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Lincoln *Secured Retirement Income*SM Solution: Fiduciary Process in Evaluating In-Plan Guarantees

A WHITE PAPER BY
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Courtesy of

Lincoln Financial Group®

Introduction

This White Paper discusses the fiduciary process for selecting in-plan lifetime income guarantees. In a companion White Paper, entitled "Lincoln *Secured Retirement Income*SM Solution: Addressing Participant Retirement Income Risks," we examine the risks confronting retirees in managing their retirement savings and review available solutions – some of which are guaranteed and some not – including, in particular, the Lincoln *Secured Retirement Income*SM solution. In this paper, we discuss the steps for a prudent process for selecting a guaranteed lifetime income solution under the Employee Retirement Income Security Act of 1974 (ERISA) and similar state laws applicable to government plans. The paper also offers a proposed fiduciary checklist to assist in that process.

At the outset, it is important to acknowledge that neither ERISA nor comparable state laws require that defined contribution plans (including 401(k), 403(b) and 457 plans) provide a lifetime income solution for participants. Nevertheless, the issue of how participants will manage their accounts and IRAs to provide sustainable lifelong income is gaining increasing attention. As a result, plan sponsors are concerned about the risks confronting their participants, and are considering services and products to help them obtain sustainable income in retirement. The selection of those products and their providers requires a prudent process, which is the subject of this White Paper. In addition to discussing the process for the selection and monitoring of these products generally, we provide a specific analysis of The Lincoln National Life Insurance Company ("Lincoln Financial") and the Lincoln *Secured Retirement Income*SM solution.

Retiree Risks

Our companion White Paper points out that participants face a variety of risks, including the following:

- *The risk of not saving enough to generate the replacement income needed to pay his bills, both recurring and unanticipated.* Studies suggest that retirees need monthly income of between 75% and 85% of final pre-retirement pay.
- *How long a retiree (and perhaps the retiree's spouse) will live following retirement.* The statistical probability is that, for married participants, either the retiree or the spouse may live 30 or more years after retirement.
- *The sequence of returns risk, that is, the risk and impact of market downturns after a retiree begins to withdraw from his investments.* Losses due to stock market volatility soon after retirement will likely never be recouped.
- *The "safe" rate at which a retiree can withdraw money out of his retirement savings each month and continue to do so for at least 30 years.* Financial models suggest that withdrawal rates of

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between 3% and 5% of a 65-year old retiree's initial account balance are "safe" (depending on the assumptions used in the model).

- *The impact of inflation, which causes the purchasing power of a retiree's money to be eroded, resulting in a lower standard of living.*
- *"Cognitive impairment," that is, the degradation of the ability to make sound financial decisions as a retiree gets older.*

For a more complete discussion of these issues, including a discussion of how few participants understand or are prepared to face them and an assessment of how the Lincoln *Secured Retirement Income*SM solution addresses them, please refer to the companion White Paper.

This paper focuses on lifetime income solutions that are guaranteed by insurance companies. "Lifetime income" refers to a product or service designed to provide a retiree with a sustainable stream of income over his projected post-employment lifetime. A product is "guaranteed" if the amount of the income and the obligation to pay that amount is backed by an insurance company. As explained in the companion White Paper, these primarily consist of guaranteed withdrawal benefit (GWB) features, such as those available in the Lincoln *Secured Retirement Income*SM investment option, and traditional annuities.

Conclusions

Selection of a lifetime income guaranteed solution is a fiduciary decision. Even though the selection, in part, involves an assessment of the ability of the insurance company to meet its financial commitments in the future, this does not require fiduciaries to guarantee the future. They must engage in a prudent process to reach an informed and reasoned decision. In this sense, the selection of an insurance product is no different than other decisions that fiduciaries make – except in the information the fiduciaries must collect and analyze about the insurance company and the GWB.

The Department of Labor (DOL) has adopted a safe harbor regulation describing the process for selecting the issuer of annuities for defined contribution plans. Using this as a framework, we have developed (along with Martin Schmidt[1] of HS2 Benefits[2], an independent financial advisor, and representatives of Lincoln Financial) a checklist of the type of information that fiduciaries should consider. While not intended to be an exclusive list, the checklist includes the following items:

There are four main areas that fiduciaries should consider when evaluating an insurance company:

- Financial strength of the company
- Evaluation by the rating agencies
- Commitment and success in the insurance industry
- Diversification of the business lines

For each of these major categories, the checklist indicates the information to be assessed, how to obtain the information, and, where relevant, how to compare the information gathered on different providers. These areas are more fully developed in the checklist.

The checklist should not be taken as a suggestion that a plan committee that fails to follow some of these steps – or even all of these steps – in selecting an insurance company has breached its fiduciary duties. The checklist is intended to be a tool to generally help plan fiduciaries to engage in a prudent process.

The complete checklist and our commentary are included in Appendix A to this White Paper.

In Appendix B, we include an analysis, based on a report prepared by Martin Schmidt of HS2 Benefits, that assesses Lincoln Financial and the Lincoln *Secured Retirement Income*SM solution using the criteria set forth in the checklist. Mr. Schmidt's conclusion is that a fiduciary would be considered to act prudently if it selects the Lincoln *Secured Retirement Income*SM solution for its plan.

1. Mr. Schmidt is a Principal with HS2 Benefits. With more than 30 years of experience working with both plan sponsors and providers of benefit-related issues, he focuses on retirement for HS2 Benefits. Mr. Schmidt's expertise covers a range of both technical and strategic issues affecting benefit and retirement plans. His areas of concentration include plan design, asset allocation strategies, fee benchmarking, and vendor selection. Prior to joining HS2, Mr. Schmidt was a Midwest region leader with Buck Consultants' Defined Contribution practice. He previously worked at Hewitt Associates in the Benefits Outsourcing practice in a variety of leadership roles with a concentration on relationship management, product design, financial services, and service delivery. Mr. Schmidt is a founding member, member of the board of directors and adviser member of the Institutional Retirement Income Council. For further information, go to http://iricouncil.org/advisers#mSchmidt.

2. See www.hs2benefits.com for further information.

In his analysis, Mr. Schmidt concludes:

At the date of this White Paper, based on the reported information and how it is measured against the standards established in the checklist, a fiduciary may reasonably conclude that The Lincoln National Life Insurance Company is financially able to make future payments on the Lincoln *Secured Retirement Income*SM *solution and would be a prudent choice for a fiduciary when evaluating an insurance company. From an objective measure, the company has a strong financial structure and is rated highly by each of the rating agencies. The company also has sufficient size when compared to other insurance companies in the industry. From a subjective measure, the company has a long history in the annuity business and has experienced significant growth over the years. While the annuity business is a core product offering, the company also benefits from diversification across multiple lines of business which should help reduce volatility in down market cycles. Finally, the company has a strong reputation in the insurance market.*

To understand the scope and limitations of this conclusion, it is essential to review the analysis set forth in Appendix B

In Appendix C, we include an analysis of the Lincoln *Secured Retirement Income*SM solution as it compares with other GWB products available in the marketplace. The analysis is based on a report prepared by Mr. Schmidt. To fully understand the basis for Mr. Schmidt's conclusions, it is essential to review the analysis set forth in Appendix C.

The Lincoln *Secured Retirement Income*SM solution is the second generation of in-plan guaranteed minimum withdrawal benefit offering available in the DC marketplace. As a product offering, it guarantees a stream of income payments to a participant, regardless of the contract account value. It also allows DC plan participants to protect their income prior to and during retirement while at the same time allowing for participation in a positive investment experience. The product offering also addresses several retiree risks, especially the sequence of returns and longevity issues, with added flexibility that is not available in other product offerings.

The Lincoln *Secured Retirement Income*SM solution compared very favorably with the other product offerings. Several unique features were identified with the *Secured Retirement Income*SM solution when compared to the other product offerings.

To fully understand the basis for Mr. Schmidt's conclusions, it is essential to review the analysis set forth in Appendix C.

In the balance of this paper, we summarize the terms of the Lincoln *Secured Retirement Income*SM solution and then discuss the legal framework applicable to selecting a guaranteed lifetime income solution.

The Lincoln *Secured Retirement Income*SM Investment Option

The Lincoln *Secured Retirement Income*SM solution provides a guarantee of lifetime income to retirees. Initially, retirees withdraw from their retirement plan account or IRA at a specific rate. If those funds are depleted, Lincoln will continue to make annual payments to the retiree at the same rate. The following summarizes the key features of the product:

- The Lincoln *Secured Retirement Income*SM guarantee is available through a group variable annuity contract. Assets are invested through a separate account in the Lincoln Financial LVIP Global Moderate Allocation Managed Risk Fund (the "Moderate Fund"). The Moderate Fund:
  - » Utilizes a multi-manager structure
  - » Invests approximately 60% in equity securities and 40% in fixed-income securities
  - » Invests in funds that employ both passive and active management styles
  - » Employs a risk management strategy that seeks to lower the volatility of returns and provide capital protection in down markets
- A primary use of the Lincoln *Secured Retirement Income*SM investment option will be in plans that use Lincoln *LifeSpan*SM custom target-date portfolios that include the Moderate Fund with the Lincoln *Secured Retirement Income*SM investment option in the portfolios' glide path.

The glide path of the portfolios allocates 10% of a participant's account balance in the portfolio to the *Secured Retirement Income* investment option beginning 10 years from the target retirement date. Each year under the glide path, an additional 10% of the account balance is allocated to the *Secured Retirement Income*SM investment option, so that when the participant reaches his target retirement date, up to 100% of his account balance will have the Lincoln *Secured Retirement Income*SM guarantee. As a result of this feature, the guarantee gradually accrues, and the participant pays for the guarantee only as it accrues. The glide path can be designed and managed by Morningstar Investment Management LLC, or the plan may engage an RIA or other intermediary acting as an investment manager under ERISA Section 3(38) who creates an asset allocation model and custom glide path.[3] Plan sponsors and their advisors can also choose to have the final glide path allocation to the *Secured Retirement Income*SM investment option be less than 100% if desired.

- There are two elements of cost paid out of a participant's account, neither of which reduce the participant's Income Base (described below):
  1. 90 basis points on the Income Base for the guarantee provided by Lincoln; and
  2. 79 basis points, which includes the investment management fee (74 basis points) and a mortality and expense charge (5 basis points):[4]

  The 90 basis-point charge only applies to the portion of a participant's balance allocated to the *Secured Retirement Income*SM investment option when used in conjunction with the Lincoln *LifeSpan* target-date portfolio. Thus, if 10% of a participant's balance is allocated to the *Secured Retirement Income*SM investment option, the fee on the Income Base would only apply to the amount allocated to that option. Additionally, the 79 basis points contains 30 basis points in available revenue sharing back to the plan for a net "all in" cost of 1.39%.
- For the 90 basis-point fee, Lincoln guarantees payment to the participant of a specified percentage (referred to as the Guaranteed Annual Income or GAI) of his Income Base if his account balance runs out during retirement. Payment of the GAI is conditioned on the retiree not withdrawing more in a benefit year than a specified amount.
- Withdrawals may start at age 55, with a single-life Guaranteed Annual Income of 4% of the Income Base and 3.5% on a joint and survivor basis. Between ages 65 and 70, the amounts will be 5% and 4.5%; from age 71 and older, 6% and 5.5%.[5]

3. Morningstar provides three landing points as part of the glide path it designs – 100%, 75%, or 50% in which the annual amount allocated to the Moderate Fund increases by 10%, 7.5% and 5% respectively. Other glide paths can be accommodated within the asset allocation models.

4. Lincoln has created three additional version of the Lincoln *Secured Retirement Income*SM guarantee with M&E charges of 25, 45 or 65 basis points to accommodate plans with different cost structures. The higher M&E charges are available to the plan as additional revenue sharing.

5. The Lincoln contract allows flexibility with the payout rates. For example, if interest rates and inflation rise, Lincoln could increase the payout rates accordingly. If this occurs, participants "lock in" their old rate on existing balances and the new rate applies to new contributions to the Moderate Fund. This creates a weighted average guaranteed annual income that is consolidated under the existing contract and consolidated within the Lincoln recordkeeping system.

- The initial amount of the Income Base is the market value of the assets in the *Secured Retirement Income*SM investment option on the beginning date, which is the date assets in a participant's account are first invested in the *Secured Retirement Income*SM investment option. Each year, on the anniversary of the beginning date, the Income Base is re-calculated and reset to equal the *greater* of:

  » The prior Income Base plus all deposits into the *Secured Retirement Income*SM investment option and less any excess withdrawals; or

  » The market value of the assets in the *Secured Retirement Income*SM investment option on the anniversary date.

  Assuming the participant does not transfer money out of the *Secured Retirement Income*SM investment option, the Income Base can only go up; it cannot go down. It may grow post-retirement (up to age 86) with increases in market value year-over-year after taking into account purchases and withdrawals

  If withdrawals exceed the Guaranteed Annual Income amount, the Income Base will decline proportionately to the reduction in market value of the participant's account.

For a more complete description, see our companion White Paper: "Lincoln *Secured Retirement Income*SM Solution: Addressing Participant Retirement Income Risks."

The Legal Framework

Summary

The first step for plan sponsors in selecting in-plan lifetime income guarantees is to have a basic understanding of the legal foundation of the fiduciary process.

Under ERISA and many state laws, the fiduciaries of defined contribution plans must act in the best interest of the participants and for the exclusive purpose of providing them with retirement benefits and defraying the reasonable expenses of operating the plan.[6] These are referred to as the "duty of loyalty" and the "exclusive purpose requirement." A fiduciary's conduct in carrying out these duties is judged under the prudent man, or prudent person, rule, which requires fiduciaries to act with care, skill, diligence and prudence in carrying out their duties, taking into account current circumstances.[7]

The prudent man rule has been interpreted to require that fiduciaries engage in a prudent process for making decisions. In a leading case, Judge Antonin Scalia (later Justice Scalia of the U.S. Supreme Court) described the rule as requiring *procedural prudence* and *substantive prudence*.[8] Procedural prudence refers to the steps that a fiduciary should take in reaching a decision. It requires gathering information a fiduciary knows or should know is relevant to the decision to be made and then assessing that information. Substantive prudence refers to the obligation of a fiduciary to make a decision based on the information and assessment, though in more recent cases, courts have used the term to mean a decision that a prudent fiduciary could have properly made even though it did not engage in a prudent process.[9] The prudent process effectively requires a fiduciary to make an informed and reasoned decision.

