to employees, which may explain, in part, the reason PBGC's guarantees were not extended to annuities outside of traditional pension plans.[229] With the metamorphosis of retirement plans, along with the federal goal of offering annuities to more Americans, it is time to consider expanding this federal protection to all annuity purchases, regardless of the form of employer-sponsored plan assets used to purchase an annuity.[230] Participants in a defined contribution plan who purchase annuities are as much at risk of losing the promised benefits or having untimely and interrupted payment of these benefits as are defined benefit plan participants.[231]

A major hurdle in reforming the federal protection for annuitants participating in defined contribution plans is that state law largely governs the insurance industry, rather than federal law.[232] If federal protections for annuitants are to be reformed, Congress would have to overhaul the regulatory structure of the insurance industry through its express constitutional authority under the Commerce Clause to regulate interstate commerce.[233] Nevertheless, the pushback against federal governance of insurance companies is presumably rooted in the federalism debate, i.e., at

[226] *Id.*

[227] Others have suggested similar or arguably identical federal solutions. *See e.g.*, Hanegbi, *supra* note 50, at 505 ("A comprehensive federal scheme to guarantee annuity payments would do much to give potential annuitants incentives to annuitize at least part of their retirement wealth. Such a scheme could follow the [FDIC] model of guaranteeing bank deposits. For instance, an agency could guarantee annuity payments up to a maximum of $500,000."); Rothman, *supra* note 15, at 946 ("Now that 401(k) plans commonly are used as primary retirement plans, Congress should amend ERISA to provide insurance to them.").

[228] *See Who We Are*, PENSION BENEFIT GUAR. CORP., http://www.pbgc.gov/about/who-we-are.html (last visited Feb. 6, 2016).

[229] Rothman, *supra* note 15, at 946.

[230] *See* discussion *supra* Sections I(C) and II(D).

[231] *See* discussion *supra* Section I(B) and *supra* note 228 and accompanying text.

[232] *See* discussion *supra* Section I(D).

[233] U.S. CONST. art. I, § 8, cl. 3.

what point, if at all, may the federal government regulate state-governed insurance companies without overreaching its authority.[234]

Changes can be enacted on a federal level by regulating or monitoring the financial health of insurance companies that sell annuities to those in the national or global marketplace without treading into other forms of insurance that arguably may be better regulated at the state level.[235] Federal regulations under the SEC are already in place for insurance companies offering a form of securities attached to their insurance products, such as variable annuities or mutual funds.[236] Thus, similar regulations applied to the sale of annuity products should not be a deterrent to many annuity providers. These insurers likely have existing procedures in place to comply with the requirements of the SEC, stock exchanges, and state insurance regulatory agencies.[237] Although insurers are currently regulated at the state level, the state insurance regulations and guaranty funds vary among the states.[238]

Considering annuities from the perspective of a plan participant, an individual may be more likely to purchase an annuity if the individual's costs and risk exposure are lower.[239] From a cost perspective, this means that annuities would be more attractive to an individual when an annuity may be purchased at institutional prices versus retail prices.[240] Although expanding the PBGC's protections to all annuity purchases could result in an increased cost to individuals in exchange for a federal guaranty, this "would go a long way towards giving retirees the option of purchasing a secure income stream."[241] Under the current funding structure of the PBGC, the amount an individual annuitant might pay to the PBGC in order to secure this federal guaranty does not appear to be overly cost prohibitive, even if the premium amounts are raised.[242] Some may find the

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[234] *See generally*, Heather K. Gerken, *Our Federalism(s)*, 53 WM. & MARY L. REV. 1549 (2012) (discussing the history of the federalism debate); *but see*, FED. INS. OFFICE, *supra* note 91, at 11–21 (documenting the history of insurance industry regulation in the United States and the precedent for federal regulation).

[235] *See* FED. INS. OFFICE, *supra* note 91, at 1 (noting that the insurance industry is regulated at the state level and proponents of modernizing insurance regulation advocate regulating the industry at the federal level to improve uniformity and effective regulation of insurance companies whose businesses span across multiple jurisdictions).

