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Key legislative developments affecting your human resources

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Consumer group calls for pension de-risking moratorium

Summing it up

The Pension Rights Center (PRC) wants Congress to impose a moratorium on pension de-risking moves, such as lump sum cashouts and annuity purchases. According to the PRC, the purpose of the moratorium is to study the impact of these moves on retirees. Although Congress could prohibit them, currently no such legislation is under consideration. A prohibition against annuity purchases would be especially problematic for terminating plans because these purchases have been an integral part of PBGC's financing and regulatory structure ever since the agency was created by ERISA. The PRC's request most likely will result in little more than informal discussions within the retirement community.

Background

Plan sponsors have increasingly seen plan liabilities as a risk to corporate balance sheets and earnings under current accounting rules. Accordingly, many are now "de-risking" their plans by removing liabilities through annuity purchases and lump sum offers. The annuity purchase option transfers benefit payment obligations and plan assets to an insurance company. The lump sum cashouts transfer obligations and assets to plan participants. The level of interest in de-risking now is high because the transition to the Pension Protection Act of 2006 (PPA) lump sum interest rates based on investment-grade corporate bond rates rather than 30-Year Treasury ("GATT") rates is complete. As a result, the lump sum basis now correlates more closely with the accounting basis for measuring liabilities than it did in the past.

In addition to de-risking their plan, plan sponsors benefit from lower PBGC premiums and other administrative cost savings. These savings include reductions in actuarial valuation charges, in the cost of distributing participant notices (e.g., summary plan descriptions, annual funding notices, benefit restriction notices, participant benefit statements), and in the cost of finding missing participants, among others.

Nothing in the Internal Revenue Code (Code) or ERISA bars offering lump sum distributions from qualified pension plans, except for the benefit restrictions under Code Section 436 for underfunded plans. However, offering the option to retirees who are already receiving benefits presents more technical complications than does offering the option to vested terminees who have not yet begun to receive monthly benefit checks. (See our August 27, 2012 *For Your Information* on "Evaluating Retiree Cash-out Windows".) In addition, both lump sums and annuity purchases are acceptable as distributions from plans that terminate under the PBGC standard termination rules.

Pension Rights Center calls for moratorium

The PRC issued its press release on October 18, 2012. It calls for a moratorium on lump sum and annuity de-risking "until Congress can look into the risks posed by these strategies to workers and retirees." Karen Friedman, the PRC's executive vice president and policy director, said "insurance company annuities backed by State Guaranty Associations could leave retirees with less protection than the pensions provided by their companies backed by the insurance provided by the Pension Benefit Guaranty Corporation. Also, lump sums place the burden on individuals to ensure that the money lasts throughout retirement. We need to stop, take a breath, and make sure that the retirement security of the people affected by these moves is fully protected."

Outlook

The list of large companies announcing lump sum or annuity de-risking has grown since the Ford and GM announcements in the spring. Although surprising to some, it should be remembered that many plans offer lump sum distribution options apart from any type of de-risking strategy. In addition, every plan undergoing a standard termination uses some combination of lump sums and annuity contract purchases to close out, thus shedding the benefit of the PBGC guaranty. This is the approach that GM took, by spinning off active employees to a new plan and then terminating the current plan through a mixture of lump sum offers and an annuity purchase. As a practical matter, it would not be possible to prohibit annuity purchases as a settlement option in the case of corporate sponsors exiting from business operations altogether. Furthermore, it is highly unlikely that Congress would prohibit lump sum options under an otherwise financially healthy plan. All in all, Congress most likely will not see a policy reason for a change, and it will be reluctant to create new obstacles for plan sponsors who have been part of this voluntary system.