Fiduciaries must make decisions on a variety of subjects. Most have to do with managing or administering the plan: interpreting the plan document; deciding who enters the plan and when; making decisions about benefits, distributions, vesting; and selecting service providers. The other major area relates to selecting the assets of the plan. In the case of participant-directed defined contribution plans, this means selecting and monitoring the plan's investment alternatives that are offered to the participants.

The selection of an in-plan lifetime income solution is one of these fiduciary decisions. And all of these decisions require the fiduciary to use the same prudent process.

Selecting a Guaranteed Lifetime Income Solution

Information to Consider

The central ingredient of a GWB solution is that an insurance company guarantees that it will make payments of a specified amount to a retiree at some point in the future. In order to obtain this guarantee, the participant's account must be invested in a specified investment portfolio, such as a balanced fund or target-date fund. In the case of a guaranteed withdrawal benefit (GWB) feature, the guaranteed payments will start if and when a retiree exhausts his account in the plan or the assets in his rollover IRA. Where a GWB is offered in the plan, the obligation to pay will not arise until years in the future, after the participant has retired and has exhausted his account or rollover IRA through periodic distributions under the GWB provisions.

For example, consider a participant who begins investing in the GWB solution at age 55, retires at age 65, and begins taking withdrawals from his account or IRA. He will be withdrawing his own funds for a number of years, and only after his funds run out will the insurance company begin making payments. Thus, the guaranteed lifetime payments will begin many years after retirement.

Because of this, some fiduciaries view the selection of an insurance company as more challenging than other fiduciary decisions. What is often overlooked, however, is that this decision is no different from any other, especially when compared to the selection of plan investment options. That is, it requires the same process of procedural and substantive prudence. The only variables are in the information that needs to be gathered and analyzed.[10]

The U.S. Department of Labor (DOL) has adopted a fiduciary safe harbor regulation under ERISA that provides a framework for selecting annuity providers

6. ERISA Section 404(a)(1).
7. *Id* at subsection (a)(1)(B).
8. *Fink v. National Savings & Trust Co.*, 772 F.2d 951, 962 (D.C. Cir. 1985)
9. *Id.*
10. *See, e.g.*, ERISA Regulation Section 2550.404a-4.

in defined contribution plans – though it states that the steps described in the regulation are not the only way a fiduciary may make a prudent selection.[11] The regulation does not specifically refer to GWBs, but in our view the concepts in the safe harbor are relevant by analogy. This is true because in both cases (annuity and GWB), a fiduciary is required to come to the conclusion that, based on available information, the provider is able to meet its future payment obligation. The regulation requires that a fiduciary take the following steps:

- A fiduciary must engage in an "objective, thorough and analytical search" to identify and select the insurance company (*e.g.*, the issuer of the GWB). In other words, a fiduciary must engage in a prudent process.
- A fiduciary must "appropriately consider information to assess the ability of the [provider] to make all future payments under the [contract]." That is, the fiduciary must gather relevant information and make a careful assessment of that information.
- Finally, a fiduciary must conclude that "at the time of the selection, the [provider] is financially able to make all future payments under the [contract] and the cost of the [contract] is reasonable in relation to the benefits and services to be provided under the contract." In other words, the fiduciary must make an informed and reasoned decision.

The DOL notes that, if necessary, the fiduciary should seek assistance from a knowledgeable advisor in connection with the decision.

The final element from this list, that the fiduciary conclude that the provider is financially able to make all future payments, is made "at the time of selection." This means that a fiduciary is not required to predict the future, only that it should evaluate the provider's ability at the time the decision is made and then monitor the financial strength periodically thereafter.

Unfortunately, the regulation offers little guidance about the information that should be considered and addressed by a fiduciary. When it originally proposed the regulation, the DOL specified that fiduciaries should consider certain information, including the insurance company's experience in providing annuities, its level of capital, surplus and reserves, ratings from insurance rating agencies, the structure of the contract, the availability of state guarantees.[12] However, these factors were omitted in the final regulation, the DOL explaining that it had concluded they were not necessary and potentially confusing.[13]

In the preamble to the final regulation, however, the DOL notes that "… although an annuity provider's ratings by insurance ratings services are not part of the final safe harbor, in many instances, fiduciaries may want to consider them, particularly if the ratings raise questions regarding the provider's ability to make future payments under the annuity contract [Emphasis added]."[14] High ratings would appear to be a strong indicator of an insurance company's ability to make future payments under its contract, especially if they are consistently high across the various rating agencies and over a full economic cycle. At the same time, fiduciaries should take into account any negative information. (For further information about ratings and the four major ratings services for life insurance companies, see Appendix A.)

Notwithstanding the deletion of these items in the final regulation, we believe that the list from the proposed regulation is helpful in understanding the types of information the DOL considered relevant. As such, they offer a guide of sorts for assessing the ability of an insurance company to make payments in the future.

In addition to information about the insurance company, fiduciaries must assess the features and cost of the GWB. Presumably, as a result of the 408(b)(2) disclosures that service providers are required to make and the 404a-5 disclosures that must be made to participants, the information should be available, though the cost assessment requires comparison with other, similar products available in the market. Based on the GWB products currently being offered, the cost of the guarantee ranges from 90 basis points to as much as 150 basis points on the invested amount to which the guarantee applies.[15] The variation in cost generally relates to the features of the guarantee. For example, can the income base grow after retirement? When does the charge begin, when a participant first invests in the product or at a specified age? Is the charge phased in over time? What are the guaranteed annual income rates? These and other factors should be considered in assessing the reasonableness of

11. *Id.*
12. 72 Fed.Reg. 52025.
13. *See* 73 Fed.Reg. 58448.
14. *Id.*
15. *See, e.g.*, http://iricouncil.org/docs/Comparison%20of%20Product%20Features%20High%20Res.pdf.

the cost. Information regarding the features of GWBs offered by various providers can be obtained on the website of the Institutional Retirement Income Council at www.iricouncil.org/comparison.

Timing of the Decision

After assessing the information, committees must determine that the insurance company is financially able to make all future payments and that the cost of the contract is reasonable. This conclusion must be made "at the time of the selection" of the insurance company.[16] This is consistent with the prudent man rule, which says that fiduciaries must base their actions and decisions on the "circumstances then prevailing." That is, prudence is determined at the time the decision is made and not measured at a later date using hindsight.

A plan committee that is considering the selection of a GWB provider must take into account information available to it at the time of the decision that would indicate the financial strength of the provider. The committee is not legally accountable for whether the provider will be around in 30 or 40 years and have the financial wherewithal to make the required payments at that time. It is not required to predict the future. It is only required to make a decision, based on today's information, about whether it is reasonable to believe that the provider has the financial ability to make the payments in the future.

The distinction between predicting the future and making a decision now about the financial ability of the provider may be a subtle one, but it is important. It hinges on the issue of whether the committee has acted prudently. If the committee can conclude, based on today's data, that the insurer can meet its obligations, the committee will have fulfilled its duty even if the insurance company later becomes insolvent. There is an ongoing duty to monitor the selection, to confirm whether the earlier determination of the financial strength of the insurance company remains prudent, but the monitoring decision will also be based on the circumstances then prevailing (*i.e.*, the information then available) and, in effect, will constitute a new "informed and reasoned" decision.

No bright-line test exists as to the frequency for such a review. The DOL website, for example, recommends that "[a]n employer should establish and follow a formal review process *at reasonable intervals* to decide if it wants to continue using the current service providers or look for replacements."[17] [Emphasis added.] At the very least, a review should occur whenever new information comes to light that suggests there might be a problem with the selection. In the absence of adverse information, a review every three to four years would seem to be adequate, in light of how the market for GWBs is evolving and the fact that new products may be introduced that are better suited for a given plan.

Portability

There are two aspects to the issue commonly referred to as "portability." The first relates to participants upon termination of employment. The second relates to a change in plan service providers.

The issue for a participant is whether he will be able to retain the GWB guarantee if he changes employment. In that situation, he will no longer be eligible to participate in the plan that offers the GWB. Does this mean that he will lose the guarantee and the amounts charged to his account to pay for it? The answer is "no" for several reasons. First, unless he has a small account (under $5,000), the employee will be able to leave his account balance in the plan of his former employer and retain the investment with which the GWB is associated. The employee will not be able to add to the investment and thus "buy" additional guaranteed amounts, but at least he will not lose what he has already accumulated.

In addition, GWB providers will generally permit the participant to roll the GWB fund to an IRA with that provider. Again, this will preserve the guarantee and may permit the participant to increase the amount that is guaranteed through additional investment in the GWB fund. As the market evolves, it may also be possible for participants to rollover the GWB fund to an IRA trusteed by a different provider, and possibly to the plan of a new employer, but these alternatives are not currently readily available.

The issue at the employer level is more complex. For a variety of reasons, the employer may decide that it is important to change providers. As currently structured, GWB products are currently only available where the provider also serves as the recordkeeper for a plan. Thus, if the employer changes providers, the GWB product may no longer be available, and the participants who elected to purchase the GWB product may lose the guarantee of

16. ERISA Regulation Section 2550.404a-4(c).

17. *See* www.dol.gov/ebsa/publications/fiduciaryresponsibility.html.

future income, the income base guarantee and effectively the amounts paid for the guarantee. This possibility raises the issue of whether the employer is precluded from changing providers because it will damage at least a portion of the participant population. In the case of a plan with a GWB product that is being taken over by Lincoln as the recordkeeper, Lincoln is able to provide the same level of guarantee that the participants had prior to the transfer through conversion to the Lincoln *Secured Retirement Income*SM product, often without any additional cost.

As to the latter issue, DOL guidance and case law indicates that fiduciaries must act in the best interest of the participants as a whole and not in the interest of each participant.[18] Thus, if the decision to change providers is a prudent one and is in the interest of the participant population generally, the fact that certain participants may be disadvantaged does not preclude the change.

In addition, providers are currently working on ways to ensure that if a plan makes a provider change, the GWB product purchased by individual participants may be retained. In the case of Lincoln, for example, it uses a recordkeeping system, also used by several other providers, under which the participant will be able to retain the GWB product and access information about it on the new provider's website. In addition, an industry group to which many recordkeepers belong has developed protocols that, if adopted by the recordkeepers will lead to the same result. While a change in providers that will not disadvantage participants and will make for a seamless transition is still a work in progress, it can be anticipated that a resolution of the portability issue will be forthcoming in the not too distant future.

GWBs as a QDIA

In a participant-directed plan, if a participant fails to provide instructions for the investment of deferrals or other contributions to his account, the fiduciaries are required to invest those amounts for him. As with any fiduciary decision, the fiduciaries must act prudently in making the investment decision and can be held liable for losses suffered by the participant if they fail to do so. ERISA Section 404(c)(5) and a related regulation under that section provide fiduciaries with a safe harbor, so long as the amounts are invested in a "qualified default investment alternative" (or QDIA) and the fiduciaries comply with certain notice requirements. In essence, the participant is deemed to have exercised control over his account.

The regulation under Section 404(c)(5) provides that three types of investments qualify as QDIAs: target-date funds, a balanced fund and a managed account service that allocates the participants account among the investment options available under the plan. It would appear that a GWB product, such as the Lincoln *Secured Retirement Income*SM solution which uses a moderate balanced fund as the underlying investment, would meet this requirement except for the fact that it includes the GWB guarantee, which is an insurance feature. So the question becomes whether this added feature disqualifies the GWB as a QDIA.

In the regulation under Section 404(c)(5), the DOL indicated that QDIAs may be offered through "variable annuity or similar contracts" and "without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment fund product or model portfolio."[19] In light of this statement, it is clear that a product that otherwise meets the definition of a QDIA will still qualify if it also contains the GWB feature.

Several years after, the issuance of the QDIA regulation, the DOL confirmed that conclusion in a letter to the U.S. Department of Treasury.[20] In that letter, the DOL specifically concluded that QDIAs could have annuity features (that is, could guarantee retirement income).

> Two years later, the DOL addressed the issue again.[21] In that guidance, the DOL stated:
>
> Section 2550.404c-5(e)(4)(vi) [the QDIA regulation] states that products and portfolios that include annuity purchase rights, investment guarantees, death benefit guarantees, or other features ancillary to the investment fund, product or portfolio may qualify as QDIAs, . . .
>
> It is now clear that a GWB can serve as a plan's QDIA.

General Comment on Policy

In recent years, the Department of Labor and Treasury have become increasingly concerned about the prospect of older retirees exhausting their 401(k), 403(b) and IRA

18. *See, e.g.*, DOL Field Assistance Bulletin 2006-01, addressing the allocation of market timing proceeds among the plan's participants. *See also* FAB 2003-3, and *Borneman v. Principal*, 291 F. Supp. 2d 935 (S.D. Iowa 2003) ("As a fiduciary, [the plan sponsor] has a duty to act in the best interests of all plan participants and beneficiaries, not simply a duty to act in the best interests of each individual plan participant or beneficiary.")

19. ERISA Regulation §2550.404a-5(e)(4)(vi).

20. Letter from Phyllis Borzi, DOL Assistant Secretary for the Employee Benefit Security Administration to J. Mark Iwry, Department of Treasury, October 23, 2014.

