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VIA ELECTRONIC DELIVERY

June 7, 2019

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2019-30) Room 5203
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Recommendations for 2019-2020 Priority Guidance Plan

To whom it may concern:

We are writing on behalf of the Committee of Annuity Insurers (the "Committee") in response to the invitation in Notice 2019-30 for public recommendations of items to include on the 2019-2020 Priority Guidance Plan. The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal policy with respect to tax, securities, ERISA, and banking law issues affecting annuities. The Committee's current 31 member companies represent over 80% of the annuity business in the United States. A list of the Committee's member companies is attached as Exhibit A.

Annuities are vital to the retirement security of millions of Americans. Other than Social Security and defined benefit plans, annuities are the only means that Americans have to guarantee they will not outlive their retirement income. Nevertheless, certain aspects of the section 401(a)(9) required minimum distribution ("RMD") regulations discourage and in some cases effectively prohibit individuals from receiving their benefits from qualified plans and IRAs as a life annuity. There is a pressing need for guidance to eliminate these barriers to the use of life annuities to distribute retirement benefits. In particular, the Committee urges the Treasury Department and Internal Revenue Service ("IRS") to include the following items on the 2019-2020 Priority Guidance Plan:

(1) **Minimum income threshold test.** Treas. Reg. section 1.401(a)(9), Q&A-14(c), requires commercial annuities to pass a minimum income threshold test ("MITT") if they provide certain types of benefits that the regulations characterize as "increasing." The MITT requires the use of a life expectancy table that has become outdated and that does not comport with industry practices in pricing life annuity payouts, particularly for single life annuities. This, combined with a historically prolonged period of low interest rates, has caused traditional and common forms of life annuities, such as a level-pay life annuity with a refund benefit, to fail the MITT in irrational circumstances, rendering these annuities unavailable to many retirees seeking lifetime income. These problems have persisted for over 10 years with no relief. To eliminate the problems, the regulations should be amended as soon as possible to (a) permit the use of the Uniform Lifetime Table ("ULT") of Treas. Reg. section 1.409(a)(9)-9 when applying the MITT to single life and joint life annuities, instead of requiring the use of single life and joint life tables, respectively, of that regulation, and (b) apply to commercial annuities the same 5% cap on annual payment increases that applies to defined benefit plans pursuant to Treas. Reg. section 1.401(a)(9)-6, Q&A-14(d)(1).

(2) **Qualifying longevity annuity contracts.** Treas. Reg. section 1.401(a)(9)-6, Q&A-17, prescribes rules for qualifying longevity annuity contracts ("QLACs"). Such contracts generally are subject to the MITT. In addition, they are subject to contribution limits that differ between qualified plans and IRAs and to death benefit rules that differ between spouse and non-spouse beneficiaries. Guidance is needed to (a) clarify how the MITT applies to QLACs in light of their unique characteristics that were not contemplated when the MITT was created, (b) clarify the contribution limits when a QLAC is purchased *via* rollover from a qualified plan to an IRA, and (c) clarify the QLAC rules governing spousal death benefits in the event of divorce.

(3) **Timing of annuity payments.** It is important for retirees to have the flexibility to receive short-term advances of some of their future annuity payments. This flexibility encourages annuitization by addressing prospective policyholders' concerns over lost liquidity. It is not clear whether such short-term accelerations are permitted in light of the rules under Treas. Reg. section 1.401(a)(9)-6 limiting "increasing" payments (Q&A-14(c)(4) and (e)(4)) and requiring the interval between payments to be "uniform" (Q&A-1(a)). Guidance is needed to clarify that these rules do not preclude these types of payment advances.

Notice 2019-30 identifies seven criteria that the Treasury Department and the Service will consider in reviewing recommendations and selecting additional projects for inclusion in the 2019-2020 PGP. Attached as Exhibit B is a brief statement demonstrating that the Committee's recommendations satisfy all of these criteria. Also attached as Exhibit C is a memorandum further discussing these issues and the guidance we are requesting.

Should any questions arise, please contact any of the undersigned.

Sincerely,

Joseph F. McKeever | Mark E. Griffin | Bryan W. Keene

Attachments

Exhibit A June 7, 2019

The COMMITTEE of ANNUITY INSURERS

AIG Life & Retirement, Los Angeles, CA
Allianz Life Insurance Company, Minneapolis, MN
Allstate Financial, Northbrook, IL
Ameriprise Financial, Minneapolis, MN
Athene USA, Des Moines, IA
AXA Equitable Life Insurance Company, New York, NY
Brighthouse Financial, Inc., Charlotte, NC
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Global Atlantic Financial Group, Southborough, MA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc., New York, NY
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Lincoln Financial Group, Fort Wayne, IN
Massachusetts Mutual Life Insurance Company, Springfield, MA
Metropolitan Life Insurance Company, New York, NY
National Life Group®, Montpelier, VT
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
Protective Life Insurance Company, Birmingham, AL
Prudential Insurance Company of America, Newark, NJ
Sammons Financial Group, Chicago, IL
Symetra Financial, Bellevue, WA
Talcott Resolution, Windsor, CT
TIAA, New York, NY
The Transamerica companies, Cedar Rapids, IA
USAA Life Insurance Company, San Antonio, TX

The Committee of Annuity Insurers was formed in 1981 to participate in the development of federal policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.

