DAVIS & HARMAN LLP

ATTORNEYS AT LAW

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230
FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

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Internal Revenue Service
CC:PA:LPD:PR (Reg-115809-11)
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Committee of Annuity Insurers Comments on Proposed QLAC Regulations

Dear Sir or Madam:

We are writing on behalf of the Committee of Annuity Insurers (the "Committee") to respond to the request for comment on the proposed regulations under section 401(a)(9) regarding qualifying longevity annuity contracts ("QLACs").[1] The Committee welcomes this opportunity to comment.

Our primary message is simple: we commend the Treasury Department and the Internal Revenue Service (the "Service") for their thoughtful and proactive efforts on the proposed regulations and the issue of longevity risk in general. Although we offer several suggestions in this letter that we believe would encourage even more individuals to purchase longevity insurance, we stress that, overall, we think the proposed regulations represent a major contribution towards Americans' retirement security and should be finalized as soon as possible.

When finalized, the regulations will remove an impediment under the minimum distribution rules that until now has largely precluded the offering of longevity insurance in retirement plans. In doing so, the Treasury Department and the Service will take a significant step forward in helping Americans to achieve a secure retirement. In that regard, financial security in retirement is a critical goal of all Americans, and we strongly support public policies that help individuals meet that goal. In recent years, considerable attention has been given to the

[1] The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal policy with respect to annuities. The Committee's current 30 member companies represent more than 80% of the annuity business in the United States and are among the largest issuers of annuity contracts in connection with employer-sponsored retirement plans and individual retirement plans. A list of the Committee's member companies is attached. Unless otherwise indicated, each of our references herein to a "section" means a section of the Internal Revenue Code of 1986, as amended (the "Code").

importance of saving for retirement, and rightfully so. However, accumulating retirement savings is only one half of the retirement security equation. The other half is making those savings last throughout retirement. This second and equally crucial component of retirement security has garnered too little attention until recently.

Converting a retirement nest egg into a sustainable stream of retirement income can be a daunting task for an individual to undertake without the right tools. In addition to uncertainty about future personal expenses, inflation, and asset returns, it is impossible for an individual to predict how long he or she will live and therefore how long that nest egg will need to last. As a general matter, individuals are living longer and spending more time in retirement than ever before, which could leave too many Americans with little or no income in the later years of retirement. This risk of guessing wrong about how long a nest egg will need to last – longevity risk – is a risk that every retiree faces. And with 77 million baby boomers poised to enter retirement in the coming years, the societal need to help individuals address that risk is escalating.

At the same time, some of the tools traditionally available to individuals to insure against longevity risk are not as widely available as they once were. For example, the well-chronicled decline in the availability of traditional defined benefit (DB) plans has made it increasingly important for defined contribution (DC) plans and individual retirement accounts (IRAs) to include life-contingent distribution options that insure against longevity risk. Unfortunately, DC plans and IRAs are not typically designed to offer such protections. The Treasury Department and the Service have taken a strong leadership role in addressing this problem, culminating to date in the release of the guidance package that included the proposed QLAC regulations.[2] The Committee remains very appreciative of the government's attention to the problem of longevity risk and its approach to addressing this problem. We look forward to continued dialogue on this important issue.

We have organized our comments on the proposed regulations into four main categories. First, we suggest certain modifications to the regulations that would increase flexibility in QLAC designs. We offer these suggestions with the hope of broadening the universe of people who may find longevity insurance appropriate in their particular circumstances, thereby improving the prospects that more people will choose to use at least a portion of their retirement assets to obtain the valuable protections afforded by longevity insurance. Second, we offer suggestions for

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[2] *See* Rev. Rul. 2012-3, 2012-8 I.R.B. 383 (providing guidance on the application of the qualified joint and survivor annuity ("QJSA") and qualified preretirement survivor annuity ("QPSA") requirements of sections 401(a)(11) and 417 to a deferred annuity option under a DC plan); Rev. Rul. 2012-4, 2012-8 I.R.B. 386 (providing guidance on the treatment of a tax-free rollover from a DC plan to a DB plan); Prop. Treas. Reg. section 1.417(e)-1(d) (regarding partial annuitizations under DB plans). More generally, *see* Dep't of the Treasury and Dep't of Labor, *Request for Information on Lifetime Income Options for Participants and Beneficiaries in Retirement Plans*, 75 Fed. Reg. 5253 (Feb. 2, 2010) (the "RFI"). In May 2010, the Committee responded to the RFI by requesting, *inter alia*, modifications to the section 401(a)(9) regulations that would facilitate longevity insurance in qualified plans and IRAs.

modifying the limits that the proposed regulations place on QLAC premiums. Here, our goals are simply to help individuals with small account balances and to make the limits more workable in practice. Third, we ask for several technical clarifications to the regulations in anticipation of questions that may arise in the future as taxpayers and the government implement the final rules. Finally, we ask that the Treasury Department and the Service coordinate with the Department of Labor ("DOL") on certain reporting and recordkeeping issues.