21. DOL Information Letter to Christopher Spence, December 22, 2016.

Conclusion

savings. As a result, there is a shift in policy to support guaranteed lifetime income. For example, the DOL recently said:[22]

> Following the publication of the final rule [that is, the QDIA regulation], a national discussion surfaced around the availability, need for, and importance of lifetime income products and features as a way to protect participants and beneficiaries against the longevity risk of outliving the assets they saved to provide retirement income, the risk of having retirement savings eroded by investment losses, and the risk of declining cognitive abilities that can hamper portfolio management and other financial decision-making skills. **The Department, along with the Treasury Department and other stakeholders, identified the need for lifetime income as an important public policy issue and has supported initiatives that could lead to broader use of lifetime income options in defined contribution plans as a supplement to and enhancement of accumulation of retirement savings.** [Emphasis added.]

Because of this change, plan fiduciaries should understand that the use of lifetime income products is consistent with Federal retirement policy.

The selection of an annuity provider is not inherently different from any other decision that must be made by plan fiduciaries. While the ERISA safe harbor regulation does not provide a roadmap of the specific information for fiduciaries to review, fiduciaries may not need to follow all the steps outlined in the safe harbor regulation, if they select an insurance company with the following characteristics:

- A well-known reputation
- A significant volume of annuity business and a history of successful management of that business
- Consistently high ratings from the major ratings agencies over a long period
- A company that is well-financed

Nevertheless, we believe that the criteria reflected in the checklist attached as Appendix A would be appropriate in selecting a provider.

22. *Supra.*

Appendix A

Sample Checklist for Evaluating an Insurance Company

Fiduciaries responsible for selecting annuity providers are not obligated to follow the steps in the safe harbor regulation. However, there are several steps fiduciaries should consider performing as part of a prudent process.

The first step is to identify the insurance companies that could meet the plan's needs, i.e., that offer the product(s) a fiduciary is looking to provide to the participants. While this could be determined through an RFP process, the fiduciary or the plan's advisor should be able to identify the likely candidates.

The next step would be to perform an evaluation of the insurance companies as outlined in the following checklist (and to retain copies of the materials that were reviewed as part of the due diligence). Fiduciaries who do not have the expertise (or perhaps the time) to conduct this type of review should consult with a knowledgeable advisor.

The checklist, prepared by Martin Schmidt of HS2 Benefits and the Institutional Retirement Income Council, with input from officials of Lincoln Financial and the authors, is intended for general guidance, since the specific circumstances of the plan must be considered by the fiduciaries. Some of the items in the checklist may be more important than others, and other considerations beyond those listed may also be important.

There are four main areas that fiduciaries should consider when evaluating an insurance company:

- Financial strength of the company
- Evaluation by the rating agencies
- Commitment and success in the insurance industry
- Diversification of the business lines

For each section of the checklist, there is an indication of the information to be assessed, how to obtain the information, and, where relevant, how to compare the information gathered on different providers. The data for each of the items should be readily available. If the information is not available that may constitute a basis for concluding a company is not a prudent choice.

We do not mean to suggest that a plan committee that fails to follow some of these steps – or even all of these steps – in selecting an insurance company has breached its fiduciary duties. This checklist is not intended to define the fiduciary process for selecting an annuity provider, but instead to provide a list of best practices to help fiduciaries perform their duties.

Items to be reviewed	Where or how to obtain this information	Benchmark/parameters for what is considered prudent by fiduciaries	Information for: (Name of Insurance Company)
		FINANCIAL STRENGTH OF COMPANY	
National Association of Insurance Commissioners (NAIC) Bond Quality	Annual Statutory Statements - Schedule D (This can be found on the insurer's website or can be requested from the insurer)	Investment-grade bonds should be at least 90% of the bond holdings of the General Account **Note:** Class 1 & 2 bonds are considered investment-grade. If the percentage of Class 1 & 2 bonds is below 90%, discuss with the insurance company for further details on bond quality.	Percent of Investment-grade bonds: As of xx/xx/xx: _____% Comment:
Diversification of Invested Assets: • Bond Type • Bond Duration • Preferred Stocks • Common Stocks • Real Estate • Alternative Investments	• Annual Statutory Statements: » Bonds: Schedule D » Preferred Stocks: Assets Schedule » Common Stocks: Assets Schedule » Real Estate: Assets Schedule » Alternative Investments: Assets Schedule	An insurance company's General Account should have the following: • Bonds should be diversified among bond types (U.S. Govt., State Govt., industries, etc.) • Bond maturities should be spread to match liabilities across the following timeframes: » 1 year or less » 1 through 5 years » 5 through 10 years » 10 through 20 years » Over 20 years • Preferred Stocks: Maximum of 5% • Common Stocks: Maximum of 5% • Real Estate: Maximum of 5% • Alternative Investments: Maximum of 5% **Note:** If the percentage exceeds 5% for any of the assets, discuss with the insurance company to understand the reason for the higher percent.	• Are the bonds owned diversified among bond types? Yes: ___ No: ___ • Are the bond maturities diversified according to the following timeframes: » 1 year or less » 1 through 5 years » 5 through 10 years » 10 through 20 years » Over 20 years Yes: ___ No: ___ If no, did a detailed conversation with the insurer take place to ensure that bond maturities match liabilities? Yes: ___ No: ___ 1. ____% for Preferred Stocks 2. ____% for Common Stocks 3. ____% for Real Estate 4. ____% for Alternative Investments Reviewed the ____ Statutory Statements Comment:
Insurer's Asset Liquidity	• Annual Statutory Statements: » Total Bonds (Assets Schedule) » Total Cash (Assets Schedule) » Total Mortgages (Assets Schedule) » Total Reserves (Reserve Analysis)	An insurer's asset liquidity should be a minimum of 100%: • Liquidity Ratio = Bonds + Cash + Mortgages / Reserves **Note**: If the percentage is below 100%, discuss with the insurance company for further details on asset liquidity.	Percent of Liquid Assets available to cover liabilities: As of xx/xx/xx: _____% Comment:

Fortune 500 Ranking: Life & Health Insurance Companies	Life & Health Insurance Companies are either listed as a "stock" or a "mutual" insurance company. The information is available at the following website: • www.fortune.com/fortune500/2017	Rankings of insurance companies are based on annual total revenue, which is defined as premium and annuity income, investment income, and capital gains or losses but exclude deposits. A history of strong and increasing revenue growth is a good indication of financial health. A ranking should be in the top 10 for Life & Health insurance companies in the Fortune 500. The 10th largest U.S. based Life & Health insurance company had annual revenues of approximately $12.4 billion in 2016. This annual revenue can be used as a baseline when assessing the size of an internationally owned insurer.	Fortune 500 ranking: ___ as of (year) Fortune 500 Life & Health Insurance ranking: _____ Comment:
Analysis of Insurer's Statutory Capital: Capital, Surplus, and Asset Valuation Reserve (AVR)	• Annual Statutory Statements • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Balance sheet strength is the most important area to evaluate in determining an insurer's ability to meet its obligations. Balance sheet strength measures the exposure of a company's surplus to volatility based on its operating and financial practices and can reflect its capital generation capabilities resulting from quality of earnings. Financial performance is also important as it determines how the balance sheet strength will be enhanced, maintained, or eroded over time. Rating agencies typically will develop a Capital Adequacy Ratio, which provides a quantitative measure of the risks inherent in a company's investment and insurance profile, relative to its risk-adjusted capital. Since the rating agencies have developed thorough analytical tools and have developed a rating derived from an in-depth evaluation of an insurer's balance sheet strength, but also operating performance and business profile, it is prudent for fiduciaries to utilize that analysis in forming a decision. Since the capital adequacy, balance sheet strength, claims paying ability, and financial strength of an insurer are all analyzed and incorporated into the rating agencies assessment, one of the most important steps a plan sponsor can take is to understand the current ratings and ratings over recent past and to ensure the insurance company offering the retirement income product fully cooperates with the information requested by the rating agencies. The next section of this check list is devoted to the ratings agencies.	Has the insurer provided the following information to the rating agencies:[23] • Reported capital and surplus, including growth rate of statutory capital, growth rate in assets and net premiums written • Information showing exposure to various types of leverage, such as operating leverage (net premiums written to capital or capital to liabilities) and financial leverage (debt and debt-like instruments to capital) • Information showing historical sources of growth in capital, such as operating gains, capital gains, capital contributions, etc. • Information showing quality and diversity of invested assets for a review of trends in asset allocations, exposure to higher-risk assets, and asset concentrations by class, issuer, and industry Yes: ___ No: ___ Comment:

23. A.M. Best Credit Rating Methodology

Items to be reviewed	Where or how to obtain this information	Benchmark/parameters for what is considered prudent by fiduciaries	Information for: (Name of Insurance Company)
EVALUATION BY RATING AGENCIES			
Ratings from each of the rating agencies to determine the consistency (or lack of consistency) among the rating agencies.	• Insurance Company Annual Report[24] / website; or • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Acceptable ratings for financially strong companies are considered: • A.M. Best: A- or Higher • Fitch Ratings: A- or Higher • Moody's: A3 or Higher • Standard & Poor's: A- or Higher	Most recent rating as of xx/xx/xx: • A.M. Best Rating: ____ • Fitch Ratings Rating: ____ • Moody's Rating: ____ • Standard & Poor's Rating: ____ Comment:
Ratings over a 5 year period (or longer) to determine if the trends have been stable over time or have fluctuated during economic cycles.	• Insurance Company Annual Reports; or • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Acceptable ratings for financially strong companies are considered: • A.M. Best: A- or Higher • Fitch Ratings: A- or Higher • Moody's: A3 or Higher • Standard & Poor's: A- or Higher	Yr 2 / Yr 3 / Yr 4 / Yr 5 AM Best Fitch Moody's S&P **Other**: If necessary, review of ratings for additional years based on economic conditions. Comment:
The report accompanying the rating from each rating agency to determine if there are adverse comments about the company that suggest vulnerability to future economic events.	• Insurance Company website; or • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Adverse comments from the ratings agencies are an indicator of a possible downgrade in the future. Any adverse comments should be further investigated.	Are there any adverse comments about the insurance company? As of xx/xx/xx: Yes: ___ No: ___ Comment:
Items to be reviewed	**Where or how to obtain this information**	**Benchmark/parameters for what is considered prudent by fiduciaries**	**Information for: (Name of Insurance Company)**
COMMITMENT AND SUCCESS IN INSURANCE INDUSTRY			
Length of time in the annuity business.	Insurance Company	The annuity provider should have enough history to demonstrate ability to maintain a strong balance sheet through different market cycles. It is recommended that an insurance company have a minimum of 10 years in the annuity industry and annuities with living benefits.	Number of years in the annuity business: As of (year): _____ Years Comment:

24. For mutual companies or foreign based companies, the insurer will need to supply the equivalent information that is reported in an annual report or 10k filing

Size of annuity business: • number of annuity contracts • amount of annuity assets	Insurance Company	A well-established annuity provider would have: • A minimum of 250,000 annuity contracts • Total traditional annuity assets of at least $15 billion, with at least $5 billion with living benefits	As of xx/xx/xx: Number of annuity contracts: _____ Amount of annuity assets: _____ Comment:
Determine if the annuity business is a part of the company's core offering.	Insurance Company Annual Report	Annuities and income guarantees should be one of the core business lines (at least 10% of annual revenue) of the insurer.	Are annuities one of the core offerings of the insurance company? Yes: ___ No: ___ Comment:
Review available information on the company's regulatory history and litigation history with particular focus on potential impacts to the annuity business	Insurance Company Form 10-K[25]	Fiduciaries should look for a company with a well established reputation and track record in the insurance and annuity business. Fiduciaries should understand available information about the types of litigation and/or regulatory action an organization has experienced in the past or currently has pending. Negative results and pending matters should be understood to assess the impact on the company. Focus should be on the potential impact. Depending on the circumstances, an example of potentially material litigation activity could be a lawsuit that has been certified as a class action.	Does available information indicate any material pending litigation or regulatory action that has or may impact the annuity business? As of xx/xx/xx: Yes: ___ No: ___ Comment:
Review the availability and extent of additional protection through state guaranty associations	Information is available from the National Organization of Life and Health Insurance Guaranty Associations at the following website: • www.nolhga.com/policyholderinfo/main.cfm/ Click on the drop down menu to locate state(s) where the majority of employees reside.	Coverage provided by state insurance guaranty associations might provide an additional safeguard for the plan in the event an insurance company fails.	Generally, most states provide at least $100,000 in coverage for annuities and many state guarantee associations provide a higher level of coverage. The actual coverage amount will depend on a number of factors including the state of residence, the type of contract, and the cause and type of insolvency with the insurer. A plan sponsor with a majority of employees in one or two states should contact the state guarantee association of those states for more information on the guarantee provided for the type of group contract being offered.

25. For mutual companies or foreign based companies, the insurer will need to supply the equivalent information that is reported in an annual report or 10k filing

Information regarding the insurer's reputation and whether there has been material adverse information regarding the company in the news	Review information reported in the financial press and financial websites	Fiduciaries should look for a company with a well established reputation and track record in the insurance and annuity business. Any material negative current information reported about the organization should be reviewed and understood to assess the impact on the company along with the potential impact of pending litigation and impact on the annuity business.	Is there any current material adverse information concerning the insurer? As of xx/xx/xx: Yes: ___ No: ___ Comment:
Items to be reviewed	**Where or how to obtain this information**	**Benchmark/parameters for what is considered prudent by fiduciaries**	**Information for: (Name of Insurance Company)**
DIVERSIFICATION OF BUSINESS LINES			
Determine the business lines and their size within the organization. Possible business lines include: • Annuities • Life Insurance • Group Insurance • Retirement Plans • Other	Insurance Company Annual Report or Form 10-K	While diversification alone does not ensure a financially strong organization, it can help with the volatility when compared to a single line of business. Insurance companies with a single line/limited line of business should be closely scrutinized to determine the financial strength of the business prior to their selection.	Is the insurance company broadly diversified across different lines of business? Yes: ___ No: ___ Does the insurance company have the following lines of business? • Annuities: Yes: ___ No: ___ • Life Insurance: Yes: ___ No: ___ • Group Insurance: Yes: ___No: ___ • Retirement Plans: Yes: ___ No: ___ • Other: Yes ___ No: ___ Revenue (in millions) by Business Line/Division: • Annuities: _____ • Life Insurance: _____ • Group Insurance: _____ • Retirement Plans: _____ • Other: _____ Comment:

Appendix B

Evaluation of The Lincoln National Life Insurance Company

Based on the criteria outlined in the checklist from Appendix A, an evaluation was performed for The Lincoln National Life Insurance Company. A summary of the evaluation is included below followed by the detailed analysis in the attached checklist.