Exhibit B

(1) Whether the recommended guidance resolves significant issues relevant to many taxpayers

- The Committee of Annuity Insurers' 31 member companies represent more than 80% of the U.S. annuity market. The barriers to the use of life annuities created by the MITT affect the customers of all 31 companies, who routinely encounter situations where the regulations are preventing current deferred annuity owners as well as potential immediate annuity purchasers from electing the common forms of life annuity options they desire. There is every reason to think the problems are similarly affecting the customers of the remaining 20% of the industry.

- We estimate that approximately 3 million households own individual annuities in connection with IRAs, *i.e.*, either IRA annuities or annuities held as an asset of IRA custodial or trust accounts.[1] All of these households will be (or already have been) limited in their choice of an RMD distribution option because of the MITT.

- There are at least 4.5 million and possibly as many as 8.2 million workers who participate in defined contribution plans that offer an annuity payout option, as of 2017.[2] All of these participants could be limited in their choice of a lifetime income option for their plan savings because of the MITT. Furthermore, given how few defined contribution plans makes QLACs available to participants, virtually all of these workers could benefit from guidance clarifying the QLAC premium limits to facilitate QLAC purchases *via* rollovers to IRAs.

- The Committee's recommended guidance on payment intervals would clarify the treatment of short-term payment accelerations for all individuals who receive or will receive in the future annuity payments from an IRA or a defined contribution plan. As indicated above, as of 2017, there are 3 million individuals who currently own an IRA annuity or an annuity held as an asset of an IRA account. There are also between 4.5 and 8.2 million workers who participate in a defined contribution plan that offers an annuity option, again, as of 2017.

[1] We estimated the number of households by dividing the total IRA assets held by life insurance companies in 2017 ($649 billion) by the amount held in traditional IRAs by the average household in mid-2017 ($223,647), which in turn is calculated by dividing the total assets held in traditional IRAs ($7.85 trillion) by the number of households with traditional IRAs (35.1 million). *See* Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release Z.1, *Financial Accounts of the United States*, Second Quarter 2018, p. 132 (IRA assets held by life insurance companies) and Investment Company Institute, *2018 Investment Company Fact Book*, figure 8.18, p. 186, available at www.icifactbook.org.

[2] *See generally* United States Department of Labor, *National Compensation Survey* (accessed July 23, 2018), https://www.bls.gov/ncs/. The National Compensation Survey provides data that can be used to calculate the number of workers who participate in different types of defined contribution plans that have access to an annuity payout option: savings and thrift plans (4.5 million), deferred profit sharing plans (1 million), and money purchase plans (2.7 million). Some overlap exists between the categories, so it is not possible to determine the exact number of workers who participate in a defined contribution plan that offers an annuity payout option. However, the true number is likely close to the sum of the categories, 8.2 million.

(2) Whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service

- None of the recommended guidance involves controversy. However, all the recommended guidance reduces burdens on taxpayers to varying extents. For example, the MITT guidance will make it far easier for life insurance companies, insurance agents, and taxpayers who are considering purchasing a life annuity to understand which annuities will satisfy the RMD requirements and which will not. Similarly, the recommended QLAC guidance will make it far simpler for taxpayers to purchase a QLAC by rolling funds from a defined contribution plan to an IRA and to understand when QLAC death benefits are permitted or not. Finally, the recommended guidance on annuity payment intervals will facilitate the ability of annuitants to access retirement funds that are being paid as life annuities and are otherwise generally illiquid.

(3) Whether the recommendation involves existing regulations or other guidance that is outdated, unnecessary, ineffective, insufficient, or unnecessarily burdensome and that should be modified, streamlined, expanded, replaced, or withdrawn

- All of the Committee's recommendations involve the required minimum distribution regulations.

- The recommendations involving the MITT relate to regulations that are outdated. They are based on interest rates and mortality that have changed materially since the regulations were issued. The MITT regulations also are ineffective because they commonly block the issuance of life annuity contracts that do not involve the concern that the MITT was designed to address, *i.e.*, inappropriate tax deferral.

- The recommendations involving QLACs and annuity payment intervals relate to regulations that are insufficient because they fail to address the significant issues on which we request guidance.

(4) Whether the recommended guidance would be in accordance with Executive Order 13771 (82 FR 9339), Executive Order 13777 (82 FR 12285), Executive Order 13789 (82 FR 19317), or other executive orders

- Executive Order 13777 directs each agency to identify regulations that are "outdated, unnecessary, or ineffective."[3] The portions of the MITT regulations that the Committee recommends be modified are compelling examples of outdated, unnecessary, and ineffective regulations. Furthermore, they "add undue complexity to the Federal tax laws." In contrast, the Committee's recommended guidance with respect to the MITT, QLACs, and annuity payment intervals would provide "useful, simplified tax guidance"

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[3] Executive Order No. 13777, 82 Fed. Reg. 12,285 (Mar. 1, 2017).

to taxpayers.[4] Thus, issuing guidance on these items is fully consistent with, and would help the Treasury Department and the IRS implement, the president's regulatory reform agenda.