I. Facilitating More Flexibility in QLAC Designs

Commercial annuities are the only source of private retirement income that is guaranteed to continue undiminished for life. Thus, encouraging the use of life annuities is an important part of helping Americans address the risk they face of outliving their retirement savings. A holistic approach to this goal should acknowledge that several factors may contribute to an individual's reluctance to elect life-contingent annuitization. For example, the preamble to the proposed QLAC regulations suggests that the availability of multiple, optional guarantees under life annuities might discourage their use because of added complexity and the effect they have on the amount of the basic lifetime payments that can be generated by a given premium. Other commentators have suggested that obstacles to life annuitization might include (1) a public lack of awareness regarding the perils of longevity risk, and (2) a behavioral response to the risk-pooling nature of insurance – an individual's fear of financially "losing" if early death prevents the payment of at least a significant amount of cash benefits under the contract.[3]

The proposed regulations will remove a tax-law impediment to the offering of longevity insurance in retirement plans, which is the most important goal in finalizing the regulations. The proposed regulations also address some of the non-tax obstacles to life annuitization by increasing awareness of longevity risk and by limiting QLAC features in a way that could help with complexity and maximize lifetime income. Individual circumstances can and do differ, however, and more flexibility in QLAC designs could make longevity insurance more appealing to more people. This, in turn, could help to further advance the broader public policy goal of promoting the availability and use of lifetime income options in retirement plans.

As a result, we believe there are several instances in which the final regulations could strike a better balance between some of the more specific goals mentioned in the preamble (such as limiting QLAC features in order to maximize lifetime payments) and the broader public policy goal underlying the RFI (to ultimately increase the use of lifetime income options). Our comments in this section are aimed at improving this balance by allowing more flexibility in

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[3] *See, e.g.,* Jeffrey R. Brown, *Rational and Behavioral Perspectives on the Role of Annuities in Retirement Planning* (Nat'l Bureau of Econ. Research, Working Paper No. 13537, 2007), *available at* http://www.nber.org/papers/w13537 (discussing (1) complexity and financial literacy, (2) "mental accounting" and "loss aversion," (3) "regret aversion," and (4) the "illusion of control" as behavioral factors that may contribute to a reluctance to annuitize); Wei-Yin Hu and Jason S. Scott, *Behavioral Obstacles to the Annuity Market* (Soc. Sci. Research Network, Working Paper, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=978246 (similar).

QLAC features while remaining cognizant of the specific goals and concerns expressed in the preamble and the importance of finalizing the regulations.

A. Flexibility to Address Inflation and Interest Rate Risks

The proposed regulations do an excellent job of focusing on the need to insure against longevity risk. Of course, longevity risk is not the only risk that can endanger retirement security. Retirees also must grapple with the risk that their income will not keep pace with inflation or that interest rate fluctuations could adversely affect their retirement income. Certain types of annuity contracts – such as variable and indexed annuities – include protections against these financial risks in addition to longevity risk. The proposed regulations do not permit a variable annuity, indexed annuity, or similar contract to be used as a QLAC.[4] In explaining this rule, the preamble says that a QLAC is intended to provide a predictable stream of payments on a specified future date, thereby easing the task of managing one's other assets to provide retirement income prior to that date.[5] We share and fully support this goal, but believe that QLACs can achieve it while also protecting against inflation and interest rate risks.

These additional financial risks are seemingly more prevalent with longevity insurance than other types of annuities. In that regard, payments under a QLAC may not be scheduled to start for 20 or more years after the purchase date. During that time (as well as thereafter), inflation could significantly erode the purchasing power of the future payments.[6] Thus, even the most predictable income stream – one that is fixed in dollar amount and will not change between the purchase date and the annuity starting date – can become unpredictable in terms of purchasing power due to inflation.[7] In addition, given that interest rates could change significantly over such an extended period, an individual may be reluctant to purchase a QLAC

[4] Prop. Treas. Reg. section 1.401(a)(9)-6, Q&A-17(a). The preamble requests comments on whether an insurance product that provides guaranteed lifetime withdrawal benefits ("GLWBs") could constitute a QLAC. It would appear from the proposed definition that a GLWB, whether offered as a stand-alone contract or imbedded in another annuity contract, could not constitute a QLAC. We understand, however, that the Treasury Department and DOL are working on other guidance that may help clarify how GLWBs are treated under the various rules applicable to qualified plans and IRAs. The Committee stands poised to continue our dialogue with the government on those issues.

[5] 77 Fed. Reg. 5445.

[6] For example, if a QLAC purchased in 1992 promised to pay $500 per month starting in 2012, by the time the payments commenced their purchasing power would have been eroded to about $305.

[7] *See*, *e.g.*, Dan Kadlec, *Boomers Flock to 'Longevity Insurance' for Retirement Security*, TIME (April 12, 2012), *available at* http://moneyland.time.com/2012/04/12/boomers-flock-to-longevity-insurance-for-retirement-security (discussing longevity insurance (including the proposed QLAC regulations) and observing that "in the end, deferred annuities are an insurance product. Unless you pay extra for certain guarantees, you and your heirs will never see a dime's worth of payout if you pass away early, and if inflation spikes the income you bought might not be sufficient 20 years down the road.").

in a low interest rate environment out of concern of locking in a low rate for determining future benefits.[8]

The preamble observes that an individual could attempt to manage his or her non-QLAC assets in a way that helps address inflation and interest rate risks. But that might not be enough. As the preamble also recognizes, the typical person may spend down all of his or her non-QLAC assets before age 85, knowing that a QLAC will commence payments at that point. Thus, there could be a very logical demand for a QLAC to protect against inflation and interest rate risks because the QLAC could be a significant part (or perhaps the only source) of an individual's private retirement income after age 85. In such case, it would be inadequate to address inflation and interest rate risks using only non-QLAC assets; the QLAC itself would need to protect against these risks.

In certain respects, the proposed regulations already facilitate a QLAC's ability to address these risks. For example, the proposed regulations state that the annuity payments under a QLAC must comply with the rules in Treas. Reg. section 1.401(a)(9)-6, which permit certain types of increasing annuity payments that can protect against inflation and interest rate risks.[9] Thus, after the annuity starting date ("ASD"), a QLAC could provide such protection. It is not clear, however, that the proposed regulations would permit a QLAC to provide such protection *before* the ASD. As indicated above, inflation and interest rate risks could significantly dilute the purchasing power of the initial (and therefore subsequent) annuity payments even before the ASD.