FINANCIAL STRENGTH OF COMPANY

The Lincoln National Life Insurance Company's overall financial strength is very strong. The company has a well-diversified portfolio of assets with limited amounts invested in equities, real estate, and alternative investments. The bond portfolio is effectively managed and diversified, with over 95 percent invested in investment grade bonds. There is also a sufficient amount of liquid assets available to pay liabilities.

Annual revenues were approximately $13.3 billion in 2016. This placed the company as the 8th largest of all U.S. based Life & Health companies (both mutual and stock companies) and 207th largest company in the Fortune 500.

EVALUATION BY RATING AGENCIES

The current year ratings from each rating agency reflect the company's strong financial position. The ratings exceeded the minimum levels for a financially strong organization. The 2017 rating from each rating agency for the company is as follows:

- A.M. Best: Second out of 16 categories
- Fitch Ratings: Fifth out of 19 categories
- Moody's: Fifth out of 21 categories
- Standard & Poor's: Fourth out of 22 categories

There were no changes in ratings of The Lincoln National Life Insurance Company over the previous four years (2013 to 2016). There were no adverse comments from any of the ratings agencies regarding the company's financial outlook. The most recent outlook from each rating agency is stable.

COMMITMENT AND SUCCESS IN INSURANCE INDUSTRY

The company has a long history with significant scale in the annuity business. This has allowed the company to demonstrate their performance in the annuity business over different market cycles.

The annuity business is a core product offering, representing approximately 30 percent of the company's annual revenue with a large number of outstanding annuity contracts. This indicates that scale should not be a problem in future years.

In reviewing the company's financial statements, no pending litigation was noted that impacted the annuity business. In addition, a review of various financial websites and trade publications did not identify any material information or negative comments regarding the company.

Finally, additional protection is available for annuitants through the state guarantee associations. This will provide an added safeguard in the event Lincoln has financial difficulties in the future.

DIVERSIFICATION OF BUSINESS LINES

The company is diversified across four main lines of business. The Life Insurance business is the largest segment, representing approximately 47 percent of annual revenue. The Annuity business is the second largest segment with approximately 30 percent of annual revenue. The remaining business lines are Group Insurance and Retirement Plans with approximately 16 percent and 8 percent of the annual revenue respectively. The diversification across multiple business segments will help the company mitigate potential risk in the event one of the business lines has financial difficulties.

CONCLUSION

At the date of this White Paper, based on the reported information and how it is measured against the standards established in the checklist, a fiduciary may reasonably conclude that The Lincoln National Life Insurance Company is financially able to make future payments on the Lincoln *Secured Retirement Income*SM solution and The Lincoln National Life Insurance Company would be a prudent choice for a fiduciary when evaluating an insurance company. From an objective measure, the company has a strong financial structure and is rated highly by each of the rating agencies. The company also has sufficient size when compared to other insurance companies in the industry. From a subjective measure, the company has a long history in the annuity business and has experienced significant growth over the years. While the annuity business is a core product offering the company also benefits from diversification across multiple lines of business which should help reduce volatility in down market cycles. Finally, the company has a strong reputation in the insurance market.

Items to be reviewed	Where or how to obtain this information	Benchmark/parameters for what is considered prudent by fiduciaries	The Lincoln National Life Insurance Company
		FINANCIAL STRENGTH OF COMPANY	
National Association of Insurance Commissioners (NAIC) Bond Quality	Annual Statutory Statements - Schedule D	Investment-grade bonds should be at least 90% of the bond holdings of the General Account **Note**: Class 1 & 2 bonds are considered investment grade. If the percentage of Class 1 & 2 bonds is below 90%, discuss with the insurance company for further details on bond quality.	Percent of Investment-grade bonds: As of 12/31/16: 95.59% Comment: The bond quality is above the required minimum.
Diversification of Invested Assets: • Bond Type • Bond Duration • Preferred Stocks • Common Stocks • Real Estate • Alternative Investments	• Annual Statutory Statements: » Bonds: Schedule D » Preferred Stocks: Assets Schedule » Common Stocks: Assets Schedule » Real Estate: Assets Schedule » Alternative Investments: Assets Schedule	An insurance company's General Account should have the following: • Bonds should be diversified among bond types (U.S. Govt., State Govt., industries, etc.) • Bond maturities should be spread to match liabilities across the following timeframes: » 1 year or less » 1 through 5 years » 5 through 10 years » 10 through 20 years » Over 20 years • Preferred Stocks: Maximum of 5% • Common Stocks: Maximum of 5% • Real Estate: Maximum of 5% • Alternative Investments: Maximum of 5% **Note**: If the percentage exceeds 5% for any of the assets, discuss with the insurance company to understand the reason for the higher percent.	• Are the bonds owned diversified among bond types? Yes: XX No: ___ • Are the bond maturities diversified according to the following timeframes: » 1 year or less » 1 through 5 years » 5 through 10 years » 10 through 20 years » Over 20 years Yes: XX No: ___ If no, did a detailed conversation with the insurer take place to ensure that bond maturities match liabilities? Yes: ___ No: ___ • < 1% for Preferred Stocks • Approx. 3% for Common Stocks • < 1% for Real Estate • Approx. 1% for Alternative Investments Reviewed the 2016 Statutory Statements Comment: The bonds are properly diversified and the investments are below the required limits.
Insurer's Asset Liquidity	• Annual Statutory Statements: » Total Bonds (Assets Schedule) » Total Cash (Assets Schedule) » Total Mortgages (Assets Schedule) » Total Reserves (Reserve Analysis)	An insurer's asset liquidity should be a minimum of 100%: • Liquidity Ratio = Bonds + Cash + Mortgages / Reserves **Note**: If the percentage is below 100%, discuss with the insurance company for further details on asset liquidity.	Percentage of liquid assets available to cover liabilities: As of 12/31/16: 111.55% Comment: There is a sufficient amount of liquid assets to pay liabilities.

Fortune 500 Ranking: Life & Health Insurance Companies	Life & Health Insurance Companies are either listed as a "stock" or a "mutual" insurance company. The information is available at the following website: • www.fortune.com/fortune500/2017	Rankings of insurance companies are based on annual total revenue, which is defined as premium and annuity income, investment income, and capital gains or losses but exclude deposits. A history of strong and increasing revenue growth is a good indication of financial health. A ranking should be in the top 10 for Life & Health insurance companies in the Fortune 500. The 10th largest U.S. based Life & Health insurance company had annual revenues of approximately $12.4 billion in 2016. This annual revenue can be used as a baseline when assessing the size of an internationally owned insurer.	Fortune 500 ranking: 207 as of 2016 Fortune 500 Life & Health Insurance ranking: 8th ranked U.S.-based Insurance Company as of 2016; annual revenue of $13.3 billion Comment: Lincoln has significant scale based on its current ranking among insurance companies.
Analysis of Insurer's Statutory Capital: Capital, Surplus, and Asset Valuation Reserve (AVR	• Annual Statutory Statements • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Balance sheet strength is the most important area to evaluate in determining an insurer's ability to meet its obligations. Balance sheet strength measures the exposure of a company's surplus to volatility based on its operating and financial practices and can reflect its capital generation capabilities resulting from quality of earnings. Financial performance is also important as it determines how the balance sheet strength will be enhanced, maintained, or eroded over time. Rating agencies typically will develop a Capital Adequacy Ratio, which provides a quantitative measure of the risks inherent in a company's investment and insurance profile, relative to its risk-adjusted capital. Since the rating agencies have developed thorough analytical tools and have developed a rating derived from an in-depth evaluation of an insurer's balance sheet strength, but also operating performance and business profile, it is prudent for fiduciaries to utilize that analysis in forming a decision.	Has the insurer provided the following information to the rating agencies:[26] • Reported capital and surplus, including growth rate of statutory capital, growth rate in assets and net premiums written • Information showing exposure to various types of leverage, such as operating leverage (net premiums written to capital or capital to liabilities) and financial leverage (debt and debt-like instruments to capital) • Information showing historical sources of growth in capital, such as operating gains, capital gains, capital contributions, etc. • Information showing quality and diversity of invested assets for a review of trends in asset allocations, exposure to higher-risk assets, and asset concentrations by class, issuer, and industry Yes: XX No: ___ Comment: The required information was reported to the rating agencies.

26. A.M. Best Credit Rating Methodology

Items to be reviewed	Where or how to obtain this information	Benchmark/parameters for what is considered prudent by fiduciaries	The Lincoln National Life Insurance Company
EVALUATION BY RATING AGENCIES			
Ratings from each of the rating agencies to determine the consistency (or lack of consistency) among the rating agencies.	• Insurance Company Annual Report / website; or • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Acceptable ratings for financially strong companies are considered: • A.M. Best: A- or Higher • Fitch Ratings: A- or Higher • Moody's: A3 or Higher • Standard & Poor's: A- or Higher	Most recent rating as of 05/03/17: • A.M. Best Rating: A+ • Fitch Ratings Rating: A+ • Moody's Rating: A1 • Standard & Poor's Rating: AA- Comment: Ratings from each of the rating agencies are above the minimum level required.
Ratings over a 5 year period (or longer) to determine if the trends have been stable over time or have fluctuated during economic cycles.	• Insurance Company Annual Reports[27]; or • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Acceptable ratings for financially strong companies are considered: • A.M. Best: A- or Higher • Fitch Ratings: A- or Higher • Moody's: A3 or Higher • Standard & Poor's: A- or Higher	2016 / 2015 / 2014 / 2013 AM Best: A+ / A+ / A+ / A+ Fitch: A+ / A+ / A+ / A+ Moody's: A1 / A1 / A1 / A1 S&P: AA- / AA- / AA- / AA- **Other**: If necessary, review ratings for additional years based on economic conditions. Comment: The ratings over the last four years have been consistent with no changes from 2013 to 2016.
The report accompanying the rating from each rating agency to determine if there are adverse comments about the company that suggest vulnerability to future economic events.	• Insurance Company website • Individual rating agencies: » www.ambest.com » www.fitchratings.com » www.moodys.com » www.standardandpoors.com	Adverse comments from the ratings agencies are an indicator of a possible downgrade in the future. Any adverse comments should be further investigated.	Are there any adverse comments about the insurance company? Lincoln Financial website as of 7/01/17: Yes: ___ No: XX Comment: The most recent outlook from each of rating agency is stable. The review date from the rating agencies ranged from January 2016 to December 2016.

27. For mutual companies or foreign based companies, the insurer will need to supply the equivalent information in an annual report.

Items to be reviewed	Where or how to obtain this information	Benchmark/parameters for what is considered prudent by fiduciaries	The Lincoln National Life Insurance Company
COMMITMENT AND SUCCESS IN INSURANCE INDUSTRY			
Length of time in the annuity business.	Insurance Company	The annuity provider should have enough history to demonstrate ability to maintain a strong balance sheet through different market cycles. It is recommended that an insurance company have a minimum of 10 years in the annuity industry and annuities with living benefits.	Number of years in the annuity business: As of 2016: Over 43 Years Comment: Lincoln Financial has a long history in serving the annuity market.
Size of annuity business: • number of annuity contracts • amount of annuity assets	Insurance Company	A well-established annuity provider would have: • A minimum of 250,000 annuity contracts • Total traditional annuity assets of at least $15 billion, with at least $5 billion with living benefits	As of 12/31/16: Number of annuity contracts: Over 1 million Amount of annuity assets: $125 billion total annuities; $69 billion with living benefits Comment: There is sufficient scale with the overall annuity business.
Determine if the annuity business is a part of the company's core offering.	Insurance Company Annual Report	Annuities and income guarantees should be one of the core business lines (at least 10% of annual revenue) of the insurer.	Are annuities one of the core offerings of the insurance company? Yes: XX No: ___ Comment: The annuity business is one of four lines of business within the company. Annual revenues of the annuity business were approximately 30% of overall company revenue for 2016.
Review available information on the company's regulatory and litigation history with particular focus on potential impacts to the annuity business.	Insurance Company Form 10-K[28]	Fiduciaries should look for a company with a well established reputation and track record in the insurance and annuity business. Fiduciaries should understand available information about the types of litigation and/or regulatory action an organization has experienced in the past or currently has pending. Negative results and pending matters should be understood to assess the impact on the company. Focus should be on the potential for material impact. Depending on the circumstances, an example of potentially material litigation activity could be a lawsuit that has been certified as a class action.	Is there any pending litigation that impacts the annuity business? As of 2016: Yes: ___ No: XX Reviewed Note 13 of 2016 Form 10-K Comment: The 2016 Form 10-K did not reveal any pending litigation that would materially impact the annuity business.