- Executive Order No. 13847[5] directs the Treasury Department to consider updating the life expectancy tables under the RMD regulations.

- The Committee's recommended guidance can comply with Executive Order 13771.

(5) Whether the recommended guidance promotes sound tax administration

- The recommended guidance would simplify existing rules and provide guidance where no guidance currently exists, both of which promote better tax administration.

(6) Whether the Service can administer the recommended guidance on a uniform basis

- All of the recommendations involve creation of bright line rules which will not require the exercise of administrative discretion.

(7) Whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance

- As noted above, all of the recommendations involve creation of bright line rules which will be easily understood. Also, in the case of the MITT, the recommended guidance will replace complex rules that few taxpayers can understand or apply.

[4] Executive Order 13789, 82 Fed. Reg. 19,317 (Aug. 26, 2017).

[5] Executive Order 13847, 83 Fed. Reg. 45,321 (Sept. 6, 2018).

GUIDANCE NEEDED ON THE TREATMENT OF ANNUITY PAYMENTS UNDER THE SECTION 401(a)(9) REQUIRED MINIMUM DISTRIBUTION REGULATIONS

The Treasury Department has focused significant effort in recent years on the important goal of encouraging greater availability and use of lifetime income options in defined contribution ("DC") plans and IRAs. These efforts have included amendments to the required minimum distribution ("RMD") regulations under section 401(a)(9) to facilitate qualifying longevity annuity contracts ("QLACs") and other helpful guidance regarding life annuities.[1] Nevertheless, certain provisions of the RMD regulations continue to discourage, and in some cases prevent, individuals from receiving common forms of life annuity benefits from DC plans and IRAs.

The Treasury Department's laudable goals on lifetime income can be further advanced by eliminating these remaining barriers to life annuities under the RMD regulations. There are three issues in particular, all arising under the Q&As in Treas. Reg. section 1.401(a)(9)-6, that need to be addressed:

- The Minimum Income Threshold Test ("MITT"): Q&A-14 limits the use of an annuity that provides payments the regulations characterize as "increasing." This provision is meant to preclude inappropriate tax deferral by limiting the ability to backload annuity payments. In practice, however, it is precluding common forms of life annuities in circumstances that do not advance the intended policy goal and instead detract from the broader goal of facilitating access to lifetime income.

- Qualifying Longevity Annuity Contracts: Q&A-17 provides important and very helpful guidance on QLACs, but there are several provisions that create uncertainty and thus discourage the use of QLACs in some situations.

- Annuity Payment Interval: Q&A-1(a) addresses the required interval between annuity payments. This provision suggests that certain types of short-term annuity payment advances are not allowed, such as an advance of three months' payments with monthly payments resuming thereafter. This unnecessarily limits liquidity in a way that discourages the election of a life annuity.

The remainder of this memorandum discusses these issues and the Committee of Annuity Insurers' proposals for addressing them.

(1) Minimum Income Threshold Test

(a) Background

The regulations under section 401(a)(9) require annuity payments to be non-increasing, subject to certain exceptions.[2] Other than in the case of certain cost of living adjustments, any

[1] Unless otherwise indicated, our references to "section" or "sections" mean sections of the Internal Revenue Code of 1986, as amended.

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

form of increasing payment under a commercial annuity must satisfy the MITT.[3] For example, the MITT applies to commercial annuity contracts that (i) provide for annuity payments that increase by a constant percentage each year (*e.g.*, 3%), (ii) provide for annuity payments that may increase due to dividends (*i.e.*, participating annuities), (iii) provide an acceleration option such as a partial or full commutation, and (iv) provide a cash refund payable on the annuitant's death (collectively, "increasing benefits").[4]

The preamble to the final regulations explains that the MITT is designed to ensure "that annuity payments start at a high enough amount to prevent inappropriate deferral."[5] To this end, the MITT requires that the "total future expected payments" must exceed the total value being annuitized.[6] For these purposes the total future expected payments are calculated based on the Single Life Table (SLT) in the regulations (or the Joint and Last Survivor Table (JLT) in the case of a joint and last survivor annuity), without regard to any increases in annuity payments after the first payment and taking into account any period certain.[7]

(b) Problems under the MITT

The MITT has been problematic since it was adopted because of its breadth, mechanics, and consequences on the use of life annuities that provide increasing benefits. It reflects a tilt in the regulations that favors non-annuitized accounts over life annuities. Specifically, RMDs from a non-annuitized account are determined using the ULT, which is a joint and survivor table that assumes the participant has named a beneficiary who is 10 years younger. This joint life table is used to determine RMDs from non-annuitized accounts even if the participant has not named a beneficiary.[8] Thus, all individual account owners get the benefit of a joint life assumption.