A QLAC could protect against these additional risks even before the ASD while still providing the predictable income stream the preamble envisions. For example, a QLAC could provide that a guaranteed minimum level of annuity payments will commence on the ASD, while also providing for the possibility of higher initial (and/or subsequent) payments based on certain criteria. The higher potential payments could reflect a pass-through to policyholders of mortality or investment gains (or expense savings) that the issuer achieves in excess of those it assumed when pricing the contract, or the higher contingent payments could be based on a specified index or a referenced pool of assets. For example, the contract could provide that payments of $1,000 per month will commence on the ASD, but that the initial and subsequent payments could be higher based on the performance of a published index after the date of purchase.

Of course, the availability of these types of supplemental guarantees under a life annuity can add some complexity and, if such an option were elected, it typically would result in

[8] The applicable federal rate (long-term) in April 2012 was 2.72%, whereas in April 1992 it was 7.83%. *See* Rev. Rul. 2012-11, 2012-14 I.R.B. 686, 687; Rev. Rul. 92-23, 1992-1 C.B. 292, 292. Interest rates greatly affect annuity purchase rates. For example, a single life annuity purchased by a 70 year-old with a $100,000 single premium would generate annual payments of about $10,500 in a 7% interest rate environment, but only about $7,500 in a 3% interest rate environment.

[9] *See* Treas. Reg. section 1.401(a)(9)-6, Q&A-14 (requiring that annuity payments be "nonincreasing" but permitting certain types of increases, such as those based on a cost-of-living index).

somewhat smaller guaranteed periodic payments per dollar of premium. On the other hand, the presence of such additional protections is likely to make a life annuity more attractive to some, at least those who are concerned that inflation or interest rates might erode their real income down the road. As a result, we think that allowing QLACs to offer protections against these risks through the types of optional guarantees outlined above, or similar features that may be developed in the future, will lead to more people finding QLACs appropriate for their particular circumstances. This, in turn, could lead to more people choosing lifetime income options in furtherance of the goal expressed in the RFI, all while remaining consistent with the desire for QLACs to provide predictable income. Balancing these considerations, we believe that QLACs should be permitted to include features that offer the potential for a higher level of annuity payments, provided that there is always a guaranteed floor of benefits payable. We ask that the final regulations be modified to allow this form of benefit.

B. Flexibility to Provide Guaranteed Minimum Death Benefits

As noted above, one reason that people do not more frequently elect life-contingent annuitization could be a behavioral response to the risk-pooling nature of insurance – an individual's fear of financially "losing" if early death prevents the payment of at least a significant amount of cash benefits under the contract. Although this response may be economically irrational in light of the purpose and nature of life annuities, commentators have cited it as potentially contributing to the infrequency of life annuitization, as well as to explain why most people who actually do elect a life annuity do so only in conjunction with some type of refund feature in the event of death, such as a period certain or a guaranteed return of premium ("ROP").[10]

The proposed regulations would allow a QLAC to provide benefits upon death, but would limit them to life-contingent survivor payments. Such a limited form of death benefit presents the risk of the same behavioral response described above, because the survivor payments, being life-contingent, could cease before a significant benefit is paid under the contract. As a result, the behavioral response may persist and discourage some people from purchasing QLACs.[11] This problem could be addressed, at least partially, if a QLAC were allowed to provide an ROP benefit upon death – *i.e.*, guarantee that regardless of when the annuitant dies (or when both annuitants have died under a joint and survivor contract), the insurance company will pay aggregate benefits at least equal to the premium(s) paid.

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[10] *See*, *e.g.*, Hu and Scott, *supra* note 3, at 16-17 (observing that 73% of all individual immediate life annuities sold in the U.S. have period certain features, and that "[a]dding guaranteed payouts to the annuity contract makes the annuity more attractive" because it "minimizes the anxiety associated with possible early death after the annuity investment is made.").

[11] *See*, *e.g.*, Kadlec, *supra* note 7 (discussing longevity insurance (including the proposed QLAC regulations) and observing that "[u]nless you pay extra for certain guarantees, you and your heirs will never see a dime's worth of payout if you pass away early….").

We understand from the preamble that the Treasury Department and the Service considered whether to allow ROP death benefits under QLACs, but decided against it because such benefits are "inconsistent with the purpose of providing lifetime income to employees and their beneficiaries…."[12] This may be true in the sense that minimum death benefits generally result in smaller periodic payments per dollar of premium, but this does not make them inconsistent with providing lifetime income. Rather, to the extent that the lack of a minimum payout such as an ROP benefit discourages people from purchasing a QLAC, including the ROP benefit is entirely consistent with the broader goal of encouraging as many people as possible to choose a lifetime income option.

We also understand from the preamble that the lower relative "cost" of a contract that lacks an ROP benefit (*i.e.*, a given level of annuity payments could be purchased for a lower premium under such a contract, compared to a contract with an ROP benefit) would leave more non-QLAC assets in the participant's account from which to satisfy any bequest motivation.[13] As the preamble also recognizes, however, "a typical participant … will need to draw down the entire account balance during the period prior to commencement of the annuity."[14] Thus, in the typical case, the account may not be available for bequests. More importantly, a bequest motivation may not be the reason an ROP benefit is desired; rather, it may be the more fundamental behavioral response described above – fear of having made a bad financial decision if early death prevents the payment of at least a significant amount under the contract. Finally, regardless of the reason why an ROP benefit would make QLACs more attractive to some, we think it would be relatively benign to do so in terms of the potential "cost" of the benefit on the basic periodic payments.