28. *Id.*

Review the availability and extent of additional protection through state guaranty associations	Information is available from the National Organization of Life and Health Insurance Guaranty Associations at the following website: • www.nolhga.com/policyholderinfo/main.cfm/ Click on the drop down menu to locate state(s) where the majority of employees reside.	Coverage provided by state insurance guaranty associations might provide an additional safeguard for the plan in the event an insurance company fails.	Generally, most states provide at least $100,000 in coverage for annuities and many state guarantee associations provide a higher level of coverage. The actual coverage amount will depend on a number of factors including the state of residence, the type of contract, and the cause and type of insolvency with the insurer. A plan sponsor with a majority of employees in one or two states should contact the state guarantee association of those states for more information on the guarantee provided for a group variable annuity contract that includes a guaranteed minimum withdrawal benefit.
Information regarding the insurer's reputation and whether there has been material adverse information regarding the company in the news	Review information reported in the financial press and financial websites	Fiduciaries should look for a company with a well established reputation and track record in the insurance and annuity business. Any material negative current information reported about the organization should be reviewed and understood to assess the impact on the company along with the potential impact of pending litigation and impact on the annuity business.	Is there any current material adverse information concerning the insurer? As of 7/1/17: Yes: ____ No: XX Comment: No negative comments were reported on the company.
Items to be reviewed	**Where or how to obtain this information**	**Benchmark/parameters for what is considered prudent by fiduciaries**	**The Lincoln National Life Insurance Company**
DIVERSIFICATION OF BUSINESS LINES			
Determine the business lines and their size within the organization. Possible business lines include: • Annuities • Life nsurance • Group Insurance • Retirement Plans • Other	Insurance Company Form 10-K	While diversification alone does not ensure a financially strong organization, it can help with the volatility when compared to a single line of business. Insurance companies with a single line/limited line of business should be closely scrutinized to determine the financial strength of the business prior to their selection.	Is the insurance company broadly diversified across different lines of business? Yes: XX No: ___ Does the insurance company have the following lines of business? • Annuities: Yes: XX No: ___ • Life Insurance: Yes: XX No: ___ • Group Insurance: Yes: XX No: ___ • Retirement Plans: Yes: XX No: ___ • Other: Yes XX No: ___ Revenue (in millions) by Business Line/Division: • Life Insurance: $6,246 • Annuities: $4,033 • Group Insurance: $2,103 • Retirement Plans: $1,103 • Other: $332 Comment: The company is diversified across four major lines of business based on a review of the 2016 Form 10-K.

Appendix C

Evaluation of the Lincoln *Secured Retirement Income*SM Solution

The Lincoln *Secured Retirement Income*SM solution is the next generation in-plan guaranteed minimum withdrawal benefit offering available in the DC marketplace. As a product offering, it guarantees a stream of income payments to a participant, regardless of the contract account value. It also allows DC plan participants to protect their income prior to and during retirement while at the same time allowing for participation in a positive investment experience. The product offering also addresses several retiree risks, especially the sequence of returns and longevity issues, with added flexibility that is not available in other product offerings.

As part of the analysis, a product comparison was performed of the *Secured Retirement Income*SM solution against four other leading in-plan guaranteed minimum withdrawal product offerings available in the DC market. The product comparison was divided into four sections when evaluating the product offerings:

- Investment Structure
- Fees and Expenses
- Account Balance during the Accumulation Phase
- Account Balance during the Distribution Phase

Within each section specific criteria was evaluated to determine how each product is structured.

The *Secured Retirement Income*SM solution compared very favorably with the other product offerings. Several unique features were identified with the *Secured Retirement Income*SM solution when compared to the other product offerings:

- When offered as part of a target date series, the *Secured Retirement Income*SM investment option is a separate investment included in the glide path of a Lincoln custom target-date portfolio starting 10 years from the target retirement date. The initial allocation to the Lincoln *Secured Retirement Income*SM investment option is 10%. An additional 10% is allocated each year to the Lincoln *Secured Retirement Income*SM investment option, so that when the participant reaches his target retirement date, 100% of his balance will be in the Lincoln *Secured Retirement Income*SM investment option.

  This design feature has the guarantee gradually increasing for the participant over a 10 year period. As a result, the participant is not paying the full cost of the guarantee fee until they are 100% invested in the Lincoln *Secured Retirement Income*SM solution. Other product offerings had the full guarantee effective 10 years prior to the targeted retirement date or when the first deposit was made to one of the investment options.

  Plan sponsors can also elect to have the participant's final allocation to the Lincoln *Secured Retirement Income*SM investment option be either 75% or 50%. If one of the alternative structures is elected, the allocation to the Lincoln *Secured Retirement Income*SM investment option is adjusted accordingly over the 10 year period prior to the targeted retirement date.

- Because the Lincoln *Secured Retirement Income*SM investment option is included within the target-date portfolios rather than wrapped around an entire fund(s), there is greater flexibility in allowing the guarantee feature to be integrated into the glide path of a custom target-date portfolio. The other product offerings had a set group of investment options that were available with the guaranteed option.

- Each of the product offerings had various payout percentages based on age and election type (single or joint life). The Lincoln *Secured Retirement Income*SM investment option had an added feature where the guaranteed annual income percent could increase to the next higher percent after the participant elected to start income payments if the participant had a step-up in the year the participants' age reached the next "age band" level. This feature offers the participant the possibility of having an increased payment amount after an election has been made. For each of the other product offerings, the withdrawal percent remained constant once the election was made by the participant.

- Finally, the Lincoln *Secured Retirement Income*SM solution offered a return of the death benefit premium for beneficiaries in the event the market value was below the participant's cost basis. In these cases, the beneficiary is guaranteed a return of the participant's cost basis in the Lincoln *Secured Retirement Income*SM investment option, reduced by any withdrawals that may have been taken prior to the payment to the beneficiary. For each of the other

product offerings, the beneficiary would only receive the market value vs. the cost basis in the event the market value was lower than the cost basis.

Beyond the items highlighted above, each of the product offerings included in the analysis had subtle differences throughout the four categories reviewed. Details of the full analysis are included in the following table. After reviewing the detailed analysis, fiduciaries will have an understanding how the Lincoln *Secured Retirement Income*SM solution compares to similar in-plan product offerings available in the market. Fiduciaries will also see that the Lincoln *Secured Retirement Income*SM solution is a prudent choice for those plan sponsors considering adding a retirement income solution in their DC plan.

Evaluation Criteria	Lincoln *Secured Retirement Income*SM	Product Offering 1	Product Offering 2	Product Offering 3	Product Offering 4
INVESTMENT STRUCTURE					
Investment Option(s) Utilized	The *Secured Retirement Income* (SRI) guarantee is offered in the Lincoln Variable Insurance Product Global Moderate Allocation Managed Risk Fund (Moderate Fund) The SRI investment option can be incorporated into the glide path of custom target-date portfolios 10 years prior to targeted retirement date; Plan sponsors may choose the final allocation of the SRI investment option in the target-date portfolios to be 100%, 75% or 50% The initial allocation to the SRI investment option is 10%, 7.5%, or 5% of the account balance; an additional 10%, 7.5%, or 5% of the account balance is allocated to the SRI investment option each year up to the targeted retirement date The glide paths for the custom target-date portfolios are developed and monitored by Morningstar or an RIA chosen by the client The SRI investment option is also available as a standalone investment option through a Balanced Fund; the guarantee starts with the first deposit to fund	Proprietary target-date funds and/or Balanced Fund The guarantee on the target-date funds starts 10 years prior to the targeted retirement date The guarantee on the Balanced Fund starts with the first contribution	Four different proprietary managed investment portfolios The guarantee starts with the first deposit into one of the investment portfolios	Proprietary target-date funds and/or Balanced Fund The guarantee on the target-date funds starts 10 years prior to the targeted retirement date The guarantee on the Balanced Fund starts with the first contribution	Externally managed indexed based target-date funds The guarantee starts 10 years prior to the targeted retirement date
Participant Investment Choices	If the SRI investment option is part of target-date portfolios, participants are able to elect a target-date portfolio that most closely corresponds to their retirement age based on birth year; the SRI investment option will enter the glide path during the last 10 years Participants are able to elect the SRI investment option as a standalone investment option through a Balanced Fund	Participants are able to elect the target-date fund that most closely corresponds to their retirement age based on birth year Participants are able to elect the Balanced Fund directly, if the option is made available by the plan sponsor	Participants are able to elect any of the investment options	Participants are able to elect the target-date fund that most closely corresponds to their retirement age based on birth year Participants are able to elect the Balanced Fund directly, if the option is made available by the plan sponsor	Participants are able to elect the target-date fund that most closely corresponds to their retirement age based on birth year

Equity Participation	The target-date portfolios have equity participation ranging from 60% to above 80% based on age; all portfolios decline in equity participation as they near the target-date of the portfolio; as the SRI investment option is added to the glide path, the overall equity participation adjusts accordingly; at age 65, when the target-date portfolio is 100% invested in the SRI investment option, the equity participation will be approximately 60% The SRI investment option, which can be invested in a stand-alone Balanced Fund or as part of a target-date portfolio, is approximately 60% equity securities	The target-date funds have equity participation ranging from 60% to 90% based on age; all funds decline in equity participation as they near the target-date of the fund The target-date funds with the guarantee and the Balanced Fund are invested in approximately 60% equity securities	Equity participation ranges from 20% to 72% between the different investment portfolios; allocation percentages may vary or be adjusted due to market or economic conditions	The target-date funds have equity participation ranging from 60% to 97% based on age; all funds decline in equity participation as they near the target-date of the fund The target-date funds with the guarantee and the Balanced Fund are invested in approximately 60% equity securities	The target-date funds have equity participation ranging from 30% to 90% based on age; all funds decline in equity participation as they near the target date of the fund The Retirement Income Fund is invested in approximately 30% equity securities
Ability to utilize in a custom portfolio	Yes The SRI investment option can be used as an investment option within the custom target-date portfolios	No	No	Yes Third party target-date funds or an asset allocation fund can be wrapped with the guarantee subject to underwriting	No
Evaluation Criteria	**Lincoln *Secured Retirement Income*SM**	**Product Offering 1**	**Product Offering 2**	**Product Offering 3**	**Product Offering 4**
FEES AND EXPENSES					
Expense of Underlying Fund(s)	The SRI investment option has fees of .69% and mortality and expense charges of .05%; additional share classes are available with mortality and expense charges of .25%, .45%, and .65% .30% (or, for the additional share classes, .45%, .60%, and .75%) of the total fee is allocated back to the plan for revenue sharing purposes Investment management fees also apply for the balance that is not invested in the SRI investment option; the fees vary by Plan based on the target-date portfolio selected by the plan sponsor. The cost of the guarantee only applies to the portion of the model allocated to the SRI investment option.	Varies by share class and fund option selected; fees range from .63% to .71%	Varies by fund option selected; fees range from .83% to .89%	Varies by fund option selected; fees range from .59% to .94%	Varies by fund option selected; fees range from .13% to .15% M&E charges and administration fees of .55%

Cost of Guarantee Fee Note: Each product offering had language which allowed for a potential increase to a set maximum fee	Current fee is .90%	Current fee is .90%	Current fee is .75%	Current fee is 1.00%	Current fee is .90%
Total Cost Range (Investment Management Fees and Guarantee Fee)	1.69% (Net fee after revenue sharing is 1.39%) Other share classes have a total fee of 1.89% (net 1.44%), 2.09% (net 1.49%), and 2.29% (net 1.54%) respectively	1.53% to 1.71%	1.58% to 1.64% Additional distribution fees may apply for compensation to the Advisor or TPA; fees are variable	1.59% to 1.94%	1.58% to 1.60%
Balance charged the Guarantee Fee	The guarantee fee is charged only on the balance in the SRI investment option	The guarantee fee is charged on the target-date fund 10 years prior to the targeted retirement date The guarantee fee is charged on the first contribution made to the Balanced Fund	The guarantee fee is charged after the first deposit is made into one of the investment portfolios	The guarantee fee is charged on the target-date fund 10 years prior to the targeted retirement date The guarantee fee is charged on the first contribution made to the Balanced Fund	The guarantee fee is charged on the target-date fund 10 years prior to the targeted retirement date

Evaluation Criteria	Lincoln *Secured Retirement Income*SM	Product Offering 1	Product Offering 2	Product Offering 3	Product Offering 4
ACCOUNT BALANCE DURING THE ACCUMULATION PHASE					
Determination of Income/Benefit Base	The initial Income Base is based on the initial contribution to the Moderate Fund Ongoing contributions increase the Income Base dollar for dollar; excess withdrawals decrease the Income Base on a proportionate basis The ongoing Income Base is adjusted to the current fund value if the fund value is greater than the current Income Base on the anniversary date	The initial Benefit Base is determined based on the initial contribution to the fund(s) once the guarantee applies Ongoing contributions increase the Benefit Base dollar for dollar; withdrawals decrease the Benefit Base on a proportionate basis The Benefit Base is adjusted to the current fund value if the fund value is greater than the current Benefit Base on the anniversary date	The initial Benefit Base is determined based on the initial contribution to the portfolio(s) Ongoing contributions increase the Benefit Base dollar for dollar; withdrawals decrease the Benefit Base on a proportionate basis The Benefit Base is increased at an annual rate of 3% each year on the participant's anniversary date At the time the participant elects to start taking lifetime income payments, the Benefit Base is adjusted to the current fund value if the fund value is great than the current Benefit Base	The initial Income Base is determined based on the initial balance of the fund(s) once the guarantee applies Ongoing contributions increase the Income Base dollar for dollar; withdrawals decrease the Income Base on a proportionate basis The ongoing Income Base is adjusted to the current fund value if the fund value is greater than the current Income Base on the anniversary date	The initial Income Base is determined based on the initial balance of the fund(s) once the guarantee applies Ongoing contributions increase the Income Base dollar for dollar; withdrawals decrease the Income Base on a proportionate basis The ongoing Income Base is adjusted to the current fund value if the fund value is greater than the current Income Base on the anniversary date
Frequency and timing of Income/ Benefit Base calculation	Determined on an annual basis Timing is based on anniversary date of the first contribution to the SRI investment option	Determined on an annual basis Timing is based on anniversary date of the first contribution once the guarantee applies	Determined on an annual basis Timing is based on anniversary date of the first contribution once the guarantee applies	Determined on an annual basis Timing is based on the participant's birthday once the guarantee applies	Determined on an annual basis Timing is based on the participant's birthday once the guarantee applies
Evaluation Criteria	**Lincoln *Secured Retirement Income*SM**	**Product Offering 1**	**Product Offering 2**	**Product Offering 3**	**Product Offering 4**
ACCOUNT BALANCE DURING THE DISTRIBUTION PHASE					
Payment Options Available	Single or Joint Life	Single or Joint Life	Single or Joint Life	Single or Joint Life	Single or Joint Life