[236] *See* discussion *supra* Section I(D).

[237] *See* discussion *supra* Section I(D).

[238] *See* discussion *supra* Section I(D).

[239] *See* Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 468 (noting "the allocation of risk carries with it the allocation of reward").

[240] *See id.* (discussing the economies of scale as related to costs of retirement options).

[241] Hanegbi, *supra* note 50, at 505.

[242] For example, the PBGC does not receive funding from general tax revenues. *Who We Are*, *supra* note 228. Its operations are funded by insurance premiums set by Congress and paid by employers that sponsor insured defined benefit plans, as well as money earned from investment returns, and funds received from pension plans that are taken over by the PBGC. *Id.* The 2016 annual flat-rate premium to sponsors of defined benefit plans insured under PBGC is $64 per participant of a single-employer plan, while the annual variable-rate premium per participant is $30 per $1,000 of unfunded investment

federally backed security of a guaranteed source of lifetime income, beyond social security, too appealing to ignore.[243]

The federal guaranty provided through the PBGC, when narrowly extended to all annuity purchases by any participant of an employer-sponsored plan, would likely encourage a uniform set of standards for annuity providers by virtue of the federal interests at stake. Uniform standards would provide equal guaranty-fund benefits for annuitants, regardless of the annuitant's state of residence.[244] Even the Federal Insurance Office, charged with conducting a study and submitting a report to Congress with recommendations on ways to modernize and improve the system of insurance regulation, proposed that, "[s]tates should enact uniform policyholder recovery rules so that all policyholders, irrespective of where they reside, receive the same benefits from guaranty funds." Moreover, "[i]n the event that states fail to achieve uniformity with respect to guaranty fund benefits . . . federal involvement may be necessary to ensure fair treatment of all policyholders."[245]

From the perspective of an employer or other 401(k) plan fiduciary, the current ERISA regulations do not incentivize an employer to offer annuities to its employees.[246] For instance, employers that sponsor a 401(k) plan and offer annuities to their employees increase their liability exposure as a result of the fiduciary duties attached to annuities.[247] To mitigate this increased risk of liability, employers may need to: (1) purchase additional liability insurance for potential claims of breach; (2) select and hire a third party or an expert to act as a plan fiduciary (who must analyze the variety of annuity products and providers and assess the financial health of the providers to ensure an insurer can meet its contractual obligations under annuity contracts); or (3) amend their existing 401(k) plan document to include annuities as an investment option or as a source of defined benefits.[248] All of these possibilities are

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benefits, with a cap of $500 per participant. *Premium Rates*, PENSION BENEFIT GUAR. CORP., http://www.pbgc.gov/prac/prem/premium-rates.html (last visited Feb. 6, 2016); *How to Determine Unfunded Vested Benefits*, PENSION BENEFIT GUAR. CORP., http://www.pbgc.gov/prac/prem/help/instructions/2015/HowtoDetermineUnfundedVestedBenefits.htm (last visited Feb. 6, 2016).

[243] *See* Hanegbi, *supra* note 50, at 504 ("Evidence exists that the risk of an annuity provider defaulting discourages annuitization, especially given the ordinary planholder's aversion to losses and tendency to overweigh small risks. A guarantee that enables retirees to feel secure about their annuity receipts would alleviate such fears and likely contribute to a rise in annuitization rates.").

[244] *See* Hanegbi, *supra* note 50, at 504.

[245] FED. INS. OFFICE, *supra* note 91, at 3, 45. Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 included the congressional directive to the director of the Federal Insurance Office to prepare and submit a report to Congress on how to modernize and improve the system of insurance regulation in the United States. *Id.* at 3.

[246] *See* discussion *supra* Section II(A).

[247] *See* discussion *supra* Section II(A).