In that regard, while we have not conducted a thorough, multi-company examination, the Committee's counsel asked one of the member companies to prepare a brief analysis of how the inclusion of an ROP death benefit under QLAC might affect the periodic payments per dollar of premium. Based on that company's analysis, a QLAC with an ROP benefit would provide lifetime annuity payments that are about 12-13% lower than the payments the contract would provide in the absence of an ROP benefit, based on what we think would be a typical case.[15] More importantly, the regulations should allow individuals to make the choice for themselves which combination of features is most appropriate in their particular circumstances – higher lifetime payments without an ROP benefit or lower lifetime payments with an ROP benefit. The

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[12] 77 Fed. Reg. 5447.

[13] *Id.* at 5445.

[14] *Id.* at 5445.

[15] This example is based on pricing assumptions for a QLAC purchased at age 65 that provides joint and survivor payments for two same-age spouses commencing at age 85. Based on those same pricing assumptions, the percentage reduction in payments would be smaller or larger depending on the particular circumstances. For example, if the contract were purchased at age 55 and payments commenced at age 75, they would be about 4% smaller than those under the same contract without an ROP benefit, while the reduction in payments would be about 35% for a single life contract purchased by a male at age 65 with payments commencing at age 85.

inability to make this choice would almost certainly discourage some individuals from purchasing QLACs, whereas making it available could encourage greater use of QLACs and the insurance against longevity risk they provide.[16]

If the regulations are modified to permit ROP benefits under QLACs, it also would be helpful to clarify how such benefits under a QLAC must be distributed. A simple and straight-forward approach might be to require that such QLAC death benefits be distributed in a lump sum within a year of the applicable death (*i.e.*, within a year after all annuitants have died). While this is not otherwise required with respect to ROP death benefits under the current RMD rules, it could make good sense for QLACs in the interest of simplicity and in recognition of the fact that QLACs would already receive different treatment under the regulations.

C. Flexibility to Provide Limited Cash Surrender Value

The proposed regulations state that a QLAC cannot provide a cash value, commutation right, or similar benefit. The preamble explains this limitation as intending to (1) maximize lifetime annuity payments and (2) make contracts more understandable and comparable across providers.[17] While we appreciate and support these goals, here, too, we think it is important to balance them against the broader public policy goal of encouraging more individuals to choose lifetime income options in their retirement plans. To the extent that the limitations placed on QLAC designs discourage some longevity insurance purchases, the regulations will not reach their full potential of advancing the broader policy goal. In that regard, we believe that allowing at least limited liquidity with respect to a QLAC would encourage more individuals to purchase longevity insurance and more plan sponsors to make QLACs available under their plans.

Such limited liquidity could be provided in a manner that is consistent with the proposed regulations. For example:

- The regulations could provide that a QLAC is permitted to have a cash value, but only before the required beginning date ("RBD"). If the cash value feature is extinguished at the RBD, the pricing for the QLAC would still reflect the lack of a cash value for a long period of time (between age 70½ and 85, for example). It appears that adding such a limited cash value feature might have only modest effects on the cost of a QLAC in terms of the periodic payments that could be generated per dollar of premium. In that regard, the Committee's counsel asked

[16] We also note that the current regulations under section 401(a)(9) recognize the popularity of ROP benefits and facilitate their use. For example, Q&A-14 of Treas. Reg. section 1.401(a)(9)-6 provides a special exception to the "nonincreasing payment" requirement for ROP benefits under a DC plan or a DB plan. Likewise, Q&A-12(c) includes a special rule that treats ROP benefits more favorably than other types of "additional" benefits under a deferred annuity by allowing the value of the ROP benefit to be ignored when calculating RMDs in certain cases. Implicit in these special rules for ROP benefits is a recognition that they are a widely-used and important feature of many annuity contracts and the RMD rules should not hinder their use.

[17] 77 Fed. Reg. 5448.

one of the member companies for help in preparing a brief analysis of the effect of such a benefit on the amount of annuity payments that would be payable. While we have not conducted an extensive examination, the results of the preliminary analysis for a joint life payout suggest that the annuity payments under a QLAC providing a cash value prior to age 70½ would be about 0.5% to 2% lower than the payments under the same contract without a cash value.[18] The effect on the payments would be somewhat greater under a single life product, *e.g.*, 5-10%.

- Another approach would be to clarify the regulations to allow a deferred annuity that provides a cash value to include a QLAC distribution option. The deferred annuity could provide all the flexibility that otherwise is available with a deferred annuity. The owner could elect the QLAC distribution option under the deferred annuity at any time and receive a "certificate" or "settlement contract" setting forth the terms of the distribution option. If those terms meet the requirements of the QLAC regulations, applied at the time the certificate or settlement contract is issued, then the certificate or settlement contract would be a QLAC.

Under either of the foregoing two approaches, individuals who otherwise view the lack of a cash value feature as a barrier to purchasing a QLAC might feel more comfortable doing so. As a result, we urge the Treasury Department and the Service to consider these suggestions when finalizing the proposed regulations.

II. Improving the Premium Limits

A. Reconsidering the 25% Limit for Small Account Balances

The proposed regulations would limit the premiums that can be paid for QLACs to 25% of the participant's account balance or $100,000, whichever is less. The proposed 25% limit will likely be controlling for most individuals because (based on EBRI data) most account balances are significantly less than the $400,000 level that would be needed to trigger the $100,000 limit.[19] As a result, the amount of future QLAC income that many individuals will be able to

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[18] This example assumes a joint and survivor payout for two same-age spouses. The range of percentages reflects different issue ages (55 or 65) and different forms of cash value (premiums paid or actuarial present value of future benefits). The example in the text for a single life payout is based on similar assumptions.