In contrast, if a participant elects a single life annuity with one of the common benefits referenced above, the MITT requires a single life assumption based on the SLT to be used in determining the "total expected future payments" under the annuity. Using the SLT rather than the ULT reduces the "total future expected payments," thereby making it more difficult to pass the MITT than if the ULT were used, as it is for individual accounts even where there is no beneficiary. As a result, the MITT has for years prevented traditional forms of increasing benefits from being used in a variety of arbitrary circumstances where it is likely that all would agree there is no "inappropriate tax deferral."

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

[4] *Id*.

[5] Required Distributions from Retirement Plans, 69 Fed. Reg. 33,288, at 33,291 (June 15, 2004) (preamble to final regulations).

[6] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c), (e)(1), and (e)(3).

[7] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(3). The Single Life Table is found in A-1 of Treas. Reg. section 1.401(a)(9)-9 and the Joint and Last Survivor Table is found in A-3 of the same regulation.

[8] Treas. Reg. section 1.401(a)(9)-5, Q&A-4.

The problem has gotten far worse in recent years, however. Mortality improvements since the MITT was created, combined with a prolonged period of historically low interest rates, have had the effect of reducing the dollar amount of a life annuity benefit that can be provided under a commercial annuity for any given amount of premium. Lower interest rates reduce the amount of an annuity payment purchased by a given premium (all other things being equal) because the insurer has lower earnings on the premium to fund the future annuity payments. Similarly, increased longevity means that the number of future payments the insurer will make for a given premium will be greater, which means the dollar amount of each payment will be less (all other things being equal). In short, the total dollar amount of payments an individual will receive for a given premium today are considerably less than an individual of the same age and sex who purchased the same annuity 15 years ago would have received.

For a life annuity to pass the MITT, the "total future expected payments" must exceed the total value being annuitized (generally the premium for the annuity). Because the regulations require the "total expected future payments" to be determined not by summing the expected number of payments that will be made as determined by the insurer based on current mortality expectations, but rather by summing the expected number using the outdated life expectancy tables in the regulations, the dollar amount of the "total future expected payments" will always be smaller than those the insurer has assumed for the premium paid. Thus, we have a circumstance where changing financial conditions and increased longevity combined with the artificial and increasingly erroneous SLT limitation of the MITT have greatly depressed one side of the equation – total expected future payments – while holding constant the other side – the actual premium paid. This, of course, has resulted in an ever smaller excess of the total expected future payments over the premium paid, making it increasingly difficult for a life annuity contract with common forms of increasing benefits to comply with the MITT.

As a result, traditional forms of life annuities are often unavailable to DC plan participants and IRA owners because they would violate the RMD rules. The following are examples from recent experiences of the Committee's member companies:

- A company found that a level-payment life annuity with a lump sum return of premium death benefit fails the MITT if issued to a 72-year-old but not if issued at other ages.

- A company found that an individual age 70 cannot purchase a life annuity with a 3% annual increase and a lump sum return of premium at death.

- A company determined that annual percentage increases would need to be less than 2% in order for its life annuities to pass the MITT. The company concluded that increases that small are not marketable as an effective hedge against inflation,[9] so the company currently does not offer any annual percentage increases under its annuities at all.

[9] *See* BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, CPI DETAILED REPORT: DATA FOR JUNE 2017, at 72-75 tbl.24 (Malik Crawford et al. eds., 2017), *available at* https://www.bls.gov/cpi/tables/detailed-reports/home.htm (showing inflation rates generally exceeding 2% per year).

- Companies generally find that life annuities with lump sum return of premium death benefits fail the MITT more often than life annuities with period certain features, despite the fact that the former distribute benefits more rapidly than the latter.

(c) Update the MITT

In view of the problems described above, the Committee requests that the MITT be updated to:

(1) Permit the use of the ULT when applying the MITT to single life and joint life annuities, instead of requiring the use of the SLT and JLT, respectively,[10] and

(2) Apply the same 5% cap on annual payment increases under commercial annuities that applies to defined benefit plans.

This approach would eliminate a real and significant barrier to life annuities while continuing to impose appropriate limits on back-loaded payouts. For example, using the ULT when applying the MITT would provide needed relief for the four types of annuity benefits described above, without the need to specifically exempt those benefits from the test.

Allowing the ULT to be used in the MITT also would eliminate the disparity in the regulations that favors non-annuitized accounts over life annuities. The regulations currently allow the ULT to be used to determine RMDs from non-annuitized accounts even if the participant has not named a beneficiary, while the MITT requires a single life assumption based on the SLT. This disparity itself discourages the election of life annuities because it allows for smaller distributions – and thus lower tax burdens – from individual accounts than life annuities. A tax disincentive to electing a life annuity is particularly inappropriate given that individuals already are often reluctant to elect a life annuity despite the substantial benefits of doing so.