[248] *See* discussion *supra* Sections II(D)(iv) and IV(A).

added costs to the employer with no reciprocal reward.[249] The problem of increased fiduciary liability is one of the reasons that few 401(k) plan sponsors are currently offering annuities to their employees.[250]

In addition, liability and accountability for annuities should be placed on the appropriate parties. An insurer selling annuities to participants of 401(k) plans receives all of the profits from their sale.[251] Likewise, the insurer holds the pool of assets underlying the annuity contracts and directs the investment strategy for these assets, retaining any return on the investments.[252] Unlike traditional pension plans, employers offering 401(k) plans to their employees do not direct the investment strategy of an individual's 401(k) account nor are they in control of plan assets.[253] Accordingly, insurers are the appropriate party to shoulder the liability and accountability for annuities.

Congress could establish a department within the PBGC composed of a team of experts to prudently select and monitor nationwide annuity providers and products. Rather than assigning this duty to individual employers, who currently are responsible for making sure this complicated, costly, and duplicative process is accomplished, employers would simply be a conduit, directing their employees to the PBGC's pre-approved list of annuity providers and products should an employee choose to purchase an annuity. In exchange for a federal guaranty under the PBGC, individuals who purchase a pre-approved annuity should be completely barred from any legal or equitable recourse against the PBGC, federal government, employer, or plan fiduciary, in excess of the PBGC's maximum guaranteed limits, regardless of any negative consequences resulting from an annuity purchase. To encourage the sale of annuity products, federal agencies like the DOL and the IRS should establish reasonable, annually adjustable requirements for annuity providers so that they may qualify as a pre-approved provider through which individuals may purchase annuities guaranteed by the PBGC.

Regardless of whether Congress amends ERISA to include the PBGC's protections to all annuitants, the DOL should provide measurable standards that fiduciaries may rely on and use when selecting and monitoring annuity providers and products.[254] The guidance offered by the DOL related to the Annuity Safe Harbor, while providing some direction for the fiduciary, does not go far enough in its specificity of prudent fiduciary practices necessary for fiduciaries to feel protected by the Annuity Safe Harbor defense.[255] Further, the guidance is expressly "limited to the selection and monitoring of annuity providers for *benefit*

[249] *See* discussion *supra* Section II(A).
[250] *See* discussion *supra* Sections II(A) and II(B).
[251] *See* discussion *supra* Section I(B).
[252] *See* discussion *supra* Section I(B).
[253] *See* discussion *supra* Section I(C).
[254] *See* discussion *supra* Sections II(A) and II(D)(iv).
[255] *See* discussion *supra* Sections II(A) and II(D)(iv).

distributions from defined contribution plans."[256] Although the DOL, in conjunction with the Treasury Department, "is considering guidance on fiduciary selection and monitoring of annuity providers and contracts that are offered as *investment options* under defined contribution plans," no formal guidance has yet been issued.[257]

IV. DOES ANYONE HAVE A COMPASS? PROFFERING PRACTICES AND PRECEDENT

Two forms of guidance are offered below to mitigate the confusion as to what actions constitute the prudent satisfaction of a 401(k) fiduciary's duties, specifically in the selection and monitoring of annuity providers and products. First, a pragmatic approach is taken by sharing guidance from industry experts who identify best practices for fiduciaries. Secondly, recent case law involving claims of breach of fiduciary duty are presented to demonstrate both prudent and imprudent practices.

A. *Are Fears Unfounded? Best Practices*

While fiduciaries of 401(k) plans have been hesitant to include guaranteed lifetime income products in their plans due to the potential liability for breach of their duties, it has been suggested by attorney Bob Toth[258] that "the barriers to offering annuities in [defined contribution] plans" have been torn down by the guidance given by the Treasury Department in recent years.[259] Toth explained that there are not "a lot of regulatory walls left, and the fiduciary rules should not be much of a burden either, though there is still resistance and concern in the marketplace on this issue."[260]

Countering this resistance among fiduciaries, industry experts have suggested a number of best practices for employers and other 401(k) plan fiduciaries when offering annuities to plan participants. For example, Steve Vernon, FSA and Consulting Research Scholar for the Stanford Center on Longevity, proposed that a fiduciary is protected from liability when a plan participant has "unfavorable investment outcomes,"[261] so long as the "plan sponsor complies with the design, disclosure, and administrative requirements" of Section 404(c) of ERISA by applying these requirements to the payout phase and offering to employees "three distinct retirement income options."[262] Income payout options for employees might include: (1) a form of annuity; (2) a "systematic