[19] For example, in 2008 the average and median IRA balances (all accounts from the same person combined) were $69,498 and $20,046, respectively. IRA owners between the ages of 65 and 69 had the highest average and median balances – $145,074 and $53,858, respectively – but still well below $400,000. *See* Employee Benefit Research Institute, *IRA Balances and Contributions: An Overview of the EBRI IRA Database*, at pp. 6-8 (EBRI Issue Brief No. 346, updated Sept. 2010), *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_09-2010_No346_IRA1.pdf. The figures for 401(k) plans are similar. For example, the average and median 401(k) account balances at year-end 2010 were $60,329 and $17,686, respectively. Only about 16% of 401(k) participants who were in their 60s had account balances greater than $100,000 at year-end 2010. *See* Employee Benefit Research Institute, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2010*, at pp. 13-14 (EBRI

(continued …)

purchase under the 25% limit may be relatively small.[20] In this sense, a percentage-based limit will disproportionately affect individuals with small account balances relative to those with large balances. As a result, we suggest that the Treasury Department and the Service consider alternatives to the 25% limit set forth in the proposed regulations. For example, the percentage limit could be increased, or it could be supplemented by a minimum QLAC premium (such as $25,000) that is permitted regardless of an individual's account balance. These or similar ideas could facilitate QLAC purchases by those with smaller account balances.

B. Preventing "Foot Faults" from Causing Disproportionate Consequences

The proposed regulations appear to treat a QLAC as permanently failing to qualify as such if any premium is paid in excess of the applicable limits. In addition, the proposed regulations do not provide a means to correct inadvertent failures to adhere to the premium limits. Disqualifying the entire QLAC even in cases where an inadvertent error was made in administering the premium limits would be a disproportionate consequence.

In that regard, the proposed regulations preclude a QLAC from providing a cash value, which means if an excess premium inadvertently caused a QLAC to be disqualified in its entirety, the owner would be unable to cash out the "bad" contract and transfer the proceeds to another investment, including a compliant QLAC. Rather, the owner would be "stuck" with the non-compliant contract. Although the owner would continue to have longevity insurance protection under the contract, the contract's value would need to be reflected in the owner's account balance when determining RMDs. In such case, the owner may have insufficient other assets in his or her account to support the RMD attributable to the non-compliant QLAC. Thus, by virtue of an innocent "foot fault," individuals could encounter the very problem that underlies the issuance of the regulations. This problem is most likely to be encountered by elderly IRA owners, on whom much of the responsibility for complying with the premium limits will rest.

These issues could be addressed by adopting an approach of disqualifying a QLAC only to the extent of an excess premium, and allowing the remainder of the contract to constitute a QLAC that can be ignored in determining the account balance for RMD purposes. Another approach would be for the final regulations to include a mechanism to correct inadvertent excess premiums. This would be consistent with the approach that the Treasury Department and the

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Issue Brief No. 366, updated Dec. 2011), *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_12-2011_No366_401(k)-Update.pdf.

[20] For example, the median IRA account balance of about $54,000 in 2008 for individuals between the ages of 65 and 69 would support a maximum QLAC premium of about $13,500. Based on the information provided in the preamble, such a QLAC purchased at age 70 would produce about $290 in monthly joint and survivor annuity payments commencing at age 85. Assuming 3% annual inflation, the purchasing power of this monthly payment would be about $185 at age 85. While some guaranteed lifetime income is better than none, individuals are more likely to be motivated to purchase a QLAC if they perceive the amount of monthly income as sufficient enough to be meaningful to them.

Service have taken generally when it comes to the rules applicable to qualified plans.[21] Whatever approach is adopted, the goal should be to soften the consequences of inadvertent errors in applying the QLAC premium limits.

C. Making More Frequent Inflation Adjustments to the $100,000 Limit

The proposed regulations include an important provision that will increase the $100,000 QLAC premium limit in the future to reflect inflation. Without such an adjustment, over time the utility of the regulations would be diminished, so we are very pleased that the adjustment was included in the proposed regulations. The adjustment is proposed to be made in $25,000 increments. We note that other limits in the qualified plan context are indexed in much smaller increments.[22] A smaller increment for inflation adjustments (*e.g.*, $5,000) would be more appropriate because it would recognize the effects of inflation sooner, thereby providing better protection against inflation risk. Accordingly, we ask the Treasury Department and the Service to consider lowering the adjustment increment in the final regulations.

III. Technical Clarifications

A. Clarifying the Implications of Irrevocable Beneficiary Elections

The proposed regulations prohibit QLACs from providing a survivor annuity to a non-spouse beneficiary if the owner dies after the ASD unless the contract (1) provides no pre-ASD survivor benefit or (2) the non-spouse beneficiary was irrevocably elected before the owner's RBD (generally age 70½).[23] This requirement that a non-spouse beneficiary be irrevocably elected on or before the RBD presents several potential questions.

For example, the proposed rule effectively precludes a QLAC purchase after the RBD if the purchaser wants to name a non-spouse beneficiary to receive a pre-ASD survivor benefit. In other words, how can the purchaser irrevocably elect a non-spouse beneficiary prior to the RBD if the QLAC is not purchased until after that date? If the irrevocability requirement is retained in the final regulations, we recommend that the regulations be modified to address this issue, *e.g.*, by allowing the use of the new minimum distribution incidental benefit ("MDIB") table in the proposed regulations[24] as long as the irrevocable designation of a non-spouse beneficiary is

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[21] *See, e.g.*, Rev. Proc. 2008-50, 2008-2 C.B. 464 (the Employee Plans Compliance Resolution System). Additional thought may be needed to ensure that a QLAC correction mechanism would be workable in practice in light of the premium and benefit structures of longevity annuity contracts.

