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Derisking With Lump Sum Payments: Participant Disclosure

BARBARA PLETCHER, March 2016

We are seeing a renewed interest in derisking of defined benefit pension plans by implementing a "lump sum window," and wanted to share with you the employee communication below. For purposes of this article, a "lump sum window" is a limited period of time during which participants in a defined benefit pension plan can elect to receive their pension plan benefit in the form of an immediate lump sum or as an immediate annuity. Participant disclosures associated with such lump sum windows are receiving increased scrutiny because legislators (and others) are concerned that defined benefit pension plan participants do not understand the consequences of electing an immediate lump sum.[1]

The employee communication below is designed to help participants who have separated from employment, but who have not yet begun to receive their pension[2] make an informed decision when presented with the opportunity, during a lump sum window (referred to in the communication as a "Special Election"), to receive an immediate lump sum payment or to commence immediate annuity payments. Such an employee communication would supplement (not replace) legally required communications distributed as part of the normal benefit election process.

Special Election — Issues To Consider

We've listed below some issues you might want to consider during the Special Election period offered under the Pension Plan ("Plan"). Your decisions during this Special Election period will depend on your particular circumstances. We encourage you to obtain investment advice before making these decisions. Neither the Plan nor the Plan sponsor is authorized (or able) to advise you.

	Issue	Lump Sum	Annuity
1.	**Life Expectancy**	Generally, a lump sum payment is more valuable to an individual who does not live out his/her full life expectancy (e.g., a participant who is terminally ill).	Generally, life annuity payments are more valuable to an individual who lives longer than the life expectancy for a person of his/her age.
2.	**Benefits for Your Heirs**	With a lump sum payment, there is the possibility of leaving money to individuals of your choice after your death.	If you are a participant, you generally can select a joint and survivor annuity with an individual of your choice as your "beneficiary." If that "beneficiary" dies after your annuity payments begin, you generally will not be able to name a new "beneficiary."
3.	**Retirement Security**	Unless you have other retirement resources, you will need to manage your lump sum so it will last. For example, you will need to choose appropriate investments and withdrawal rates.	Monthly income provided by an annuity is guaranteed by the Plan and, up to certain limits, by the Pension Benefit Guaranty Corporation.

Issue	Lump Sum	Annuity
4. Investment Expertise	Will you be able to invest your lump sum so that it will generate as much (or more than) the monthly income provided by an annuity from the Plan?	The Plan invests pursuant to advice received from professional money managers. The Plan assumes investment risk associated with monthly income provided by the Plan.
5. What Happens If You Change Your Mind?	If you receive a lump sum and decide, later, that you would rather have an annuity, you may be able to purchase an annuity from an insurance company. Due to insurance company fees, it generally will cost you more than the amount you received as a lump sum to purchase an annuity with payments equal in value to the payments available under an annuity provided by the Plan during the Special Election.	If you begin receiving an annuity, it is unlikely you will be able to convert that annuity to a lump sum at a later date. See, e.g., footnote 2 of this article.
6. Professional Money Management	If you hire a professional to manage your money you generally must pay for this service.	Your annuity payments will not be reduced to pay for professional management of assets invested by the Plan.
7. Inflation Risk (e.g., increased cost of goods and services)	All or a portion of your lump sum payment could be invested in assets that increase in value as inflation increases.	Annuity payments are set for your lifetime and will not increase in value if inflation increases.
8. Need for Significant Amounts of Immediate Cash *See Items 10 and 11, below regarding certain tax and unanticipated consequences*	With a lump sum payment, you take control of your pension assets and your entire Plan benefit becomes immediately available for your use.	If you elect an annuity, you will not have access to your entire Plan benefit. You will have access to periodic payments made to you each month.
9. Subsidized Benefits[3]	If you elect a lump sum payment, the lump sum payment will include [exclude] the value of early retirement subsidies (if any) available to you at the later of your current age or the relevant early retirement age. Once you receive Special Election materials, you should review the sections entitled [Relative Value] and [Right to Defer Payment] for additional information.	Certain early retirement annuity benefits offered pursuant to standard Plan terms are subsidized (i.e., payments are not reduced completely to reflect the value of early commencement). An immediate annuity offered only during the Special Election period will include [not include] the value of early retirement subsidies (if any) available to you at the later of your current age or the relevant early retirement age. Once you receive Special Election materials, you should review the sections entitled [Relative Value] and [Right to Defer Payment] for additional information.
10. Age of Participant	A 10% penalty tax generally applies to a lump sum payment to a participant who has not attained age 59-1/2. This penalty tax, which is in addition to standard income tax, can be avoided if your lump sum is rolled over to an IRA or to another tax-qualified plan.	A 10% additional penalty tax generally does not apply to annuity payments that begin after a Participant has separated from service because those payments constitute a series of substantially equal periodic payments made over the lifetime of the participant or the joint lifetime of the participant and his/her designated beneficiary.

Issue	Lump Sum	Annuity
11. Unanticipated Consequences	If your lump sum is taxed (not rolled over), it could cause you to move into a higher tax bracket and/or make you ineligible for premium tax credits when purchasing health insurance on a healthcare exchange.	Same issues as for a lump sum payment, but the annual amount of annuity payments will be smaller so the impact of these annuity payments is less likely to be significant with respect to these issues.
12. One-Time Offer	Once the Special Election period has closed, we do not anticipate that lump sum payments again will be offered to participants with total Plan benefits in excess of $5,000 who are not otherwise eligible for a lump sum payment under standard Plan terms. If you have not attained the early retirement age applicable to you under the Plan and you choose not to take the lump sum available during the Special Election, you will need to wait until you attain the applicable early retirement age in order to commence your annuity payments. Once you receive Special Election materials, see the [*"consequences of failure to defer"*][3] discussion in those materials for additional information regarding benefit increases resulting from delayed commencement of an annuity.	Each year you postpone commencement of your monthly annuity, that annuity could increase, depending on your age. For example, if your annuity benefit available today is $500 per month, delaying commencement for one year could increase your monthly benefit to something closer to $525. If you have not attained the early retirement age applicable to you under the Plan and you do not commence your monthly benefit during the Special Election period, you will need to wait until you attain the applicable early retirement age in order to again be eligible to commence your benefit. Once you receive Special Election materials, see the [*"consequences of failure to defer"*] discussion in those materials for additional information regarding benefit increases resulting from delayed commencement of an annuity.

1 See, e.g., United States Government Accountability Office, Report to the Ranking Member, Committee on Ways and Means, House of Representatives entitled "Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits." (January 2015)

2 See, e.g., IRS Notice 2015-49 (announcing the intent of the Department of Treasury and the Internal Revenue Service to prohibit lump sum offers to participants already in pay status).

3 Bracketed language would need to be edited to be consistent with plan document language and legally required disclosures provided by the plan to plan participants.