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[256] *See* FAB 2015-02, *supra* note 173.
[257] *Id.*
[258] Robert Toth, Jr., Esq., Law Office of Robert J. Toth, Jr.
[259] Conference Proceedings, *Building Best Practices in Retirement Income*, STAN. CTR. LONGEVITY FIN. SEC. DIV. 1, 23–24 (May 15-16, 2014), http://longevity3.stanford.edu/-wp-content/uploads/2014/08/Proceedings_7.31_final_draft_3_1.pdf.
[260] *Id.* at 24.
[261] Unfavorable outcomes to a participant might include such things as a participant running out of money or the participant's retirement income not keeping up with inflation. *Id.*
[262] *Id.*

withdrawal solution"; and (3) a temporary payout to participants so that they may delay taking social security benefits, thereby maximizing their payout amount received on a monthly basis from social security.[263]

When an employer is evaluating annuity providers and must determine whether a provider has the financial ability to make all promised payments under its annuity contracts, the employer will likely need the assistance of a financial adviser or other expert.[264] Hiring a financial adviser or expert may limit the employer's liability as plan sponsor to only its selection of the financial adviser, rather than also being liable for the selection of the annuity provider.[265] Drawing from *Bussian v. RJR Reynolds*,[266] it has been suggested that a fiduciary, when assessing the insurer, should make a number of inquiries of the insurance company to determine its financial well-being.[267] These inquiries are similar to the information provided by insurance companies to financial analysts who assess whether to invest in the publicly traded stock of the insurer.[268] A list of appropriate inquiries from the insurer may include: (1) an assessment of the financial condition of the insurer by independent third parties, such as ratings, or information disclosed to regulatory authorities (e.g., the state insurance department); (2) any material changes in the insurer's financial condition in the last five years, accompanied by an explanation as to the cause of the changes and whether the changes affected the interest rate by which the pricing of its annuities are based; (3) material outcomes of recent state insurance examinations; (4) the insurer's level of reserves and an explanation of why the level was chosen; and (5) the risk profile of the investment portfolio supporting the insurer's annuity contracts.[269]

Pointing to *Tibble v. Edison International*,[270] some experts have suggested that employers, or other plan fiduciaries, establish processes to perform periodic, systematic reviews of the plans they monitor.[271] To reduce the risk of litigation, fiduciaries should carefully document the processes used to monitor a plan and the results of their monitoring.[272]

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[263] *Id.*
[264] TOTH & GILLER, *supra* note 2, at 13-22.
[265] *Id.* at 13-21.
[266] Bussian v. RJR Nabisco, Inc., 223 F.3d 286 (5th Cir. 2000). For details on this case, see discussion *infra* Section IV(B).
[267] TOTH & GILLER, *supra* note 2, at 13-21.
[268] *Id.*
[269] *Id.*
[270] Tibble v. Edison Int'l, 135 S. Ct. 1823 (2015), *remanding to* 820 F.3d 1041 (9th Cir. 2016) (on remand to the Ninth Circuit Court of Appeals, the court affirmed the district court's judgment and dismissed the beneficiaries' duty-to-monitor claim as time barred because the beneficiaries failed to raise the claim in their opening brief on the initial appeal, only raising this claim in their petition to the Supreme Court). For details on this case, see discussion *infra* Section IV(B).
[271] Brian D. Netter, Nancy G. Ross & Gary B. DeTurck, *ERISA Litigation In 2015 And A Forecast For The Year Ahead*, LAW360 (Jan. 4, 2016, 03:38 P.M.) (LexisNexis).
[272] *Id.*

Additionally, rather than only monitoring certain investment options, fiduciaries should have regular, periodic reviews of every investment option under the plan.[273]