[22] For example, the annual limit on amounts allocated to a participant's account under section 415 is indexed in $1,000 increments for DC plans and the limit on annual plan compensation in determining contributions or benefits is indexed in $5,000 increments. *See* sections 415(d)(4)(B) and 401(a)(17)(B); *see also* Internal Revenue Service, *Determinations – Summary of EGTRRA Changes for Retirement Plans* (Jan. 23, 2012), *available at* http://www.irs.gov/retirement/article/0,,id=218383,00.html.

[23] Prop. Treas. Reg. section 1.401(a)(9)-6, Q&A-17(c)(2)(iii).

[24] That is, the table in Prop. Treas. Reg. section 1.401(a)(9)-6, Q&A-17(c)(2)(iv).

made by the later of the RBD or the date the QLAC is purchased. In addition, if our recommendation to allow ROP benefits under QLACs is adopted, a clarification will be needed that the irrevocability requirement does not apply to the recipient of the ROP benefit (*i.e.*, the ROP beneficiary would be someone other than a measuring life for any life-contingent survivor annuity payments, so the MDIB table in the proposed regulations and its associated irrevocability requirement would be irrelevant). As an alternative to making these clarifications, the irrevocability requirement could be eliminated altogether.

In that regard, it is unclear how the irrevocability requirement would be able to satisfy the Code and ERISA provisions regarding QJSAs and QPSAs.[25] Under those provisions, certain requirements apply to a married participant who elects a life annuity form of distribution. For example, a participant, even with spousal consent, may not designate someone other than the spouse as the recipient of a survivor annuity until the 180-day period ending on the annuity starting date.[26] Further, any waiver of a QJSA is effective only with respect to that spouse and does not bind a subsequent spouse.[27] While the Service did recently provide very helpful guidance on the application of the QJSA and QPSA requirements to deferred annuities in DC plans, this guidance does not address a situation in which a non-spouse beneficiary is named irrevocably well in advance of the annuity starting date.[28] If an unmarried participant were to name a beneficiary, it appears this "irrevocability" must be revoked if the participant is married when the annuity commences. We recommend that the Service provide guidance on these and similar situations that could arise in the context of an irrevocable designation of a non-spouse beneficiary if an irrevocability component is retained in the final regulations.

B. <u>Clarifying the Treatment of Increasing Annuity Payments</u>

The proposed regulations provide that, after distributions under a QLAC commence, they must comply with Treas. Reg. section 1.401(a)(9)-6.[29] That section permits certain increases in annuity payments. In order for an increasing payment pattern to be permitted under an annuity contract purchased from an insurance company, the "total future expected payments" must exceed the "total value being annuitized."[30] In the case of a QLAC, the "total value being annuitized" is not clear.

In that regard, prior to the date annuity payments commence under a QLAC, the contract is a deferred annuity. In the case of a deferred annuity purchased for a section 401(a) trust, the current regulations define the total value being annuitized as the value of the employee's entire

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[25] Code sections 401(a)(11) and 417 and ERISA section 205.

[26] Sections 417(a)(1)(A) and 417(a)(6)(A).

[27] Section 417(a)(2).

[28] Rev. Rul. 2012-3, 2012-8 I.R.B. 383.

[29] Prop. Treas. Reg. section 1.401(a)(9)-6, Q&A-17(a)(3).

[30] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c).

interest that is being annuitized, determined as of the date annuity payments commence.[31] This definition, which contemplates that a deferred annuity has a cash value, does not fit well with QLACs because they do not have cash values (and would not have such values on the ASD even if our recommendation to allow certain limited cash values is adopted). Thus, it may be necessary to "deem" an amount to be the "total value being annuitized" in order to determine whether the existing RMD rules regarding nonincreasing payments are satisfied with respect to a QLAC providing increasing payments.

If such an approach is adopted, it will be important for plan participants, IRA owners, plan sponsors, and QLAC issuers to know, at the time a QLAC is purchased, whether the future increases in annuity payments will meet the RMD rules. As a result of this need for certainty, a preferred approach would be one that applies an appropriate nonincreasing payment test at the time a QLAC is issued (taking into the account the possibility of multiple premium payments). If, instead, a nonincreasing payment test were applied at the ASD, then the rule would need to be carefully crafted to prevent unexpected results. For example, if the test were to require a calculation of the present value (PV) of future payments on the ASD using then-current interest rates as a proxy for the total value being annuitized, a payment stream that was thought to be compliant on the issue date could unexpectedly fail the test on the ASD merely because of a change in interest rates after the QLAC was issued.[32] Whatever standard is ultimately adopted, an important goal should be to facilitate certainty, as of the purchase date, regarding whether a scheduled payment stream will meet the requirements applicable to increasing payments. We ask the Treasury Department and the Service to consider clarifications in the regulations to facilitate such certainty.

C. <u>Applying the 25% Limit to an Account that Already Holds a QLAC</u>

For individuals who purchase only a single QLAC and pay a single premium for it, the 25% limit is fairly straightforward: the single premium cannot exceed 25% of the individual's account balance at the time the single (*i.e.*, only) premium is paid (or, in the case of an IRA, the account balance on 12/31 of the preceding year). As the preamble recognizes, however, a QLAC also could permit multiple premium payments. In such cases, at the time the second or any subsequent premium is paid, the account will already hold a QLAC. The proposed regulations say that for RMD purposes the account balance does not include the value of a QLAC.[33] This

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[31] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(1)(i).