Age Lifetime Income Withdrawals can Start	The youngest covered person must be age 55 or older to begin withdrawals	The youngest covered person must be age 55 or older to begin withdrawals	Single Life option payments can start at age 59 1/2 Joint Life option payments can start at age 65 for both spouses For both options the participant must have been invested in the product for at least 5 years	The youngest covered person must be age 55 or older to begin withdrawals	Single Life option payments can start at age 55 Joint Life option payments can start at age 55 for the participant or age 50 for the spouse
Withdrawal Percents Allowed of Income/Benefit Base	Single Life: Age 55 to 64: 4% Age 65 to 70: 5% Age 71 and older: 6% Joint Life: Age 55 to 64: 3.5% Age 65 to 70: 4.5% Age 71 and older: 5.5% The Guaranteed Annual Income percent may increase to the higher percent after the participant has elected to start income payments if the participant has a step-up in the year the participants' age reaches the next level The payout percentages can vary (increase or decrease) based on the interest rate and inflation environment; accrued rates are protected	Single Life: Between 4% to 7% based on age lifetime income begins Joint Life: Between 3.5% to 6.5% based on age of youngest joint life	Single Life: Between 4% to 5% based on age lifetime income begins Joint Life: 4.5% for all ages greater than 65	Single Life: Between 4.25% to 5.75% based on age lifetime income begins Joint Life: Between 3.75% to 5.25% based on age lifetime income begins	Single Life: Between 3.5% to 5.5% based on age lifetime income begins Joint Life: Between 3% to 5% based on the age of the younger spouse
Frequency and timing of Income/ Benefit Base calculation	Determined on an annual basis Timing is based on anniversary date of the first contribution to the SRI investment option	Determined on an annual basis Timing is based on anniversary date of the first withdrawal	Determined on an annual basis Timing is based on anniversary date of the first contribution	Determined on an annual basis Timing is based on the participant's birthday	Determined on an annual basis Timing is based on the participant's birthday

Death Benefit - Return of contributions to beneficiary	Yes In the event the market value is below the participant's cost basis the beneficiary is guaranteed a return of the participant's cost basis reduced by any withdrawals that may have been taken prior to the payment to the beneficiary	No The beneficiary will receive the Account Value in a lump sun	No The beneficiary will receive the Account Value in a lump sun	No The beneficiary will receive the Account Value in a lump sun	No The beneficiary will receive the Account Value in a lump sun
Annuitization Required	No	No	No	No	No
COLA Option Available	No	No	No	No	No
Ability to Rollover to an IRA after Termination	Yes The same investment with the same investment management fee is used in the Lincoln *Secured Retirement Income*SM IRA program The SRI investment option is invested in the share class with mortality and expense charges of .25% No additional fees apply	Yes Investment management fees may vary from the funds offered in the plan No additional fees apply	Yes Investment options available are similar to those available in the plan An annual account maintenance fee applies	Yes Investment options available are similar to those available in the plan Additional fees may apply	Yes Investment options available are the same to those available in the plan No additional fees apply

Appendix D

Analysis of Legal Issues

INTRODUCTION

The selection of a guaranteed lifetime income solution is a fiduciary act governed by ERISA and applicable state law (in the case of governmental 401(a) and 403(b) plans). To lay the foundation for this legal analysis, we concentrate on the relevant provisions of ERISA, on DOL regulations under ERISA and on court decisions interpreting ERISA, rather than state law. We use this approach because many state laws follow the ERISA fiduciary and "prudent man" rules closely – some even copying the language verbatim[29] -- and the interpretation of these state laws is generally less fully developed than ERISA.

Also, several states have a form of "any willing provider" law under which governmental plans are effectively prevented from excluding any provider that meets specified criteria from offering products to their 403(b) plans. The fiduciary rules discussed in this paper may have limited applicability to governmental 403(b) plans in those states.[30]

The same standards and processes applicable to the selection of investments and service providers apply to the selection of a lifetime income solution. The information to gather and evaluate will differ, but the steps and analysis do not; and fiduciaries are held to the same standard of care in making all these decisions. Fiduciaries should not feel a greater challenge in selecting a lifetime income provider than they do in the other choices they routinely make.

THE ERISA REQUIREMENTS

ERISA fiduciaries are obligated to follow the "duty of loyalty" and the "exclusive purpose" requirements. ERISA Section 404(a) states that fiduciaries must act "solely in the interest of the participants," and must carry out their duties "for the exclusive purpose" of providing benefits and defraying reasonable expenses of administering the plan. (In this paper, we generally use the term "plan committee" to refer to the officers, managers and directors of the plan sponsor who serve as the fiduciaries of their employer's plan.) Thus, a plan committee must make decisions in the context of providing retirement benefits and ensuring that the costs of the plan are no more than reasonable.

How do committee members fulfill these duties? They are required to 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 context of an enterprise of a like character and with like aims …"[31] Stated differently, the success of fiduciary conduct is judged under this "prudent man rule,"[32] which means that a fiduciary be "familiar with such matters" – *i.e.*, the management of a retirement plan – which sets the ERISA prudence requirement apart from the test of what an average person would do in managing his own affairs.

Telling plan committees to act prudently has little value unless they understand how that is to be done. In interpreting the prudent man rule, the DOL and the courts have focused on process rather than results. For example, in the context of selecting investments, the DOL adopted a regulation that describes the process for satisfying the prudent man standard. It said the fiduciaries must give "appropriate consideration" to information they know or should know is relevant to the decision and then act accordingly in making their decision.[33] In essence, the DOL described four steps:

- Determine the issues that are relevant to the decision to be made;
- Conduct an investigation of facts needed to evaluate those relevant issues so that the fiduciaries are properly informed about the decision to be made;[34]
- Analyze the information gathered through the investigation;
- Make a decision that is reasonably connected to the information analyzed.[35]

Using these steps, the fiduciaries are able to make what we sometimes refer to as an "informed and reasoned" decision -- or, in other words, a prudent decision.

29. States that have incorporated language identical to or very similar to ERISA include Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nevada, New Hampshire, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Virginia and Washington.
30. California Insurance Code §770.3. *See also* California Education Code §§25100-25115 for information regarding registration by vendors.
31. Id. Emphasis added.
32. ERISA §404(a)(1)(B).
33. 29 C.F.R. §2550.404.a-1(b)(1).
34. *See, generally, Riley v. Murdock*, 890 F.Supp. 444, 458 (E.D.N.C. 1995).
35. *See, generally, Fink v. National Savings and Trust Company*, 772 F.2d 951, 962 (D.C. Cir. 1984).

As noted earlier, fiduciary conduct is judged more on process and less on the outcome of the decision. While results are important, courts will generally ask whether the fiduciaries engaged in an appropriate process, which one court has described as "at the time they engaged in the challenged transaction, [whether the fiduciaries] employed the appropriate methods to investigate the merits" of the transaction.[36]

SELECTING A LIFETIME INCOME SOLUTION

The selection of a lifetime income solution requires the prudent choice of both the provider and the product offered by that provider. Our focus in this section is on the selection of the provider, which requires that a plan committee make a prudent decision using a prudent process. There is no direct authority under ERISA related to selecting an insurance company as a GWB provider. The most analogous guidance involves selecting an insurance company to provide annuities for a defined contribution plan. We will discuss this regulation in some detail. We have done so on the basis that the undertaking by an insurer to make periodic payments under a GWB is similar in concept to making periodic payments under an annuity. In both instances, the insurer is taking on the obligation to make payments in the future from the general account of an insurance company, though the GWB payments are made only if the retiree depletes the funds in his account in the plan or in a rollover IRA.

One process for selecting an insurance company for defined contribution plans is found in a DOL regulation adopted in 2008. The regulation describes a fiduciary "safe harbor." "Safe harbors" are ordinarily viewed as creating a higher standard than what the law requires, that is, fiduciaries may satisfy their obligation in ways other than by following the regulation. The DOL acknowledged this in the regulation,[37] indicating that it is not the only means by which fiduciaries could satisfy their obligations, does not establish minimum standards and only describes an optional means for satisfying the fiduciary obligation.[38] In this respect, the regulation exceeds the "baseline" of the prudent man requirement. As a result, it should be viewed as providing fiduciary "best practices" in selecting an insurance company and an annuity contract to provide benefits under a defined contribution plan rather than establishing a "standard of care" to which fiduciaries must adhere.

The regulation provides that fiduciaries will be deemed to have met their fiduciary obligation by engaging in five steps.[39] Fiduciaries should:

- Engage in an objective, thorough and analytical search for the purpose of identifying and selecting providers from which to purchase annuities.
- Appropriately consider information necessary to assess the ability of the annuity provider to make all future payments under the annuity contract.
- Appropriately consider the cost (including fees and commissions) of the annuity contract in relation to the benefits and administrative services to be provided under the contract.
- Appropriately conclude that, at the time of the selection, (i) the annuity provider is financially able to make all future payments under the annuity contract and (ii) the cost of the annuity contract is reasonable in relation to the benefits and services to be provided under the contract.
- If necessary, consult with an appropriate expert or experts in connection with their consideration and conclusions.

The regulation does not describe the information that fiduciaries should consider, though the proposed regulation did contain specific items and the preamble to the final regulation references certain information that fiduciaries may wish to consider. (See Appendix A for a suggested checklist of information for fiduciaries).

Each of the five steps in the regulation is discussed in detail below.

The Objective, Thorough and Analytical Search Requirement

In the preamble to the proposed regulation, the DOL described this step as "consistent with the requirements applicable to the selection of service providers generally."[40] In other words, the DOL acknowledges that the selection of an annuity (or GWB) provider (that is, an insurance company) is not inherently different from, or more difficult than, other fiduciary decisions.

The concept of an "objective, thorough and analytical search" is not new. There are a number of instances in which the same concept appears. For example, the DOL stated that "a fiduciary must engage in an

36. *Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir.1984); cert. denied sub nom, *Cody v. Donovan*, 469 U.S. 1072, 105 S.Ct. 565, 83 L.Ed.2d 506 (1984).
37. 29 C.F.R. §2550.404a-4.
38. 29 C.F.R. §2550.404a-4(a)(2).
39. 29 C.F.R. §2550.404a-4(b).
40. 72 Fed. Reg. at 52022.

objective, thorough, and analytical process that involves consideration of the quality of competing providers and investment products, as appropriate"[41] in selecting a qualified default investment alternative (QDIA), such as a target-date fund.

In the preamble to the final regulation, the DOL also reiterates two other requirements related to the process for selecting service providers generally. It states:

"With regard to the prudent selection of service providers generally, the Department has indicated that a fiduciary should engage in an objective process that is designed to elicit information necessary to assess the provider's qualifications, quality of services offered and reasonableness of fees charged for the service. The process also must avoid self-dealing, conflicts of interest or other improper influence."[42]

In the context of selecting an insurance company, plan committees may take comfort from the fact that retirees have been receiving monthly payments from annuities for decades, and insurance companies have been making those annuity payments for decades. (The deep recession of the past decade suggests that the insurance industry is reasonably strong. Since the start of 2008, even though there have been failures of many commercial banks and thrifts, investment banks, hedge funds and credit unions, there have been no life insurers that had to be liquidated.[43] It is true that parent companies of several insurers received government loans under the government Capital Purchase Program, but in general, the insurance company subsidiaries appear to have been insulated from the liabilities and imprudent business decisions of the parent or brother-sister entities.)

What does this mean for the prudent fiduciary process? There is no way to know whether all the fiduciaries of all the plans that purchased annuities in the past engaged in an objective, thorough and analytical search – that is, a prudent selection process. Assume that the plan committee of the Company A 401(k) plan engages in a prudent process and selects an annuity provider. The plan committee for the Company B plan conducts no investigation, but winds up making the same selection. It is difficult to conclude that the Company B committee committed a *per se* fiduciary breach.

This concept is supported in *In re Unisys Savings Plan Litigation*,[44] a 1999 Court of Appeals decision. In Unisys, the plaintiff – a participant in the Unisys 401(k) plan – sued the plan fiduciaries responsible for purchasing three guaranteed investment contracts ("GICs") issued by Executive Life Insurance Company. The GICs were selected through three separate bid processes in 1987 and 1988. In the first of these, the plan's Investment Committee worked with a consultant to assist in the process, but in the third, they did not.

The Court found in favor of Unisys, concluding that the Unisys fiduciaries had made a reasonable and thorough investigation of the Executive Life GICs, and agreed with the lower court's determination that "… Unisys was prudent under the standard articulated in ERISA."[45] As an alternative basis for finding in favor of the fiduciaries, the court held that, even if the fiduciaries had not performed a prudent investigation, a "hypothetical" prudent fiduciary would also have decided to invest plan assets in the GICs, and thus the Unisys fiduciaries should not be held to have violated ERISA. This concept may not have wide acceptance – the DOL would likely take the position that a failure to investigate is a per se violation of the prudent man standard regardless of the outcome.[46] And most observers take the position that under ERISA's prudence requirement, fiduciaries must evaluate the particular circumstances of their plans in making decisions. Nevertheless, fiduciaries faced with the decision of which insurance company to choose may take comfort in the decisions reached by others.

Assessing the Ability of the Annuity Provider to Make Payments

The safe harbor requirement is that a fiduciary must "appropriately consider" sufficient information and "appropriately conclude" that, *at the time of selection*, the annuity provider will be able to make all future payments. There are two important aspects of this assessment and conclusion. First, what information should the plan committee consider? Second, what is the relevance of the words "at the time of selection"?

