

The DOL Clarifies Its Safe Harbor Guidance for Selecting Annuity Providers and Contracts for Defined Contribution Plans

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In 2008, the Department of Labor (DOL) issued a safe-harbor regulation for plan investment fiduciaries regarding a prudent process for selecting and monitoring annuity providers and contracts for defined contribution plans (the "Safe Harbor Rule"). In Field Assistance Bulletin (FAB) [2015-2](#) (the "FAB"), issued this past summer, the DOL provides guidance that clarifies the Safe Harbor Rule, in response to what the DOL says is a "recurring comment" from plan fiduciaries that the Safe Harbor Rule remains unclear as to the scope of their obligations with respect to selecting annuities.

In particular, the DOL says questions continue to be raised about how to reconcile the "time of selection" standard in the Safe Harbor Rule — "which embodies the general principle that the prudence of a fiduciary decision is evaluated under ERISA based on the information available at the time the decision was made" — with the fundamental fiduciary obligations to continue to monitor and review fiduciary decisions. The DOL also expresses concern that "confusion or lack of clarity regarding the nature and scope of fiduciary responsibilities to act prudently in making, monitoring and reviewing annuity selections under a defined contribution plan could lead plan sponsors or their advisors in some instances to overestimate or otherwise misunderstand the duration or extent of those fiduciary responsibilities." And, these problems could amount to disincentives to offering plan participants annuities as a lifetime distribution option. To address these concerns, the FAB focuses on the issue of how to apply the "time of selection" standard of the Safe Harbor Rule.

Somewhat unfortunately, the FAB does not address the extent to which, if at all, the Safe Harbor Rule applies to the selection of insurance companies and products providing for guaranteed payments *other* than an immediate annuity or a qualifying longevity annuity contract (a "QLAC") option. However, the DOL does note in the FAB that "The Department is considering guidance on fiduciary selection and monitoring of annuity providers and contracts that are offered as investment options under defined contribution plans as part of its project on the Department's regulatory agenda to evaluate possible amendments to the Safe Harbor Rule." Until such guidance is provided, plan investment fiduciaries will have to rely on the general fiduciary standards described below, including the Safe Harbor Rule.

General Fiduciary Standards

ERISA imposes high standards upon fiduciaries responsible for managing the operations of retirement plans. Section 404(a) of ERISA sets forth the key fiduciary duties of: (i) absolute loyalty to the plan participants and their beneficiaries (e.g., the requirement to act solely in their best interests); (ii) the exclusive purpose requirement (e.g., to duty provide benefits at a reasonable cost); and (iii) the prudent person rule (e.g., the requirement to act with the care, skill, prudence and diligence of what amounts to an expert). ERISA does not specifically explain how fiduciaries must fulfill these duties; however, the DOL explains the relevant standards through advisory opinions, regulations and other guidance.

Specifically, in describing a prudent selection process for an annuity provider, the DOL explained what is required of a fiduciary by stating in [Interpretive Bulletin 95-1\(c\)](#) as follows:

“In addition, the fiduciary obligation of prudence... requires, at a minimum, that plan fiduciaries conduct an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities.”

Clearly, this guidance requires fiduciaries to be diligent in gathering relevant data and analyzing it thoroughly and objectively for the purpose of making informed decisions that are in the best interest of the plan, its participants and beneficiaries.

Furthermore, under ERISA plan fiduciaries have an ongoing duty to prudently monitor and evaluate service providers, investments and other plan activities. That is, fiduciaries must review their decisions periodically to ensure that they continue to be prudent in light of the current circumstances of the plan. And this duty to monitor must be carried out using the same prudent process required with respect to the initial fiduciary decision. (See [DOL Interpretive Bulletin 96-1\(e\)](#).)

Specific Fiduciary Standards and DOL Safe Harbor Guidance for Selecting Annuities and Annuity Providers for a Defined Contribution Plan

The determination of which annuities and providers to offer retirement plan participants is a fiduciary decision, as it is an exercise of discretion regarding management and control of a plan and its assets, as described in ERISA §3(21). And, as is the case with any investments offered to plan participants, the fiduciaries responsible for administering the plan must engage in a prudent decision-making process regarding the selection and retention of those annuities. That is, the process must be carried out in accordance with the ERISA standards of (i) the “duty of loyalty”; (ii) the “exclusive purpose requirement” and (iii) the “prudent person rule.” Furthermore, the fiduciary must make certain the process by which it makes the relevant selections is free from self-dealing and conflicts of interest, and it should include consideration of multiple annuity providers; that is, it should be a truly independent and informed decision. (See [ERISA §404\(a\)\(1\)\(B\)](#), [DOL Reg. §2550.404a-1](#), the preamble to [DOL Reg. §2550.404c-5\(b\)\(1\)](#) and the Safe Harbor Rule, discussed below.) Then, after the selections have been made, the fiduciaries have a duty to periodically re-evaluate (monitor) these decisions to make sure they continue to be appropriate for the plan, its participants and their beneficiaries.