[32] To illustrate, if interest rates are lower on the ASD than they were on the contract's issue date, and such lower rates were used on the ASD to calculate the PV of future payments, the resulting PV would be higher than the one the issuer expected would arise based on the interest rate used in establishing the benefit levels under the contract. In that circumstance, the deemed "total value being annuitized" could be greater than the "total future expected payments," thereby failing the test, even though the issuer designed the contract to comply with the test when the contract was issued, and even though the "failure" resulted solely from a later change in interest rates causing a different interest rate assumption to be used in the PV calculation.

[33] Prop. Treas. Reg. section 1.401(a)(9)-6, Q&A-12, and Prop. Treas. Reg. section 1.401(a)(9)-5, Q&A-3(a) and (d).

could suggest that a previously purchased QLAC is ignored in determining the account balance against which subsequent premiums are measured in applying the percentage limit to the subsequent premiums.

Such an approach would mean that QLACs funded with multiple premiums could effectively be subject to a lower limitation relative to QLACs purchased with a single premium.[34] This would not seem to be the right result because some individuals may find it more attractive, convenient, or affordable to purchase QLACs with multiple premium payments. Such individuals should be permitted to purchase just as much longevity insurance protection as those who are more willing (or in a better position) to pay a single premium. Accordingly, we ask the Treasury Department and the Service to clarify that for purposes of applying the 25% limit, the rule that ignores the QLAC in determining the account balance does not apply.

D. Clarifying the Treatment of Premiums Paid for Non-QLACs

The proposed regulations state that the premium limits apply based on premiums paid for any contract that is "intended" to be a QLAC.[35] If read literally, this would mean that, even if a QLAC inadvertently fails to qualify as such, the premiums paid for that non-compliant contract would count against the premiums the individual could pay for a compliant QLAC. This could lead to inappropriate results.

A QLAC could become "disqualified" for a number of reasons. For example, a premium could be paid in excess of the applicable limit. If this were to occur, and our recommendation above to disqualify the contract only to the extent of the excess premium is adopted, then the adverse consequences would be somewhat muted because the compliant portion of the QLAC would exhaust the individual's capacity to pay further premiums. If, however, the QLAC is disqualified for reasons unrelated to the premium limits (such as due to a contract feature that is not permitted), then the entire contract would be disqualified.

In such case, the non-compliant QLAC would be reflected in the individual's account balance for purposes of calculating RMDs, and the individual would take RMDs with respect to the contract just like any other asset in the account that must be valued and reflected in the RMD calculation. Thus, a non-compliant QLAC will result in no additional tax deferral relative to the deferral otherwise permitted under the RMD rules. In such cases, the individual should be allowed to pay premiums for compliant QLACs up to the full limit without regard to non-

[34] For example, assume that the prior year-end account balance of an IRA was $100,000. The individual could pay QLAC premiums up to $25,000 in the current year, but he pays only $10,000. At year-end, his account balance is $90,000 due to the QLAC premium (assuming no investment gains or losses). The next year's premium limit would be 25% of $90,000, or $22,500. Thus, the premium limit would decrease solely because a QLAC was purchased in the prior year.

[35] *See*, *e.g.*, Prop. Treas. Reg. section 1.401(a)(9)-6, Q&A-17(b)(2)(ii)(B) and (3)(ii)(B).

compliant QLACs. In light of the foregoing, we request a clarification that only those premiums paid for compliant QLACs count towards the premium limits.

E. Clarifying the Aggregation Rules for SEPs, SIMPLEs, and Traditional IRAs

The proposed regulations include an aggregation rule for IRAs for purposes of the 25% limit.[36] Under the current regulations, simplified employee pensions within the meaning of section 408(k) (SEPs) and SIMPLE IRAs within the meaning of section 408(p) are treated as IRAs for purposes of the RMD rules.[37] As a result, it appears that SEPs and SIMPLE IRAs are aggregated with traditional IRAs for purposes of the 25% limit. Clarification on this point in the final regulations would be helpful, however.[38]

IV. Clarifying Reporting and Recordkeeping Requirements

The QLAC regulations will be more effective if sponsors of employment-based plans can easily offer QLACs to plan participants. As a result, it is important to ensure that offering a QLAC will not result in unnecessary or burdensome administrative requirements. There should be a seamless interface between the insurer and the service provider that assists the plan sponsor with compliance. This is particularly important where the QLAC is offered as part of an "in-plan" investment option, allowing participants to accumulate deferred annuity income over time. To meet this goal, we recommend that the Treasury Department coordinate with DOL to address various technical questions that could arise with QLACs offered in plans governed by ERISA.

For example, ERISA section 105(a), as amended by the Pension Protection Act of 2006, provides that DC plans must furnish participants with pension benefit statements on a regular basis (quarterly for participant-directed plans). The statute requires that the statement indicate, on the basis of the latest available information, the total and nonforfeitable benefits that have accrued.[39] In addition, if the plan allows participants to direct the investment of their accounts, the statement must show the "value" of each investment in the participant's account "determined as of the most recent valuation date under the plan."[40]

DOL intends to propose implementing regulations, and has advised plans to act, in the interim, in good faith with a reasonable interpretation of the requirements.[41] We urge the

[36] Prop. Treas. Reg. section 1.408-8, Q&A-12(b)(2)(ii)(B) and (3)(ii)(B).

[37] Treas. Reg. section 1.408-8, Q&A-2.

[38] The preamble also asks for comments on whether certain changes are needed to the manner in which Roth IRAs would be treated under the regulations. We believe the proposed regulations treat Roth IRAs appropriately.

