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Compliance Bulletin

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DOL publishes final rules on annuity selection for defined contribution plans

On October 7, 2008, the Department of Labor (DOL) published [final regulations](#) regarding the selection of annuity providers and annuity contracts for defined contribution plans. The final regulations establish a safe harbor in selecting an annuity provider for benefit distributions.

Background

In 1995, the DOL issued Interpretive Bulletin 95-1, which provided guidance about the fiduciary rules that apply when a plan sponsor selects an annuity provider to make benefit payments. This guidance clarified that plan fiduciaries must take appropriate steps to obtain the safest available annuity, unless under the circumstances, it would be in the interest of participants and beneficiaries to do otherwise. The guidance required plan fiduciaries to conduct an objective, thorough and analytical search to identify providers for both defined benefit and defined contribution plans.

However, since many defined contribution plans only provide lump sum distributions, which may not be effectively managed by retirees, the ERISA Advisory Council asked the DOL to revise the Bulletin to make it easier to offer annuity options in defined contribution plans. In addition, the Pension Protection Act of 2006 (PPA) directed the DOL to issue guidance to clarify that Interpretive Bulletin 95-1 does not apply to defined contribution plans and to issue regulations stating that the selection of an annuity contract as an optional form of payment from a defined contribution plan is not subject to the safest available annuity standard.

Safe harbor

The final regulations establish a safe harbor for selecting an annuity provider and annuity contracts for benefit payments from defined contribution plans. The regulations clarify that the DOL is not establishing either minimum requirements or the exclusive means for satisfying fiduciary duties for selecting an annuity provider.

The safe harbor requirements are satisfied if the plan's fiduciary:

- Engages in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities. This process must avoid self-dealing, conflicts of interest or other improper influence and should to the extent possible, involve consideration of competing annuity providers;
- Appropriately considers information sufficient to assess the ability of the annuity provider to make all future payments under the annuity contract;
- 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;
- 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
- If necessary, consults with an appropriate expert or experts for purposes of compliance with these provisions. The final regulations clarify that engaging an independent expert is not required in all cases.

Although an annuity provider's ratings by insurance rating services (e.g., Standard & Poor's, Moody's) are not part of the safe harbor, in many instances plan fiduciaries may want to consider them, particularly if the ratings raise questions

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regarding the provider's ability to make future payments under the annuity contract. The DOL also believes that some information regarding additional protections that might be available through a state guaranty association for an annuity provider would be useful information to a plan fiduciary.

The DOL clarifies that the safe harbor does not apply to the selection of investment options offered through annuity contracts but only applies to a plan fiduciary's decision to purchase a distribution annuity for a defined contribution plan. Despite DOL's statements, it may be expected that the DOL will be asked for additional clarification regarding the application of the safe harbor to investment options that include distribution features such as guaranteed minimum withdrawal benefits. Even if the DOL's safe harbor does not apply in a particular situation, many plan fiduciaries will find the safe harbor to be a helpful and general indication of DOL's views on what a plan fiduciary should consider in evaluating a potential investment option.

Time of the selection

A fiduciary who wants to take advantage of the safe harbor may perform his review either when:

- Selecting an annuity provider and contract for making payments to a specific participant or beneficiary; or
- Selecting a provider to provide annuity payments at future dates to participants or beneficiaries. In this situation, the fiduciary must periodically review the annuity provider's financial ability to make all future payments under the annuity contract, as well as the reasonableness of the cost of the contract in relation to the benefits and services to be provided under the contract.

Amendment to Interpretive Bulletin 95-1

The DOL simultaneously amended Interpretive Bulletin 95-1. The amendment limits the application of the safest available annuity rule to defined benefit plans.

Effective date

Both the final regulations and the amendment to Interpretive Bulletin 95-1 are effective on December 8, 2008.

Next steps

Plan sponsors should carefully read the guidance discussed in this newsletter. If you have any questions about the application of these rules to your specific plan, please contact your Prudential Retirement representative for assistance.



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