Others have made recommendations as to how fiduciaries can structure a defined contribution plan and draft the plan document in order to incorporate annuities as an investment option within the plan.[274] The purchase of an annuity "should be structured as a *directed investment of the plan participant*, as opposed to a *payout benefit option* under the plan, and the plan language should reflect this status."[275] This would allow a variety of forms of annuities under a plan's investment rules.[276] In traditional drafting of a defined contribution plan document, annuity payments are specified in the terms of the plan document and considered as only payout options.[277] However, as a best practice, the plan document should be drafted to incorporate the terms of the annuity contract.[278] These terms would thus be viewed as governing the underlying investment, *allowing distributions to be treated as payouts from the investments*, rather than as payouts under the terms of the plan.[279] As such, complications could be avoided that might otherwise arise when including the proper annuity language within the plan document's benefit structure.[280] Instead, the plan document should provide general broad language, authorizing the use of a variety of annuities as investment options.[281]

B. *Exploring Case Law to Guide the Selection of an Annuity Provider and Annuity Product*

First, a disclaimer: case law related to a 401(k) fiduciary's selection and monitoring of annuity providers and products, specifically discussing the Annuity Safe Harbor defense, is slim at best. Therefore, by way of analogy, recent case law on claims of fiduciary breach of duty for defined benefit plans or other factual differences is offered to demonstrate the foundational principles of fiduciary duties related to the selection and monitoring of annuity providers and products, as well as the types of imprudent actions that could be considered a breach of these duties.

In the first analogous case, *Bussian v. RJR Nabisco*, a claim was brought against RJR alleging that RJR breached its fiduciary duty of loyalty when, in the course of purchasing a single-premium annuity to cover its pension obligations after termination of its pension plan, RJR improperly investigated various annuity providers and based its selection

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[273] *Id.*.
[274] TOTH & GILLER, *supra* note 2, at 13-5.
[275] *Id.* (emphasis added).
[276] TOTH & GILLER, *supra* note 2, at 13-6.
[277] *Id.*
[278] *Id.*
[279] *Id.*
[280] *Id.*
[281] *Id.*

on the lowest bid.[282] RJR employed Buck Consultants, Inc. (Buck), to assist RJR in the selection of an annuity provider, looking to Buck to evaluate the solvency and safety of the bidding annuity providers.[283] Overgard, an investment consultant for Buck, testified that his analysis of the financial health of the insurance companies was limited to his review of the ratings and reports of credit rating agencies.[284] He went on to explain "that he had spent less time on evaluating companies than . . . 'on stuff that [Buck] had been hired to do, and that is to work with the insurance companies to get the best bids.'"[285] Overgard was responsible for composing a list of insurance companies that were able to provide the requested annuity.[286] After Overgard had a discussion with a colleague, who advised him that Executive Life should not be on the list of insurance companies because of its nontraditional investment strategy focused on a large percentage of low-quality bonds, Executive Life remained on the list of insurance companies.[287]

As to his investigations of Executive Life, Overgard did not evaluate the insurer solely based on credit ratings; he also sought the opinions of investment bankers and industry insiders (who viewed Executive Life's investment strategy as "bad").[288] Moreover, Overgard learned that Moody's, one of the credit rating agencies, had not spoken with Executive Life management prior to issuing its ratings.[289] He also did not review Executive Life's reports, financial statements, or disclosures, and was unaware that California regulators were investigating the reinsurance practices of Executive Life.[290]

The *Bussian* court expressed that "[ERISA's] test of prudence . . . is one of conduct, and not a test of the result of performance of the investment."[291] The relevant inquiry is "*whether the fiduciary, in structuring and conducting a thorough and impartial investigation of annuity providers, carefully considered such factors and any others relevant under the particular circumstances it faced at the time of decision*."[292] A fiduciary satisfies the obligations of ERISA if, depending on the results of the fiduciary's investigation, the selected annuity provider was reasonably found by the fiduciary to best promote the interests of the plan's participants and beneficiaries.[293] Thus, ERISA's obligations are properly satisfied when the selected annuity provider would have been

