HOW DOES THE DOL'S LIFETIME INCOME ILLUSTRATION WORK?

A closer look at lifetime income illustrations for pension benefit statements. **By Richard W. Rausser**

On Sept. 18, 2020, after much anticipation, the U.S. Department of Labor (DOL) published its interim final rule (IFR) on lifetime income disclosures for pension benefit statements. A 60-day comment period expired on Nov. 17, 2020, and assuming no major changes take place, the final rule will become effective on Sept. 18, 2021.

The interim final rule is in response to the SECURE Act, which requires plan administrators to include illustrations of a participant's account balance converted to monthly lifetime income streams. The lifetime income illustrations must be provided at least once every 12 months and the illustrations must be included on the same pension benefit statement. The income disclosures are required to provide illustrations on the basis of a single life annuity (SLA)[1] and a qualified joint and 100% survivor annuity (100% QJSA).[2]

The reasons behind providing the illustrations are simple: Most people don't know how to convert their retirement savings into lifetime income, which means that they are unsure of how to determine whether or not they will have enough money to support themselves in retirement. In addition, illustration of lifetime income on benefit statements will enable participants to plan more effectively for their retirement since the disclosure may encourage participants to save more money in order to boost their retirement income down the road.

A primary concern for many will be how to "pensionize" their retirement savings in an effort to provide more reliable retirement income. Maximizing one's retirement income is of course a major challenge for many. Spending too much in the early years of one's retirement and running out of savings, or being too

Footnotes

1. An SLA provides a fixed monthly benefit payable for the life of the participant with no survivor benefit.
2. A qualified joint and 100% survivor annuity provides a fixed monthly benefit for life of the participant, and the same fixed monthly amount to the surviving spouse after the participant's death.

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Account Balance as of [DATE]	Monthly Payment at 67 (Single Life Annuity)	Monthly Payment at 67 (Qualified Joint and 100% Survivor Annuity)
$125,000	$625/month for life of participant assuming Participant X is age 67 on 12/31/2022	$533/month for participant's life, and $533/month for life of spouse following participant's death (assuming Participant X and her hypothetical spouse are age 67 on 12/31/2022

frugal and leaving excess savings behind, requires quite a balancing act; factors including inflation, longevity and market volatility further complicate the picture. The lifetime income disclosure should prove to be a useful tool for some in the effort to convert a participant's account balance to monthly retirement income. By translating the savings experience into a future income stream, participants can better assess their retirement readiness.

APPLYING THE ASSUMPTIONS

The IFR provides plan fiduciaries, plan sponsors and others with liability relief for the illustrations under which they will not have any liability under ERISA with respect to how the lifetime income illustrations are calculated. To qualify for this liability relief, the lifetime income illustrations must be calculated using the assumptions that are set forth in the IFR and must be accompanied by the model language in the IFR, or by language which is similar to the model language provided in the IFR.

In general, the IFR takes a "simple is better" approach to many of the assumptions used for the lifetime income illustrations. Here's an overview of the assumption used for the calculations:

1. **Commencement date:** the monthly payment illustrations must assume that payments begin on the last day of the benefit statement period.
2. **Age:** Participants are assumed to be age 67 on the commencement date (actual attained age is used if the participant is older than age 67).
3. **QJSA survivor benefit:** must be a qualified joint and 100% survivor benefit and participants are assumed to be married, and the spouse is assumed to be the same age as the participant.
4. **Interest rate:** 10-year constant maturity Treasury rate (10-year CMT) as of the first business day of the last month of the statement period.
5. **Mortality:** gender neutral mortality table specified in Code Section 417(e)(3)(B) (the mortality table generally used to calculate lump sum benefit payments in DB plans).

Notably, the IFR does not include any assumptions with respect to projection of the account balance to normal retirement age, or age 67. This means that future contributions, investment returns and inflation are not considered in the lifetime income illustrations.

CRUNCHING THE NUMBERS

The IFR includes the following example, based on these facts:

- Participant benefit statement period ending Dec. 31, 2022
- $125,000 account balance on that date
- 10-year CMT interest rate = 1.83% per annum on Dec. 1, 2022
- Participant X is a 40-year-old female

Based on these assumptions, the benefit statement for this participant would show the data in the above table.

Model language is provided in the IFR that defines and details many elements of the lifetime income disclosures. This language is provided to help participants understand how the illustrations were calculated and it specifically states that the illustrations are estimated benefits and they are not guaranteed benefits. The IFR does provide plan administrators with some flexibility with respect to how these disclosures are added to their standard benefit statements.

SPECIAL RULES

Special rules apply for plans that provide in-plan distribution annuities. These plans have the option to use the regulatory assumptions specified in the IFR, or they may base the lifetime income illustrations on the actual terms of the plan's insurance contract. Illustrations similar to the IFR illustrations must be provided. See the IFR for the specific details.

For plans with deferred income annuities (DIAs), special disclosure requirements apply. Basically, any portion of the participant's account that is not invested in DIAs must provide the normal illustrations specified in the IFR.

CONCLUSION

In general, this is a big step in the right direction, however, the lifetime income illustrations based on the IFR may be misleading to some participants due to the simplification of the assumptions and the lack of a projection of benefits to NRA or age 67. Time will tell if this disclosure will prove to be a boon to plan participants and sponsors alike; however, it will take at least some of the guesswork out of pensionizing one's retirement income. For that we can all be grateful. PC