As noted earlier, the final regulation does not specify what information plan committees should consider in making this assessment and reaching this conclusion, but the proposed regulation included a number of specific requirements that we believe are illustrative of the obligation and helpful in meeting these requirements. These are discussed later.

41. Preamble to ERISA Regulation §2550.404c-5, 72 Fed Reg. at 60453. *See, also*, Field Assistance Bulletin (FAB) No. 2007-01, Feb. 2, 2007, in which the DOL said, "With regard to the prudent selection of service providers generally, the Department has indicated that a fiduciary should engage in an objective process…."
42. FAB 2007-01.
43. Gallanis, Peter G., *NOLHGA, the Life and Health Insurance Guaranty System, and the Financial Crisis of 2008-2009, June 5, 2009*, at page 4.
44. 173 F.3d. 145 (3rd Cir. 1999).
45. *In re Unisys Savings Plan Litigation*, 173 F.3d at 153.
46. For a contrary view, *see Fink v. National Savings & Trust Co.*, 772 F.2d 951, 962 (D.C. Cir. 1985).

The proposed regulation indicated that fiduciaries should consider:[47]

- The annuity provider's experience and financial expertise in providing annuities of the type being selected or offered.
- The annuity provider's level of capital, surplus and reserves available to make payments under the annuity contract.
- The annuity provider's ratings by insurance ratings services (including consideration of whether the ratings demonstrate or raise questions regarding the provider's ability to make future payments under the annuity contract).
- The structure of the annuity contract and benefit guarantees provided, and the impact of using separate accounts to underwrite the provider's obligation to make payments in the future, that is, whether the payment guarantee is based on segregated assets or the provider's general account.
- The availability and extent of additional protection through state guaranty associations.
- Any other information that the fiduciary knows or should know would be relevant to its evaluation.

These factors were omitted in the final regulation. The DOL explained the omission on the basis that they were not necessary and potentially confusing.[48] Nevertheless, in the preamble to the final regulation, the DOL mentioned two of the items included in the proposed regulation list. This suggests that consideration of these two items (state guarantee information and negative information from rating agencies) may be viewed as a equaling or exceeding the ERISA fiduciary standard. We also believe that the list from the proposed regulation is helpful in seeing the types of information the DOL apparently considered relevant. As such, they offer a guide of sorts for assessing the ability of an insurance company to make payments in the future.

With reference to ratings, the DOL notes in the preamble to the final regulation that "… although an annuity provider's ratings by insurance ratings services are not part of the final safe harbor, in many instances, fiduciaries may want to consider them, particularly if the ratings raise questions regarding the provider's ability to make future payments under the annuity contract."[49] The DOL indicates that it considers insurance company ratings related to the company's claims paying ability to be relevant information. High ratings, especially if they are consistently high over a number of years and across the various rating agencies, would appear to be a strong indicator of an insurance company's ability to make future payments under its contract. At the same time, if the ratings agencies provide any *negative* information, that should be taken into account.

Four major services provide rating information for life insurance companies: Standard & Poor's, Moody's Investor Service, Fitch Ratings and A.M. Best. Each has its own criteria for establishing ratings – each uses letter grades to indicate the stability or riskiness of an insurer and to identify those companies that offer questionable or poor financial security – and the way in which it distinguishes between sound and poor financial stability. That said, all are similar and all include a "financial strength rating" which represents "… an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations."[50] This would include its obligations with respect to GWBs.

The following is a brief description of the ratings of each service:

1. Standard & Poor's uses AAA and AA for companies with extremely or very strong financial security characteristics, whereas those ranked A or lower have some or considerable likelihood of being affected by adverse business conditions.[51]
2. Moody's identifies "high grade" companies with an Aaa or Aa rating, while those with an A or lower rating have some or considerable susceptibility to impairment;
3. Fitch uses AAA and AA to designate companies with little or no expectation of ceased or interrupted payments, whereas companies with lower ratings have some or considerable risk of ceased or interrupted payments;
4. Finally, Best's Financial Strength Rating describes companies as either "Secure" (those rated B+ or better, with those rated A++ and A+ considered "superior") or "Vulnerable" (those rated B or below).[52]

47. 72 Fed.Reg. 52025.
48. 73 Fed.Reg. 58448.
49. *Id.*
50. *See*, http://www3.ambest.com/ratings/default.asp.
51. In August 2011, S&P lowered the credit rating of the United States from AAA to AA+ and as a result, similarly lowered the rating of all insurers with a AAA rating because the "U.S. sovereign credit rating constrains the long-term ratings on these U.S. insurers…"
52. In August 2011, S&P lowered the credit rating of the United States from AAA to AA+ and as a result, similarly lowered the rating of all insurers with a AAA rating because the "U.S. sovereign credit rating constrains the long-term ratings on these U.S. insurers…"

Plan committees that obtain rating information should make certain that the rating applies to the insurance company and not to a parent company.

In issuing ratings, the services prepare a detailed report that provides the foundation for the letter grade given to the company and any observations the service has regarding the financial health of the company. This report may not be readily available, though in our experience, many companies make the reports available on their websites or provide them upon request. Since an analysis of the report may outside the expertise of the plan committee members, they may wish to engage an advisor to help them with the evaluation.

In the preamble to the final regulation, the DOL also referenced "some information regarding additional protections that might be available through a state guaranty association for an annuity provider … even if limited to that information which is generally available to the public and easily accessible through such associations, state insurance departments, or elsewhere."[53] Virtually all states offer at least $100,000 in protection for withdrawal and cash values[54] for annuities.[55] While insurance companies are not legally permitted to provide information about the state guarantees that may be available, information regarding the level of backing available through the various state guaranty associations is readily accessible via the internet.[56]

After assessing the information, committees must determine that the insurance company is financially able to make all future payments and that the cost of the contract is reasonable. This conclusion must be made "at the time of the selection" of the insurance company.

The prudent man rule says that fiduciaries must base their actions and decisions on the "circumstances then prevailing." Stated slightly differently, prudence is determined at the time the decision is made and not measured using hindsight. Thus, a plan committee that is considering the selection of an insurance company must take into account information available to it at the time of the decision that would indicate the financial strength of the provider. The committee is not legally accountable for whether the provider will be around in 30 or 40 years and have the financial wherewithal to make the required payments at that time. It is not required to predict the future. It is only required to make a decision, based on today's information, about whether it is reasonable to believe that the provider has the financial ability to make the payments in the future.

The distinction between predicting the future and making a decision now about the financial ability of the provider may be a subtle one, but it is important. It hinges on the issue of whether the committee has acted prudently. If it can be concluded, based on today's data, that the insurer can meet its obligations, the committee will have fulfilled its duty even if the insurance company later becomes insolvent.

For example, if a committee engages in an objective, thorough and analytical search and makes an informed, reasoned decision to select an insurance company to provide an immediate annuity, the fiduciary will not have any liability if the insurance company is later unable to make the promised payments. Similarly, if the committee engages in the same process and reaches the same type of conclusion regarding a carrier to make deferred payments, under a deferred annuity or GWB, the committee should not have liability. In the second situation, there is an ongoing duty to monitor the selection, to confirm whether the earlier determination of the financial strength of the insurance company remains prudent. But the monitoring decision will be based on the circumstances then prevailing (*i.e.*, the information then available) and, in effect, will constitute a new "informed and reasoned" decision.

But when is the "time of selection"? In the safe harbor regulation related to the selection of annuities for defined contribution plans, the DOL indicates that it may be either:

- The time that the insurance company and contract are selected for distribution of benefits to a specific participant or beneficiary;[57] or
- The time that the insurance company is selected to provide an annuity for payments in the future, so long as the selecting fiduciary periodically reviews the continuing appropriateness of its conclusion that the insurance company is financially able to make all future payments.[58]

In the case of a GWB, the "time of selection" falls into the second category, that is, for payments in the future. The plan committee will therefore need to make a prudent selection initially and then fulfill an ongoing obligation to monitor the decision. In so doing, it will need to evaluate

53. *Id.*
54. The terms and conditions for coverage will vary depending on the specific wording of the specific state involved.
55. *See*, http://www.nolhga.com/policyholderinfo/main.cfm/location/insolvencyprocess.
56. *See*, *e.g.*, http://www.nolhga.com/policyholderinfo/main.cfm/location/ga.
57. 29 C.F.R. § 2550.404a-4(c)(1).
58. 29 C.F.R. § 2550.404a-4(c)(2).

and decide, using the same process and the same types of information that went into the original selection, whether at the time it is making the new (monitoring) decision, the provider is still capable of making future payments and whether the cost of the contract continues to be reasonable in light of its features.

There is no bright line test as to the frequency for such a review. The DOL website, for example, recommends that "[a]n employer should establish and follow a formal review process *at reasonable intervals* to decide if it wants to continue using the current service providers or look for replacements."[59] If adverse information comes to light regarding the insurance company, the committee should undertake a review as soon as it becomes aware of the information. In a Field Assistance Bulletin issued in 2015, the DOL explained the monitoring requirement as follows:

> The periodic review requirement in the Safe Harbor Rule 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.[60]

In the absence of a red flag, plan committees should consider the fact that the market is continuing to evolve, with new products being introduced from time to time that may be better suited for their participants. As a result, a review every three to four years would appear to be adequate, again assuming no adverse information comes to light in the meantime.

Considering the Cost in Relation to the Benefits

Regarding cost considerations, the final regulation differed from the proposed regulation only in the sense that it specifically added a reference to "fees and commissions" (as opposed to simply "the cost of the annuity contract"). The DOL explained that the addition was made "to emphasize [the importance of fees and commissions] to the fiduciary's decision making process."[61]

The requirement for plan committees to evaluate the cost of the GWB product is part of a fiduciary's obligation under the "exclusive purpose" requirement of ERISA, which provides that fiduciaries must act for the exclusive purpose of providing benefits and defraying no more than reasonable expenses.[62] In addition, under the ERISA prohibited transaction requirements, the plan committee must conclude that service providers are receiving no more than reasonable compensation.[63] The evaluation of cost should be facilitated as a result of the implementation of the service provider disclosure rules under ERISA Section 408(b)(2) and the participant disclosures under ERISA Regulation Section 2550.404a-5. The service provider disclosure regulation under ERISA Section 408(b)(2) generally requires that brokerage commissions be disclosed by a service provider at the "point of sale,"[64] so this portion of the "fees and commissions" information should be made available without undue effort on the part of the fiduciary. In addition, a plan's recordkeeper or broker is also required to provide, as part of the 408(b)(2) disclosures, the information needed by the plan administrator to comply with the 404a-5 disclosures to participants, including the costs of the GWB product itself.[65]

Having the information is only the first step. Plan committees must then evaluate it. To evaluate the commissions payable to the financial advisor, the committee may rely on benchmarking data or other industry information to compare the commission on the GWB to that payable on similar products. Unfortunately, there is no benchmarking service that has developed to compare GWB products, but the Insured Retirement Income Council (IRIC) has posted on its website product comparisons that committees can use to compare the costs of the products currently available in the marketplace.[66] Based on the information provided on the IRIC website, as well as other information from the providers, the cost of similar GWB products are in the range of 90 basis points up to as much as 150 basis points (.9% to 1.5%). While some products vary from this, the variations can be justified in light of variations in the products.

59. *See*, http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html. Emphasis added.
60. Field Assistance Bulletin 2015-02.
61. 73 Fed.Reg. 58448.
62. ERISA Section 404(a)(1)(A).
63. ERISA Sections 406(a)((1)(C) and 408(b)(2).
64. ERISA Regulation §2550.408b-2.
65. *Id* at subsection (c)(1)(iv)(E)(3).
66. http://www.iricouncil.org/docs/Comparison%20of%20Product%20Features%20High%20Res.pdf

While comparative pricing and other contract features are important, as discussed earlier, plan committees must assess the financial strength of the carrier. For example, annuities issued by Executive Life were relatively lower priced than competing products, but in the long run, that company's financial weaknesses made the lower price a less significant factor in the selection process. The DOL consistently takes the position that the costs, fees and expenses associated with the investments and services in a plan should not be viewed in a vacuum. Rather, the reasonableness of charges for a product or service should be evaluated with reference to the value being received. In other words, fiduciaries should not be viewed to have breached their duties simply because they do not select a "less expensive" GWB over a "more expensive" one. As the DOL notes in its own website, "[f]ees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments."[67]

The issue is not whether the plan committee selects the least expensive option but rather whether the fiduciary engages in a prudent, comparative process that takes into consideration, for example, the features of the products offered and the abilities of the competing insurance companies to meet their future obligations (*i.e.*, the financial stability and security of the insurance company). Further, advisors may be able to help fiduciaries evaluate the costs of competing annuity products, and to evaluate those costs in relation to their potentially differing features.

Ensuring that the product and product features are competitive in the market place is another important aspect of the fiduciary process. GWBs are becoming more prevalent in the marketplace. The emergence of several GWB products has enabled plan committees to compare product features to ensure that they have an understanding of the GWB offerings in the marketplace and how the GWB being consider compares to other available products. For example, a plan committee should consider the payout rates of the GWB product under consideration; and if the payout rates are significantly lower than other similar products on the market, the committee must consider whether the choice is prudent and document its conclusion. Other features that can be compared include: the investment options to which the guarantee attaches; the ability to utilize a custom investment option; the investment balance on which the guarantee fee is charged; how the income base is determined; and the death benefit, if any, for the beneficiary. (For a comparison of the Lincoln *Secured Retirement Income*SM solution with other products currently available, see Appendix C.)