[282] Bussian v. RJR Nabisco, Inc., 223 F.3d 286, 288 (5th Cir. 2000).
[283] *Id.* at 289, 303.
[284] *Id.* at 289.
[285] *Id.*
[286] *Id.* at 303.
[287] *Id.*
[288] *Id.* at 303–04.
[289] *Id.* at 304.
[290] *Id.*
[291] *Id.* at 299.
[292] *Id.* at 300 (emphasis added).
[293] *Id*.

chosen by the fiduciary had a thorough and impartial investigation been conducted.[294]

Of further note, the court emphasized that a fiduciary's blind reliance on an expert's advice, credit ratings, or other ratings, is not consistent with fiduciary standards.[295] In general, ratings reflect the evaluation of a company, not the company's specific product line.[296] Reports accompanying an agency's ratings may provide fiduciaries with a means to assess the basis for the particular rating and identify any additional information to consider.[297] As is the case with using experts, a fiduciary does not need to duplicate the analysis conducted by rating agencies.[298] Nevertheless, "the duty of care imposes on the fiduciary an obligation to ascertain the extent to which the ratings can be relied upon in making the decision at hand."[299]

Ultimately, the *Bussian* court held that *an annuity's price could not be the motivating factor for selection until the fiduciary reasonably determines, through prudent investigation, that the providers being considered were comparable in their ability to promote the interests of participants and beneficiaries*.[300] Without this prior determination by the fiduciary, the "consideration of an annuity's price, because it directly benefits the employer, can be taken as evidence that a fiduciary has placed an interest . . . above the interests of plan beneficiaries."[301] If the fiduciary determines that the alternative providers are "comparable in their ability to serve the best interests of plan beneficiaries and participants, a fiduciary does not violate ERISA's commands by subsequently considering which provider offers its annuity at a lower price."[302]

Another case, *Tibble v. Edison International*, decided by the Supreme Court in 2015, involved participants in a multi-billion dollar 401(k) plan who filed suit in 2007, challenging the defendants' inclusion in 1999 and 2002 of higher-fee, retail-class mutual funds as investment options in the plan, when materially similar, lower-fee, institutional-class funds were available for selection.[303] As to the three funds added to the plan in 2002, the district court stated that the defendants had "not offered any credible explanation" for including higher-priced mutual funds that cost plan participants entirely unnecessary administrative fees, concluding

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[294] *Id*.
[295] *Id.*
[296] *Id.*
[297] *Id.*
[298] *Id.*
[299] *Id*.
[300] *Id.* at 302 (emphasis added).
[301] *Id.*
[302] *Id.*
[303] Tibble v. Edison Int'l, 135 S. Ct. 1823, 1825–26 (2015), *remanding to* 820 F.3d 1041 (9th Cir. 2016) (on remand to the 9th Circuit, the court affirmed the district court's judgment and dismissed the beneficiaries' duty-to-monitor claim as time-barred because the beneficiaries failed to raise the claim in their opening brief on the initial appeal, only first raising this claim in their petition to the Supreme Court).

that, with respect to those mutual funds, respondents had failed to exercise "the care, skill, prudence and diligence under the circumstances" that ERISA demands of fiduciaries.[304] As to the mutual funds selected in 1999, the district court granted summary judgment in favor of the defendants, holding that ERISA's six-year statute of limitations barred the plaintiffs' claim related to these funds.[305] Moreover, within the six-year limitations period, the plaintiffs failed to meet their burden of demonstrating that circumstances had changed enough to charge defendants with an obligation to review the mutual funds for purposes of converting them to lower-priced institutional-class funds.[306] The Ninth Circuit affirmed the district court's judgment, holding that "petitioners had not established a change in circumstances that might trigger an obligation to conduct a full due diligence review of the 1999 funds within the 6-year statutory period."[307]