[39] ERISA section 105(a)(2)(A)(i).

[40] ERISA section 105(a)(2)(B)(i).

[41] *See* Dep't of Labor, Employee Benefits Security Administration Regulatory Agenda, RIN 1210-AB20 (Fall 2011), *available at* http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201110&RIN=1210-AB20;

(continued …)

Treasury Department and the Service to work with DOL to ensure that plans can comply with the benefit statement rules with respect to a QLAC held in a participant's account without undue administrative burden. For example, to the extent that a QLAC must be reflected on the statement, plans should have flexibility, working with the insurer, in how the QLAC is described and valued.[42] One workable solution would be to base the value of the QLAC for purposes of these and similar rules on the premiums paid for the QLAC.[43] We intend this flexibility for reporting and similar rules that do not directly affect a participant's or beneficiary's rights.

Similarly, under some circumstances a QLAC may need to be described in the participant disclosure required under DOL's new ERISA section 404(a) regulation.[44] These rules require certain disclosures to be made where a plan investment option permits participants to allocate contributions to the current purchase of a stream of income guaranteed by an insurance company. This information is not the same as that required under the proposed QLAC regulations.[45] We urge the Treasury Department and the Service to work with DOL to identify where the disclosures can be harmonized.

Finally, we note that IRS Form 5498 requires IRA issuers, custodians, and trustees to report certain information regarding IRAs, including the year-end fair market value (FMV) of the account. The preamble to the proposed regulations states that, for Form 5498 purposes, the FMV of an IRA includes the value of any QLAC it holds, even though the QLAC's value is ignored when determining the account balance for RMD purposes.[46] In some (or many) cases, IRA owners presumably look to the FMV shown on their copy of Form 5498 when calculating their RMDs. If that FMV includes the value of a QLAC the IRA holds, the owner might mistakenly include the QLAC's value in his or her account balance for RMD purposes. We ask that the Treasury Department and Service consider this potential for confusion when finalizing the regulations. In addition, to the extent that clarifications are made regarding how QLACs should be reflected on benefit statements under employer-sponsored plans, we urge that the same clarifications be applied to IRAs for purposes of Form 5498. This will ease administrative

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Dep't of Labor, Field Assistance Bulletin 2006-03 (Dec. 20, 2006), *available at* http://www.dol.gov/ebsa/regs/fab_2006-3.html.

[42] We note that a QLAC's "value" is unlikely to change as frequently as market-based investments such as stock and bond mutual funds, because the QLAC's value is based largely on age and the proximity to the ASD. As a result, daily reporting of QLAC values to participants in ERISA plans is likely to be of little utility to participants and could involve administrative difficulties that discourage some plans from offering QLACs.

[43] Committee members have indicated that valuing a QLAC using the total premiums paid may be the easiest method to administer on DC plan recordkeeping systems. Because this market is not fully developed, however, we recommend that Treasury and DOL regulations provide plans with flexibility as to the method used, so long as the method used is applied consistently by the plan.

[44] 29 C.F.R. section 2550.404a-5.

[45] *Compare* 29 C.F.R. section 2550.404a-5(i)(2)(ii) and Prop. Treas. Reg. section 1.6047-2.

[46] 77 Fed. Reg. 5450.

burdens by imposing only a single set of valuation reporting rules for insurance companies regardless of whether they issue QLACs to employer plans or IRAs.

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In closing, we would like to commend the Treasury Department and the Service for publishing the proposed regulations. While our comments suggest ways that we believe the regulations could be modified to encourage even more individuals to purchase longevity insurance, the Committee is very pleased with the regulations overall and we think they should be finalized as soon as possible. We look forward to continuing a dialogue with the government on the important issue of longevity risk, including during our testimony at the June 1st hearing on the proposed regulations. In the meantime, should any questions arise with respect to our comments or the issue of longevity risk more generally, please do not hesitate to contact the Committee's counsel Joe McKeever (jfmckeever@davis-harman.com), Bryan Keene (bwkeene@davis-harman.com), Mike Hadley (mlhadley@davis-harman.com), or Mark Griffin (megriffin@davis-harman.com). All can be reached at 202-347-2230 as well.

Sincerely,

Joseph F. McKeever, III

Bryan W. Keene

Attachment

The Committee of Annuity Insurers
The Willard Office Building
Suite 1200
1455 Pennsylvania Ave., NW
Washington, D.C. 20004

Allstate Financial, Northbrook, IL
Aviva USA, Des Moines, IA
AXA Equitable Life Insurance Company, New York, NY
Commonwealth Annuity and Life Insurance Co.
(a Goldman Sachs Company), Southborough, MA
CNO Financial Group, Carmel, IN
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc, New York, NY
Hartford Life Insurance Company, Hartford, CT
ING North America Insurance Corporation, Atlanta, GA
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Life Insurance Company of the Southwest, Dallas, TX
Lincoln Financial Group, Fort Wayne, IN
MassMutual Financial Group, Springfield, MA
Metropolitan Life Insurance Company, New York, NY
Nationwide Life Insurance Companies, Columbus, OH
New York Life Insurance Company, New York, NY
Northwestern Mutual Life Insurance Company, Milwaukee, WI
Ohio National Financial Services, Cincinnati, OH
Pacific Life Insurance Company, Newport Beach, CA
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Prudential Insurance Company of America, Newark, NJ
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Ameriprise Financial Company), Minneapolis, MN
SunAmerica Financial Group, Los Angeles, CA
Symetra Financial, Bellevue, WA
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The Committee of Annuity Insurers was formed in 1981 to participate in the development of federal tax and securities law policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.

May 3, 2012