With respect to the selection of an annuity provider for a defined contribution plan, the DOL provides guidance in [Reg. §2550.404a-4](#). This regulation does not establish the exclusive means by which a plan fiduciary satisfies its responsibilities with respect to the selection of an annuity contract and/or provider, but it does serve as important guidance, and particularly so because it contains the Safe Harbor Rule in subparagraph (b) thereof.

The Safe Harbor Rule describes actions that defined contribution plan fiduciaries can take to satisfy their ERISA fiduciary responsibilities in selecting annuities and their providers. According to the DOL, 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.

For purposes of the forgoing requirements, the DOL explains that "the time of selection" means:

- the time that the annuity provider and contract are selected for distribution of benefits to a specific participant or beneficiary; or
- the time that the annuity provider is selected to provide annuities as a distribution option for participants or beneficiaries to choose at future dates.

Consistent with the duty to monitor, the Safe Harbor Rule provides that when an annuity provider is selected to offer annuities that participants may later choose as a distribution option, the fiduciary must periodically review the continuing appropriateness of the conclusion that the annuity provider is financially able 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. **The fiduciary is not, however, required to review the appropriateness of its conclusions with respect to an annuity contract purchased for any specific participant or beneficiary**, as is made clear in paragraph (c)(2) of the Safe Harbor Rule.

The FAB cites authority from a number of court cases in explaining that fiduciary prudence is to be "evaluated with respect to the information available at the time the decision is made — and not based on facts that come to light only with the benefit of hindsight." Furthermore, to clarify the

timeline for a fiduciary's ongoing duty to monitor annuity products, the DOL states in the FAB that the "fiduciary's selection and monitoring of an annuity provider is judged based on the information available at the time of the selection, and at each periodic review, and not in light of subsequent events."

With respect to the periodic review requirement of the Safe Harbor Rule, the FAB states in relevant part as follows:

The periodic review requirement . . . 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 distribution option. The frequency of periodic reviews to comply with the Safe Harbor Rule depends on the facts and circumstances. For example, if a "red flag" about the provider or contract comes to the fiduciary's attention between reviews (e.g., a major insurance rating service downgrades the financial health rating of the provider or several annuitants submit complaints about a pattern of untimely payments under the contract), the fiduciary would need to examine the information to determine whether an immediate review is necessary, or, depending on the facts and circumstances, the fiduciary may need to conduct an immediate review.

By way of an example regarding the purchase of an immediate annuity, the DOL confirms that once an annuity contract is actually selected for a particular participant or beneficiary, future changes in the qualifications (suitability) of the annuity provider are not applicable to the determination of whether the fiduciary acted prudently in selecting the provider, because that issue is to be assessed as of the date the annuity was purchased, and not thereafter. That is, there is no fiduciary duty to review the appropriateness of any annuity that has already been purchased. In a second example, regarding the purchase of a deferred annuity (a QLAC), the DOL confirms that the duty to monitor an annuity provider ends when the plan stops offering annuities from that provider, and not when all the annuities from that provider have been paid out. Thus, the FAB clarifies any confusion that may have led some to erroneously conclude that the duty to monitor extends beyond the time when purchases from an annuity provider cease.

Final Comments

As with any investment or product offered to plan participants, fiduciaries must be careful to engage in a prudent, thoughtful process of gathering relevant information, assessing that information and making informed, well-reasoned decisions both about whether to offer annuities and, if so, which providers and products best fit the particular needs of the plan participants.

The applicable standards require the fiduciaries to engage "in an objective, thorough and analytical search in identifying and selecting providers" (DOL Reg. § 2550.404a-4(b)(1)). And, even if the Safe Harbor Rule is not used, plan investment fiduciaries should, at a minimum, undertake a process to gather information regarding competing providers. This information will provide the fiduciaries with a reasonable starting point to assess what the DOL indicates they have an absolute duty to assess — that is, costs, product features, the financial stability of the annuity provider, and administrative capabilities of competing providers.

The fiduciaries must then determine **at the time they are making the decision** regarding annuities and annuity provider, and with the advice of experts to the extent necessary (see DOL Reg.

§2550.404a-4(b)(5)), that the information they have gathered and analyzed reasonably supports a determination that the annuity product is suitable for the plan and the provider is financially able to make future payments under the contract, and that the cost of the contract is reasonable in view of the benefits and services to be provided (see DOL Reg. § 2550.404a-4(b),(2) and (4)). Thereafter, the fiduciaries must continue to periodically assess the appropriateness of the annuity and the annuity provider as facts and circumstances change (DOL Reg. § 2550.404a-4(c)).

Finally, as a matter of best practices, both the initial and ongoing evaluative processes should be captured in writing with sufficient detail to substantiate compliance with the ERISA's high fiduciary standards.

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