Thereafter, the plaintiffs petitioned for certiorari before the Supreme Court.[308] In a unanimous opinion, the Supreme Court vacated the summary judgment granted in favor of the defendants and remanded the case to the Ninth Circuit, concluding that the Ninth Circuit erred when it applied the statute of limitations to bar a claim of breach of fiduciary duties "based solely on the *initial selection* of the three funds without considering the contours of the alleged breach of fiduciary duty."[309] Explained another way, the Court noted that the nature of the fiduciary duty must be considered in light of analogous trust law principles, that is, "a trustee has a continuing duty to monitor trust investments and remove imprudent ones. This continuing duty exists separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset."[310] Therefore, the "fiduciary is required to conduct a regular review of its investment with the nature and timing of the review contingent on the circumstances."[311] Nevertheless, on remand to the Ninth Circuit, the court affirmed the district court's judgment, declining to excuse the beneficiaries' failure to raise their duty-to-monitor argument in their opening brief on initial appeal prior to their petition to the Supreme Court. As the court stated, since the "beneficiaries never presented to us an argument about an ongoing duty-to-monitor, it is 'elementary' that beneficiaries should not be allowed a second bite at the apple on remand."[312]

In *Fifth Third Bancorp v. Dudenhoeffer*, yet another unanimous decision by the Supreme Court, the suit involved an employee stock

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[304] *Id.* at 1826.
[305] *Id.*
[306] *Id*. at 1827.
[307] *Id.*
[308] *Id.*
[309] *Id.* at 1828–29 (emphasis added).
[310] *Id.* at 1828.
[311] *Id.* at 1827–28 (emphasis added).
[312] Tibble v. Edison Int'l, 820 F.3d 1041, 1049 (9th Cir. 2016).

ownership plan (ESOP).[313] The issue before the Court was whether an ESOP fiduciary is entitled to a special presumption of prudence if the fiduciary makes the decision to buy or hold the employer's stock and that decision is later challenged in court.[314] This presumption of prudence was a special standard held by certain lower courts and was generally defined as "a requirement that the plaintiff make a showing that would not be required in an ordinary duty-of-prudence case, such as that the employer was on the brink of collapse."[315]

Under Fifth Third's defined contribution plan, employees had the choice to contribute a portion of their compensation to the plan as retirement savings, with Fifth Third providing up to 4 percent of an employee's compensation in matching contributions.[316] The assets of the 401(k) plan were invested in separate funds that included ESOP and mutual funds.[317] Employees could allocate their contributions however they wished, but the matching contributions of Fifth Third were always initially invested in the ESOP, with the employee having an option to later move these matching funds to another plan fund.[318] The plan required that the ESOP funds be invested primarily in shares of Fifth Third common stock.[319] The plaintiffs, former Fifth Third employees, claimed that Fifth Third breached its fiduciary duties of loyalty and prudence under ERISA and alleged that, by July 2007, the fiduciaries knew or should have known that Fifth Third's stock was overvalued and excessively risky.[320]

The Supreme Court held that no such special presumption of prudence applies for ESOP fiduciaries.[321] Instead, ESOP fiduciaries are subject to the same duty of prudence that applies to ERISA fiduciaries in general, except that they need not diversify a fund's assets.[322] The Court noted that "*the duty of prudence trumps the instructions of a plan document*, such as an instruction to invest exclusively in employer stock," even if the financial goals of the company demand the contrary.[323] Because the Court of Appeals did not point to a special circumstance that would have rendered the ESOP fiduciary's reliance on the market price of the Fifth Third stock as imprudent, the Supreme Court vacated the judgment of the Court of Appeals and remanded the case to the lower court for further proceedings.[324]

While the above breach of fiduciary duty cases are analogous to breaches by a 401(k) fiduciary in the selection and monitoring of annuities

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313 Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459, 2463 (2014).
314 *Id.*
315 *Id.*
316 *Id.*
317 *Id.* at 2463–64.
318 *Id.* at 2464.
319 *Id.*
320 *Id.*
321 *Id.* at 2463.
322 *Id.* at 2467.
323 *Id*. at 2468 (emphasis added).
324 *Id.* at 2472–73.