Research suggests that the reasons for this reluctance include (1) a behavioral response to the risk-pooling nature of insurance, *i.e.*, the fear of financially "losing" if early death prevents the payment of at least a significant amount of cash benefits under the contract, and (2) a perceived loss of "control" over one's savings, because converting a lump sum into a series of life annuity payments often involves a corresponding reduction in liquidity with respect to the annuitized sum.[11] Not only do the RMD rules add a tax disincentive to these behavioral barriers

[10] Use of the ULT in the MITT should be optional and not mandatory. For example, in the case of a joint and survivor annuity, taxpayers should continue to be allowed to use the JLT when applying the MITT to their contracts. This would be desirable, for example, if the joint annuitant was a spouse who is 10 years younger than the participant.

[11] *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 October 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 March 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=978246 (similar).

to life annuities, the MITT also has been precluding the availability of life annuity options that are expressly designed to address those behavioral barriers, namely, return of premium death benefits and acceleration rights.

Based on the foregoing, we urge the Treasury Department to update the MITT to allow the use of the ULT in the manner described above. Doing so would create parity between the treatment of individuals who elect life annuities and those who do not,[12] while also eliminating the current-law barriers to life annuities. Allowing the use of ULT in this manner would also reaffirm the Treasury Department's commitment to encouraging lifetime income elections.

(d) Update mortality tables for the MITT

- The current life expectancy tables in the RMD regulations (the SLT, JLT, and ULT) were derived from the basic 2000 individual annuity mortality table, projecting mortality improvements through 2003.[13] The regulations authorize the Service to update the tables, but they have not been updated.[14] As Executive Order 13847, *Strengthening Retirement Security in America*,[15] suggests, there is a need to update the tables now and to make future updates annually or on another periodic basis in order to help retirees retain their savings for longer if needed. We recommend the following approach:

- Initial update. The first update should be based on the 2012 Individual Annuity Reserving Table and its corresponding mortality improvement projection factors through the date of the update (the "2012 IAR Table"). This table, which is published by the Society of Actuaries ("SOA"), is currently the prescribed table for standard valuation and statutory reserve purposes under state law for individual annuities. The table is among three published by the SOA and, because it is used principally in determining required reserves for life insurance companies, it reflects the longest life expectancies of the three SOA tables. Thus, using this table would allow plan participants and IRA owners to "keep more money in 401(k)s and Individual Retirement Accounts for longer" and to "spread retirement savings over a longer period of time," which are two of President Trump's goals in issuing Executive Order 13847.

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[12] This disparity between accounts and annuities has been recognized by Senators Portman (R-OH) and Cardin (D-MD), who on October 15, 2018, released a discussion draft of legislation that would help establish parity between such forms of benefit. Specifically, in recognition of "the fact that in the vast majority of cases, annuity payments are in excess of the amounts that would have been required under the individual account rules," the proposal would direct the Treasury Department to amend the RMD regulations to allow any such excess to reduce the RMD obligation with respect to any portion of an individual's benefit that remains in a non-annuitized account. On May 13, 2019, Senators Portman and Cardin introduced S. 1431, the Retirement Security and Savings Act of 2019, which contains the identical provision (§ 203).

[13] *See* Required Distributions From Retirement Plans, 67 Fed. Reg. 18988, 18989 (April 17, 2002) (preamble to final and temporary regulations).

[14] Treas. Reg. section 1.409(a)(9)-9, Q&A-4.

[15] 83 Fed. Reg. 45,321 (Sept. 6, 2018).

- Future updates. In order to assure that the life expectancy tables will not again become outdated, they should be updated regularly in the future. We have identified two approaches for doing so. First, they could be updated automatically whenever a new SOA table becomes the prescribed table for state law standard valuation and statutory reserve purposes.[16] Alternatively, the Treasury Department and IRS could update the tables through guidance published at regular intervals, at least every five years.[17] This latter approach should include a default update if the Treasury Department and IRS do not publish the necessary guidance, with the default being the state-prescribed tables described above.

(2) Qualifying Longevity Annuity Contracts (QLACs)

For the reasons discussed below, the Committee requests that the 2019-2020 Priority Guidance Plan also include guidance on the following three issues, each of which discourages and impedes the use of QLACs to provide life annuities to plan participants and IRA owners.

(a) Clarify how the MITT applies to QLACs and DIAs

Annuity payments under QLACs and similar annuity products known as deferred income annuities ("DIAs") generally must satisfy the MITT.[18] For example, QLACs and DIAs typically provide lump sum return of premium death benefits, which the RMD regulations treat as "increasing" payments that are not allowed unless the MITT is satisfied. As discussed above, the MITT requires the total future expected payments to exceed the total value being annuitized. There is considerable uncertainty regarding how the total value being annuitized should be determined for a QLAC or DIA.