Consulting with a Knowledgeable Advisor

In this respect, the final regulation differs somewhat from the original proposal, which would have required the fiduciary to appropriately determine "… either that the fiduciary had, at the time of the selection, the appropriate expertise to evaluate the selection or that the advice of a qualified, independent expert was necessary."[68] Before assessing whether a plan committee needs to reach out for assistance, it is important to understand the type of person or entity to which it can turn for that advice. While the DOL uses the term "expert," in other contexts, it has made clear that a fiduciary may rely on the assistance of a knowledgeable advisor unless it has reason to "doubt the competence, integrity or responsibility" of the advisor.[69] In light of this, and the fact that it is difficult to determine who would qualify as an "expert" in this context, we use the term "advisor" in referring to the party to whom a fiduciary might turn for assistance in analyzing the prudence of an annuity provider selection.

The final regulation indicates that engaging an advisor is not required in all cases. Instead, it is up to the fiduciary to determine the extent to which it needs help in gathering and assessing the information needed to select the annuity provider.[70] However, other than to clarify that it is not required in all cases, the final regulation is vague with respect to whether – and to what extent – fiduciaries are required to engage advisors in connection with the selection of an annuity provider for distribution purposes. Other DOL guidance, and case law, sheds light on when fiduciaries should engage advisors, what they should consider in hiring them and what they must do with the information they receive from them.[71]

Generally speaking, the law "does not impose a rule that fiduciaries be 'experts' on all types of investments they make. However, if a fiduciary lacks the education, experience, or skills to be able to conduct a reasonable, independent investigation and evaluation of the risks and other characteristics of the proposed investment, it must seek independent advice."[72] Consider, for example, the use of advisors by the plan committee in the *Unisys II* case

67. http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html.
68. 72 Fed.Reg. 52024.
69. Interpretive Bulletin 75-8, Q&A D5.
70. *Id*.
71. *See, e.g.*, Field Assistance Bulletin 2007-01, Q2; *Tips for Selecting And Monitoring Service Providers For Your Employee Benefit Plan and Selecting And Monitoring Pension Consultants – Tips For Plan Sponsors*, available at www.dol.gov/ebsa;fiduciaryeducation.html.
72. *Harley v. Minnesota Mining and Manufacturing Company*, 42 F.Supp.2d 898, 207 (D. Minn. 1999).

discussed earlier. The size of the plan and the amount of its assets is relevant in deciding whether a fiduciary may need to consult with an expert in connection with the selection of an annuity provider. The DOL has recognized that, because the prudent man rule requires fiduciaries to conduct themselves in a way that a prudent person in "a like capacity" would do, fiduciaries of smaller plans may not be obligated to incur the expense of an expert advisor to the same extent as fiduciaries of larger plans. As the DOL stated in the preamble to its 1979 regulation relating to fiduciary investment duties:

> "Under the "prudence" rule, the standard to which a fiduciary is held in the proper discharge of his investment duties is defined, in part, by what a prudent person acting in a like capacity and familiar with such matters would do. Thus, for example, it would not seem necessary for a fiduciary of a plan with assets of $50,000 to employ, in all respects, the same investment management techniques as would a fiduciary of a plan with assets of $50,000,000."[73]

Assuming the plan committee concludes that advice is needed, it must act prudently in selecting the advisor. As part of that process, the fiduciary must investigate the advisor's qualifications, ensure that it is independent, provide it with complete and accurate information and make certain that reliance on the advisor's advice is reasonably justified under the circumstances.[74] Many factors go into determining that reliance on the advisor's advice is justified, including its reputation and experience, the extensiveness and thoroughness of the advisor's investigation, whether its report is supported by relevant material, and whether the methods and assumptions are appropriate to the decision at hand.[75] This means, essentially, that a plan committee may not simply "rubberstamp" an advisor's advice or recommendations, but must carefully review them and the reasons for them and make an informed and reasoned decision whether to follow the advice.

Once it has hired an advisor to help, however, a plan committee may not blindly follow the advisor's advice. Instead, the committee must reach an independent conclusion regarding the merits of the course of action, in this case, the selection of the insurance company and GWB product. "ERISA's duty to investigate requires fiduciaries to review the data an advisor gathers, to assess its significance and to supplement it where necessary."[76] Fiduciaries must make "independent inquiry into the merits of particular investments rather than … rely wholly on the advice of others."[77] Among other things, this means that a plan committee must actually review the terms of the contract they enter into on behalf of a plan: "Fiduciaries need not become experts in employee benefits, and may rely on independent expert advice, but requiring that a fiduciary read the policy he signs and that he have a basic understanding of its most important provisions does not ask too much."[78]

Portability

The issue of "portability" arises in two contexts. The first is what happens to a GWB product or feature when a participant terminates employment. The second is what happens if the plan sponsor elects to change service providers. In each case, participants who have invested in the underlying fund to which the GWB feature attaches may not be able to retain the investment and thus the GWB guarantee.

When a participant changes employment, he will no longer be able to make deferrals to the plan that offers the GWB. In addition, many participants elect to take a distribution of their benefit and roll it over to the plan of their new employer or to a rollover IRA. However, unless the participant has a small account (under $5,000), the employer may not force the participant to take a distribution without his consent.[79] The participant will be able to leave his account balance in the plan of his former employer and retain the investment with which the GWB is associated, even though he cannot continue to add to it and thus "buy" additional guaranteed amounts, but at least he will not lose what he has already accumulated.

Many participants may not view this as an acceptable alternative; in light of this, most GWB providers permit the participant to roll the GWB fund to an IRA with that provider. This will preserve the guarantee and may permit the participant to increase the amount that is guaranteed through additional investment in the GWB fund. As the market evolves, it may also be possible for participants to rollover the GWB fund to an IRA trusteed by a different provider, and possibly to the plan of a new employer, but these alternatives are not currently readily available.

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73. 44 Fed.Reg. 37221, 37224.
74. *Howard v. Shay*, 100 F.3d 1484, 1489 (9th Cir. 1996).
75. *Bussian v. RJR Nabisco, Inc.*, 223 F.3d 286, 301 (5th Cir. 2000).
76. *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 435-436 (3rd Cir. 1996); *see also, Bussian v. RJR Nabisco, Inc.* 223 F.3d 286, 301 (5th Cir. 2000).
77. *Gregg v. Transportation Workers of America Intern., supra*, 343 F.3d at 843, citing *Withers v. Teachers' Retirement Sys.*, 447 F.Supp. 1248, 1254 (S.D.N.Y. 1978), *aff'd mem.*, 595 F.2d 1210 (2nd Cir. 1979).
78. *Gregg, supra*, 343 F.3d at 843.
79. Internal Revenue Code section 401(a)(31).

The issue at the employer level is not so easily resolved. As currently structured, GWB products are currently only available where the provider also serves as the recordkeeper for a plan. Thus, if the employer decides to change providers, the GWB product may no longer be available as an investment alternative in the plan. Participants who elected to purchase the GWB product may be forced to transfer the investment into another product on the new recordkeeper's platform, thus causing the participant to lose the guarantee of future income, the income base guarantee and effectively the amounts paid for the guarantee. These detriments to participants raise the issue of whether the employer is precluded from changing providers because it will damage at least a portion of the participant population.

As to the latter issue, DOL guidance and case law indicates that fiduciaries must act in the best interest of the participants as a whole and not in the interest of each individual participant.[80] Thus, if the decision to change providers is a prudent one and is in the interest of the participant population generally, the fact that certain participants may be disadvantaged does not preclude the change.

In addition, providers are currently working on ways to ensure that if a plan makes a provider change, the GWB product purchased by individual participants may be retained. With respect to a transfer of the plan to a new provider, Lincoln has made a significant investment in its recordkeeping system to permit portability. First, it has subscribed to the data transfer protocols established by the SPARK Institute,[81] which have been or will be adopted by roughly 80% of the recordkeeping industry.[82] Second, it has invested in a recordkeeping integration implementation model developed by a provider called DST that will facilitate the transfer of data and permit participants to continue to be able to access information about and make contributions to the Moderate Fund investment, with the guarantee, in their account even after the account is being recordkept by a new provider. This system, called the Retirement Income Information Clearing and Calculation system (or RICC) has been acquired by several of the largest providers of GWB features.

If a plan sponsor elects to move the plan to a new provider that subscribes to the SPARK data feeds or has acquired the RICC system, participant investments in the Moderate Fund and thus the Lincoln *Secured Retirement Income*SM guarantee will be preserved so long as the plan sponsor requests that the Moderate Fund be retained as an "outside" plan asset.

In the case of a plan with a GWB product that is being taken over by Lincoln as the recordkeeper, Lincoln may be able to provide the same level of guarantee that the participants had prior to the transfer and does not require the use of RICC or the SPARK solutions. Lincoln obtains information on the participants' income bases, market values, years the participants have held the product and whether the participant is currently contributing to the plan or is in the payout phase. Based on this information, Lincoln may be able to convert the former recordkeeper's product into the Lincoln GWB, often without any additional cost.

Another solution is available for older participants, who could be impacted more significantly if the plan is moved to a new provider that doesn't offer similar guarantees (*e.g.*, GWBs). A plan can be amended to permit distributions (including in-service distributions) as early as age 59½.[83] In that case, any participant age 59½ or older could roll his benefits, including the GWB protection, out of the plan and into an IRA, thus preserving his guarantee.

GWBs as Qualified Default Investment Alternatives

In a participant-directed plan, if a participant fails to provide instructions for the investment of deferrals or other contributions to his account, the fiduciaries are required to invest those amounts for him.[84] As with any fiduciary decision, the fiduciaries must act prudently in making the investment decision for that participant and may be held liable for losses suffered by the participant if they fail to do so. The concern over fiduciary liability for the investment of defaulting participants resulted in the adoption of ERISA Section 404(c)(5), which provides a fiduciary a safe harbor if the defaulting participant's account is invested in a "qualified default investment alternative" (or QDIA) and certain other requirements are met. The conditions of the safe harbor are set out in ERISA Regulation Section 2550.404c-5. If the fiduciaries comply with the requirements of the regulation, defaulting participants are deemed to have exercised control over their accounts.

80. *See* sources cited at footnote 18.

81. The SPARK Institute is an industry organization that, according to its website, "helps to shape national retirement policy by providing research, education, testimony and comments on pending legislative and regulatory issues to members of Congress and relevant government agency officials. Our members play a key role in identifying our priorities and in developing the positions we take on critical issues."

82. *See* SPARK survey regarding SPARK data standards on Guaranteed Income Products, 2010.

83. IRC section 401(k)(2)(B)(i)(III).

84. *See*, e.g., Preamble to Proposed Regulation, Default Investment Alternatives Under Participant Directed Individual Account Plans, 71 Fed.Reg. No 187, at page 56807 (September 27, 2006).

For purposes of this discussion, we focus on the types of investments that qualify as QDIAs and will use Lincoln *Secured Retirement Income*SM solutions as an example. The 404(c)(5) regulation describes three types of QDIAs: target- date funds, a balanced fund and a managed account service that allocates participant accounts among the investment options available under the plan.[85] As described earlier, participant assets in the Lincoln *Secured Retirement Income*SM option are invested in a "moderate" or balanced fund. The *Secured Retirement Income*SM investment option may also be included in the glide path of a target-date portfolio. In situations where the underlying Moderate Fund is used as a stand-alone investment option, this would meet the safe harbor requirement to be a QDIA as a balanced fund. In situations where it is used in a target-date portfolio, this would also meet the safe harbor requirement as a managed account service. However, in each case, an issue still remains of whether the addition of the GWB feature would disqualify a product due to the GWB insurance feature.

In the regulation under Section 404(c)(5), the DOL indicated that QDIAs may be offered through "variable annuity or similar contracts" and "without regard to whether such contracts or funds provide annuity purchase rights, investment guarantees, death benefit guarantees or other features ancillary to the investment fund product or model portfolio."[86] (This conclusion has been confirmed in subsequent DOL guidance.[87])

In late 2016, the DOL addressed the issue again.[88] In that guidance, the DOL stated:

> Section 2550.404c-5(e)(4)(vi) [the QDIA regulation] states that products and portfolios that include annuity purchase rights, investment guarantees, death benefit guarantees, or other features ancillary to the investment fund, product or portfolio may qualify as QDIAs, . . .

In light of these statements, it is clear that a product that otherwise meets the definition of a QDIA will still qualify if it also contains the GWB feature. As a result, in this example the Lincoln *Secured Retirement Income*SM solution will qualify for QDIA treatment so long as the plan otherwise complies with the 404c-5 regulatory requirements.

CONCLUSION

As discussed in detail in our companion White Paper, making withdrawals that will last a lifetime is complex. To do so successfully and ensure that they have sustainable lifelong income, participants need help. Plans are not required to offer guaranteed withdrawal benefit products or similar solutions, but if they do so, plan committees must engage in a prudent process to select and monitor both the product and the insurance company that issues the product. The decision-making process is not inherently different from or more difficult than other fiduciary decisions, and the prudent selection process is achievable if the fiduciaries evaluate the insurance company and its GWB product thoughtfully and seek help from their advisors.

85. ERISA Regulation Section 2550.404a-5(e).
86. ERISA Regulation §2550.404a-5(e)(4)((vi).
87. *See* footnote 20, supra.
88. DOL Information Letter to Christopher Spence, December 22, 2016.

The law and analysis contained in this white paper are current as of October 2017, are general in nature and do not constitute a legal opinion that may be relied on by third parties. Readers should consult their own legal counsel for information on how these issues apply to their individual circumstances and to determine if there have been any relevant developments since the date of this paper. The factual descriptions and information in this White Paper are based upon information provided to us, and we have not undertaken an independent review of that information.

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The guarantee is provided by a contract between the client/plan sponsor and The Lincoln National Life Insurance Company that provides a plan participant with guaranteed annual retirement income. The LVIP Global Moderate Allocation Managed Risk fund is not guaranteed or insured by Lincoln or any other insurance company or entity, and shareholders may experience losses. The protection strategy used by this fund is separate and distinct from any annuity or insurance contract rider or features.

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