for plan participants, they exemplify the importance of a 401(k) fiduciary acting with prudence. Employers, as plan sponsors, and other 401(k) fiduciaries act prudently when they: (1) thoroughly and impartially investigate annuity providers and products and select those that will solely promote the interests of plan participants and beneficiaries; (2) separately evaluate an expert's analysis or other ratings used to select an annuity provider or product, ascertaining the extent to which the expert's advice or ratings may be relied upon; (3) consider the annuity's price and fees, but only after investigating the providers and products and determining that those under consideration are comparable in their ability to promote the interests of participants and beneficiaries; (4) conduct a regular review of the selected annuity provider and product, being mindful of changes in circumstances that may necessitate the selection of a different provider or product; and (5) are mindful that the duty of prudence trumps the terms of the 401(k) plan document, even those terms in the plan document requiring particular investments. In sum, the duty of prudence demands that the fiduciary act solely in the interests of plan participants and beneficiaries.

V. Conclusion

The potential societal burden as a result of baby boomers reaching retirement age over the next few years, along with the prediction that these Americans will live longer than the preceding generation, looms like a dark cloud on the horizon. The fear of outliving one's retirement savings is a legitimate concern for many. President Obama's aspirations, along with the joint actions of multiple federal agencies, may give some Americans the hope of accessing institutionally priced, guaranteed sources of income for life in the near future. However, when navigating the complexities of guaranteed lifetime income products like annuities, caution must be taken.

To rely on the protection of the Annuity Safe Harbor[325] when selecting an annuity provider for benefit distributions from a 401(k) plan, employers and other fiduciaries must objectively and thoroughly analyze, identify and select annuity providers, sufficiently assess the ability of the provider to make all future payments under the annuity contract, and consider the cost of the annuity contract, including fees and commissions, in relation to the benefits and administrative services to be provided under the contract. The fiduciary must appropriately conclude that at the time of selection of the annuity provider and contract (for either distribution of benefits to specific participants or beneficiaries, or to provide annuity contracts at future dates to participants) that the provider is financially able to make all future payments under the contract and the cost of the annuity is reasonable in relation to the benefits and services provided under the contract. The fiduciary should consult with appropriate experts if necessary.

[325] 29 C.F.R. § 2550.404a–4(c) (2016).

Furthermore, as clarified by the DOL in FAB 2015-02,[326] the fiduciary must not only use prudence at the time of selection of the annuity provider and contract, but also must periodically review the provider and contract. This review by the fiduciary includes evaluating the costs of the annuity contract relative to the benefits and services it provides, as well as the financial ability of the provider to make all future payments under the annuity contract. The frequency of periodic reviews depends on the facts and circumstances, but the fiduciary may need to conduct an immediate review if the fiduciary becomes aware of any red flag events, such as multiple complaints of untimely annuity payments from a provider or when a major insurance rating service downgrades a provider's rating. Responsibility for monitoring and reviewing an annuity provider ends when the fiduciary selects a new annuity provider for the plan or when annuities from that provider are no longer offered as a distribution option to plan participants. If a claim based on the imprudent selection of an annuity provider or contract arises against a plan fiduciary, the prudence of the fiduciary decision will be judged based on information available at the time of selection and at each periodic review and not on subsequent events.

Nevertheless, despite the guidance issued in FAB 2015-02, practitioners have expressed the need for further guidance. FAB 2015-02 seems to apply only to immediate annuities or QLACs as distribution options, and no guidance has been given for employers seeking to offer annuities as an investment option under a 401(k) plan. Additionally, there is a perceived lack of a usable standard for fiduciaries to evaluate the financial ability of the provider to make all future payments under the annuities it sells. Neither the Annuity Safe Harbor nor FAB 2015-02 clearly specifies the type of information that should be considered by a fiduciary when assessing the financial condition of an annuity provider. Moreover, there is uncertainty as to what constitutes a definitively prudent annuity product. Until more clarification is provided by the DOL, or congressional reform of the insurance industry or the PBGC is made, 401(k) fiduciaries should heed the best practices suggested by industry experts and hire financial analysts or experts to evaluate the financial condition of annuity providers and the propriety of specific annuity products to more confidently be within the protection of the Annuity Safe Harbor.

[326] FAB 2015-02, *supra* note 173.