The regulations provide that in the case of a deferred annuity purchased by a section 401(a) trust the "total value being annuitized" equals the value of the employee's "entire interest" being annuitized, valued as of the date annuity payments commence.[19] This definition, which seems to contemplate a deferred annuity with a cash value that is determinable at the annuity commencement date, does not fit well with QLACs or DIAs because (1) they do not have cash values, and (2) premiums are paid years in advance of the annuity commencement

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[16] *See*, *e.g.*, section 7702(f)(10) (reflecting a similar standard for determining the mortality assumptions used in the tax definition of a "life insurance contract"). Under the rules in effect as of 2017, when the National Association of Insurance Commissioners (NAIC) adopts a new, updated mortality table to be used for state valuation and nonforfeiture purposes, that table will be reflected in the NAIC *Valuation Manual* and will automatically become the mortality table also used for section 7702 purposes.

[17] S. 1431, *supra* note 12, section 109, endorses a similar approach, which requires the Treasury Department to update the life expectancy tables in the RMD regulations every 10 years.

[18] A DIA generally is a deferred annuity contract that provides annuity payments commencing on a specified future date, provides no cash surrender value, and often provides a return of premium death benefit.

[19] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(1)(i). Similarly, the regulations provide that "[i]n the case of a defined contribution plan, the [total value being annuitized equals the] value of the employee's account balance used to purchase an immediate annuity under the contract." Treas. Reg. section 1.401(a)(9)-6, Q&A-14(e)(1)(iii).

date. Thus, for QLACs and DIAs it may be necessary to deem an amount to be the "total value being annuitized" as of the annuity commencement date.

The regulations do not address this, but one possibility is that the total value being annuitized as of the annuity commencement date of a QLAC or other DIA is the present value of the future annuity payments. If that is the case, unexpected results could arise for such contracts under the MITT. For example, payments that were thought to comply as of a QLAC's issue date could unexpectedly fail the test on the annuity commencement date merely because of a change in interest rates after the contract was issued.

To illustrate, if interest rates are lower on the annuity commencement date than they were on a QLAC's issue date, and such lower rates were used on the annuity commencement date to calculate the present value of future payments, the resulting present value would be higher than the one the issuer expected would arise based on the interest rate used in establishing the benefit levels under the QLAC when the contract was issued. In that circumstance, the deemed "total value being annuitized" could be greater than the "total future expected payments," thereby failing the MITT, 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 present value calculation.

All this creates uncertainty regarding how the RMD rules apply to QLACs and DIAs and under what circumstances an insurer can confidently issue a compliant contract. Such uncertainty will dissuade insurance companies from issuing these contracts in the retirement context or increase the costs of issuing such contracts, which will be passed on to retirees. These uncertainties could be eliminated if the rules were amended to allow the total value being annuitized to be determined at the time of the contract's issue date or as of the last premium payment made for the contract.

(b) Clarify the QLAC premium limits to facilitate purchases *via* rollovers to IRAs

QLACs are readily available in the IRA market, but it is rare for a qualified plan to offer a QLAC option directly. As a result, the only way for virtually any participant in a qualified plan to obtain a QLAC is by rolling money out of the plan to an IRA. However, there is considerable uncertainty regarding how the limits on QLAC premiums in the regulations apply when an amount is rolled from a qualified plan to an IRA in order to obtain a QLAC. This uncertainty is having a significantly adverse effect on the availability of QLACs in the marketplace.

In that regard, the regulations limit the premiums that an individual can pay for a QLAC to the lesser of $125,000 or 25% of the account balance under the plan or IRA.[20] The $125,000 limit applies across all types of arrangements, whereas the 25% limit applies separately to each qualified plan in which the individual participates and collectively to all IRAs that an individual owns.[21] For purposes of the 25% limit, the account balance of a qualified plan is determined as

[20] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(a)(1) and (b). The limit was adjusted for inflation to $130,000, effective January 1, 2018. Notice 2017-64, 2017-45 I.R.B. 486. The limit remains at this level in 2019. Notice 2018-83, 2018-47 I.R.B. 774.

[21] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(b); Treas. Reg. section 1.408-8, Q&A-12(b)(3).

of the most recent valuation date and is adjusted up or down to reflect subsequent contributions or distributions, respectively.[22] In contrast, the account balance of an IRA is determined as of December 31st of the previous calendar year, and there is no specific mention of any adjustment for subsequent contributions or distributions.[23]

When a QLAC is purchased in a direct rollover from a qualified plan to an IRA, it is not clear which account balance should be used when applying the 25% limit. In other words, it is not clear whether the regulations limit the purchase to 25% of the individual's account balance in the plan or 25% of the account balance in the individual's IRAs. If the limit applies based on the IRA account balance, the QLAC purchase could be unnecessarily complicated and delayed. Moreover, in many cases the individual would need to quadruple the amount of the rollover just to facilitate the QLAC purchase. These problems are illustrated in the following example:

> Assume that an individual has a $500,000 account balance in her former employer's qualified plan. She wants to use 10% of that balance, or $50,000, to purchase a QLAC, but her plan does not offer one. She decides to roll the money from the plan to purchase a QLAC that also qualifies as an IRA annuity. However, she currently does not own any IRAs. If the 25% limit on QLAC premiums applies based on her IRA account balance (which is zero), she will need to roll <u>$200,000</u> from her plan just to facilitate the $50,000 QLAC purchase. Moreover, because the regulations measure her IRA account balance as of the prior year-end (which, again, was zero), she will need to roll the $200,000 from the plan to an IRA, wait until the next year, then transfer $50,000 from the IRA to a QLAC that qualifies as an IRA annuity. After the transaction, the individual would own a QLAC that clearly complies with the intent of the premium limits, but would have unnecessarily moved $150,000 from her plan to an IRA and would have suffered a considerable delay and possibly additional expense in obtaining the QLAC.

