

Guaranteed Minimum Withdrawal Benefits

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The Distribution Dilemma

Policymakers, plan sponsors and participants have become concerned about whether employees will be able to live on their 401(k) accounts, together with social security, in retirement.



The Distribution Dilemma

The concern is twofold:

- Will they have enough money when they retire?
- Will they withdraw it responsibly, so that they do not exhaust their 401(k) accounts or IRAs before they die?



The Distribution Dilemma

Research has shown that, if retired participants withdraw more than 4% or 5% of their account balance per year, there is a significant possibility that they will run out of money during their retirement.

In light of this – and the lack of widespread acceptance of traditional annuity products – the 401(k) community and the investment and insurance industries have been working to develop other solutions.



The Guaranteed Minimum Withdrawal Benefit

One approach is the “guaranteed minimum withdrawal benefit” or “GMWB,” which enables 401(k) participants to buy, as an add-on to specified investments, a guarantee of retirement income if a retired participant exhausts the underlying investments.



The Guaranteed Minimum Withdrawal Benefit

The GMWB is analogous to an insurance policy that:

- will pay the participant a specified benefit each year;
- but only if the account is exhausted during the participant's retirement;
- provided the participant withdraws no more than a specified amount (typically 4½% to 5%) each year.



The Guaranteed Minimum Withdrawal Benefit

Unlike a traditional annuity, if the money does not run out, the remaining value of the investments can be left to the participant's beneficiaries.



GMWB Features

The following are typical elements of the GMWB feature:

- The feature is generally tied to specified investment options offered by the 401(k) plan, generally a balanced investment portfolio such as a conservative, moderate or growth lifestyle fund, or a target maturity fund.



GMWB Features

- The participant is charged an annual fee – or premium – for this feature, which usually ranges from 35 basis points (or 0.35%) per year to 100 basis points (or 1%) and is in addition to the management fees for the investment.



GMWB Features

- In exchange for this premium, the insurance company guarantees the participant a benefit equal to a set percentage (e.g., 5%) of the “base amount” if the funds invested in the participant’s account run out during the participant’s retirement.



GMWB Features

- To be eligible to receive the guaranteed payment, the participant must generally make premium payments for a minimum period set by the insurance company.
- This period is often 5 years and the qualification period is one of the factors that dictates the premium charge.



GMWB Features

- Beginning at retirement, a participant who elected the GMWB may withdraw the set distribution amount (e.g., 5% per year).
- Withdrawals in excess of 5% per year are permissible, but they will reduce the “benefit base.”



The Fiduciary Standard

The decision to offer GMWBs is a fiduciary decision. Fiduciaries (for example, the plan committee) are required to engage in a process consistent with:

- the duty of loyalty
- the exclusive purpose rule
- the prudent man standard

For the White Paper on “Fiduciary Considerations in Offering a Lifetime Income Feature to 401(k) Participants,” go to <http://wwwrs.massmutual.com/retire/media/power togrow/products.htm>.



The Fiduciary Standard

The fiduciary conduct in fulfilling these duties is measured by the “prudent man standard.” To fulfill their duties under that standard, fiduciaries must act:

*“with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity **and familiar with such matters** would use in the conduct of an enterprise of a like character and with like aims....”*



The Fiduciary Standard

This “prudent process” has been described by the Department of Labor (DOL) in a regulation that addresses investment decisions, though the process applies to any fiduciary decision . . . where the fiduciary:

Has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved

.....



The Fiduciary Standard

This regulation lays out a number of steps in the fiduciary decision-making process:

- the fiduciaries must determine what information is *relevant* to the decision, both what the fiduciary knows and what he *should know is* relevant;



The Fiduciary Standard *(continued)*

- the fiduciaries must obtain the relevant information to make the decision;
- the fiduciaries must evaluate the information; and
- the fiduciaries must make a decision that is an *informed and reasoned decision*.



The Relevant Facts

Based on our analysis of the issues and conversations with people in the industry, the following are the key facts and circumstances:

- The needs of the participants: *Is a GMWB feature appropriate for the workforce?*
- The value of the features offered: *Is the cost reasonable in relation to the features offered?*
- The quality of the underlying investment.

The Relevant Facts *(continued)*

- Employee understanding: *Are the employees provided with the information needed to*
 - *appropriately evaluate the guarantee?*
 - *understand the effect of excess withdrawals?*
 - *understand the investment requirement?*

- Portability of GMWB feature
 - *Is the GMWB transferable if the plan switches providers?*
 - *Is the GMWB transferable to another plan or an IRA, and at what cost?*

- Financial viability of the provider: *Is it likely that the insurance company will be able to pay the benefits over the long term?*



The Relevant Facts *(continued)*

- Discontinuance of GMWB
 - *by plan sponsor*
 - *by employee*



The Duty to Monitor

The fiduciary's duty does not end when the GMWB is selected. There is a continuing duty to monitor.

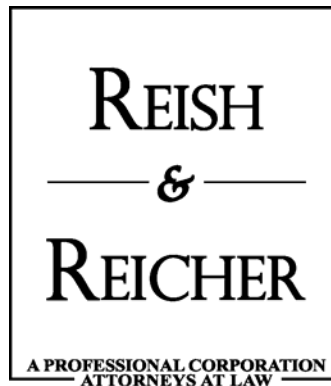
Among other things, fiduciaries should periodically review whether there have been any changes in the information relied upon:

- in selecting the insurance company;
- in evaluating the costs and features; and
- the investment to which the GMWB is attached.



Concluding Thoughts

- Plan sponsors should be attentive to new products and services that will benefit their participants.
- As fiduciaries, plan sponsors must use a prudent process to make decisions.
- A prudent process produces an informed and reasoned decision.



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