The market is generally interpreting the regulation conservatively and is applying the cumbersome approach described in the example above. This, in turn, is having a significantly adverse effect on the ability of individuals to protect themselves against longevity risk through the purchase of a QLAC. The solution to this problem would be for the IRS to issue guidance clarifying that the 25% limit applies based on the account balance in the plan in the following circumstances.

- The guidance could describe a situation like the one in the example above, involving a direct rollover from a plan to an IRA for the specific purpose of purchasing a QLAC.

- The guidance would then clarify that in such a situation the 25% limit is applied based on the account balance in the plan as of the most recent valuation date occurring immediately before the rollover, not the prior year-end account balance in the IRA.

- This would merely clarify which of two existing rules in the regulations applies to the transaction. Moreover, in the direct rollover context where the distribution is used to

[22] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(d)(1)(iii).

[23] Treas. Reg. section 1.408-8, Q&A-12(b)(3)(i).

directly purchase a QLAC, treating the distribution as coming from the plan for purposes of the 25% limit is entirely consistent with the structure of the section 401(a)(9) regulations, which state that in the context of a rollover, "the amount distributed is still treated as a distribution by the distributing plan for purposes of section 401(a)(9), notwithstanding the rollover."[24]

- Thus, the regulations would not need to be amended. In addition, the transaction would be reported on existing forms without the need for the IRS to amend those forms.[25]

(c) Clarify QLAC spousal death benefits in the event of divorce

The QLAC regulations prescribe very different rules depending upon whether the owner's beneficiary is his or her spouse. If a QLAC owner's sole beneficiary is his or her spouse, the contract can provide *both* a lump sum return of premium death benefit *and* a 100 percent survivor annuity.[26] However, if the owner's sole beneficiary under a QLAC is not his or her spouse, the contract can provide *either* a lump sum return of premium death benefit *or* a survivor annuity (but not both), and a non-spouse survivor annuity is subject to a required reduction in the annuity payments after the owner's death.[27]

The regulations do not address how these death benefit rules apply if the beneficiary is the owner's spouse when the contract is issued, but because of a subsequent divorce is no longer the owner's spouse when annuity payments commence or when the owner dies.[28] If a beneficiary's status as a spouse or non-spouse is determined after a QLAC is issued, *e.g.*, on the date annuity payments commence, a contract that was issued with permissible benefits might be viewed as providing impermissible benefits merely because of the divorce.

If a contract that is intended to be a QLAC provides impermissible benefits, the value of the contract must be included in the account balance used to determine the owner's required minimum distributions. To prevent this potential adverse and unintended result, in theory the issuer could modify the contract's benefits after the divorce, but this may be difficult or impossible. The price and benefits can differ materially based on whether the spouse or non-spouse rules apply, and insurers need to know which rules will apply so they can price the product at issuance and so the purchaser will know what they are getting for what price. If a contract failed to be a QLAC following the divorce, the owner could become liable for a 50% excise tax under section 4974. The mere possibility that this problem can arise in the event of a

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[24] Treas. Reg. section 1.401(a)(9)-7, Q&A-1.

[25] Specifically, the applicable IRS forms would be Form 1099-R (reporting the direct rollover), Form 5498 (reporting the contribution to the IRA annuity that qualifies as a QLAC), and Form 1098-Q (reporting the premiums and other information regarding the QLAC).

[26] Treas. Reg. section 1.401(a)(9)-6, Q&A-17(c)(1).

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

[28] *Compare* Treas. Reg. section 1.401(a)(9)-6, Q&A-2(b) (spousal status is determined "as of the annuity starting date for annuity payments") and Treas. Reg. section 1.401(a)(9)-5, Q&A-4(c)(2) (spousal status for individual accounts is re-determined on January 1st of each year).

divorce after a QLAC is purchased may prevent a QLAC issuer from offering the maximum permissible death benefit to a spouse beneficiary.

The solution to this problem would be for the IRS to issue guidance clarifying that a divorce occurring after a QLAC is purchased but before payments commence will not affect the permissibility of the joint and survivor benefits previously purchased under the contract if a qualified domestic relations order ("QDRO") (in the case of a retirement plan) or a divorce or separation instrument (in the case of an IRA) provides that the former spouse is entitled to the promised spousal benefits under the QLAC. Such a clarification would be consistent with a general rule that already exists in the section 401(a)(9) regulations, which provides that a former spouse is treated as a spouse for purposes of the minimum distribution requirements if certain requirements are met. That rule states:

> A former spouse to whom all or a portion of the employee's benefit is payable pursuant to a QDRO will be treated as a spouse (including a surviving spouse) of the employee for purposes of section 401(a)(9), including the minimum distribution incidental benefit requirement, regardless of whether the QDRO specifically provides that the former spouse is treated as the spouse for purposes of sections 401(a)(11) and 417.[29]

It appears, though not clearly, that this general rule applies to QLACs, but in light of the repercussions of being wrong on this point, the market appears to have generally taken a conservative position on the application of the rule to QLACs, which makes selling QLACs in the plan context very difficult. Accordingly, it is very important that there is confirmation that the above quoted general rule applies to QLACs in the plan context.

In addition, although QDROs are a concept applicable to employer-sponsored plans and not IRAs, a parallel concept should apply to IRAs, but obviously without regard to the technical requirements that apply to QDROs. Applying a parallel concept to IRAs is supported by the existing regulatory provision that, except as otherwise provided, all of the section 401(a)(9) rules for plans apply to IRAs.[30] As a result, clarification that such a parallel concept regarding former spouses applies for purposes of QLACs issued in the IRA market would be both appropriate and very helpful in addressing an uncertainty that has inhibited the QLAC/IRA market. Such a clarification could provide that "divorce or separation instruments"[31] can cause a former spouse to be treated as the spouse for minimum distribution purposes, including QLACs, in the same manner as a QDRO.

For IRAs, spousal rights may continue after a divorce in two distinct ways. First, a former spouse may have rights under the contract which remain pursuant to a divorce or separation instrument. Second, the former spouse may be contractually entitled to benefits

[29] Treas. Reg. section 1.401(a)(9)-8, Q&A-6(a).

[30] *See* Treas. Reg. section 1.408-8, Q&A-1

[31] This term would have the meaning set forth in section 71(b)(2).

originally purchased under the contract which remain unchanged after a divorce or separation. In the latter case, the parties may not think they need to specify in the divorce or separation agreement that the former spouse will continue to be the beneficiary of the QLAC upon the owner's death. For this reason, the guidance would have an even broader and more appropriate effect if it could also clarify that, even in the absence of a formal divorce or separation instrument that addresses the contract, a former spouse is treated as the spouse for purposes of the QLAC requirements as long as the former spouse remains contractually entitled to the benefits originally purchased under the contract following the divorce.

These clarifications would ensure that former spouses can be protected both in plans and IRAs. Moreover, because these clarifications are consistent with the existing regulations and would merely explain how those regulations apply to QLACs, the clarifications could be provided through IRS guidance without having to amend the regulations.

(3) <u>Flexibility on the timing of annuity RMD payments</u>

An IRA owner or employee is permitted to take his RMD for a calendar year with respect to an individual account at any time during the calendar year.[32] In addition, an individual is not required to take withdrawals from an individual account in uniform intervals during a year or from year to year. For example, an individual may withdraw an RMD in a single lump sum at the beginning of one calendar year, in a single lump sum at the end of another calendar year, and in installments throughout another calendar year. This flexibility is obviously helpful and desirable to some elderly individuals because they can accelerate some or all of their account-based RMDs for the year if they have an unexpected financial need during the year.

Annuity issuers would like to provide IRA owners and employees who annuitize part of their retirement savings with similar flexibility. Some commercial annuities already allow owners to accelerate, or advance, one or more annuity payments scheduled to be made within a specified period of time, *e.g.*, within a contract year. Although annuity payments can be accelerated in some cases under the RMD regulations, it appears that the acceleration must shorten the annuity period or reduce the amount of the payments to be made under the annuity.[33] A more limited form of acceleration, *e.g.*, the receipt in January of the monthly payments for February and March, would affect only the timing within a year of the payments, *i.e.*, neither the duration of the annuity period nor the sum of the payments that will be made under the annuity is reduced, and thus may run afoul of the regulations. In addition, the regulations can be read as precluding a change in the interval between annuity payments even though the change is only temporary and results only in an acceleration of payments.[34]

This matter can be easily addressed by modifying the RMD regulations to clarify that a short-term advancement of annuity payments is not subject to the limitations on increasing

[32] Treas. Reg. section 1.401(a)(9)-5, Q&A-1(c).

[33] Treas. Reg. section 1.401(a)(9)-6, Q&A-14(c)(4) and (e)(4).

[34] Treas. Reg. section 1.401(a)(9)-6, Q&A-1(a) ("The interval between payments for the annuity must be uniform over the entire distribution period and must not exceed one year.").

annuity payments and will not result in a change in the interval between annuity payments. Importantly, such a clarification would remove a restriction on the frequency of annuity payments which is completely unnecessary in these circumstances. It would also reduce the disparate treatment of individual accounts and annuities under the regulations.

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