



A DEFINED PENSION BENEFIT BUYOUT INFORMATION SHEET **BY THE NATIONAL RETIREE LEGISLATIVE NETWORK - MAY 2012**

This document is intended to be basic information only. Please consult with company experts and personal advisors when considering the specifics of a defined benefit pension buyout offer.

THE DEFINED PENSION BENEFIT PLAN:

Protections:

A defined benefit pension plan (plan) is a plan which provides a lifetime annuity option with the risk of investment and longevity/mortality of the beneficiary borne by the plan/employer. The plan is covered by ERISA which requires that the plan sponsor report annually to participants on the plan's ability to make payments through all participants' retirement years (actuarial lifetime). If the plan is not fully funded, ERISA requires that the plan sponsor make contributions to the plan over a specified time frame until the plan reaches full funding.

Voluntary Terminations:

A defined benefit pension plan may be terminated voluntarily by the plan sponsor only if the plan has sufficient assets to purchase annuities for all plan participants that would pay 100% of their accrued pension benefit for life. The annuity would include a survivorship option if you had chosen to accept a discount to purchase one. If any Cost Of Living Adjustments (COLA) could have been expected, you would not be eligible for COLA consideration as part of your annuity terms.

Involuntary Terminations:

If a defined benefit pension plan is terminated involuntarily, through bankruptcy proceedings or action taken outside of bankruptcy by the Pension Benefit Guaranty Corporation (PBGC), your pension plan and payments from that plan cease and the PBGC takes ownership of plan assets and liabilities. The PBGC is an agency of the Federal Government which guarantees defined benefit plan benefits (within certain limits). Participants in terminated plans would receive a monthly payment from the PBGC as determined by the PBGC's plan provisions, ERISA and PBGC's rules and regulations. For example, in 2012, the PBGC maximum annual guaranteed pension payment (for a lifetime annuity without spouse option) for those at age 65 is \$56,000. It is lower for each year under age 65 (\$24,300 at age 55) but is also higher for those over age 65 (\$164,160 at age 75) (see www.pbgc.gov for details). Depending upon whether or not you benefited from pre-termination special pension enhancements or favorable IRS tax treatment, these payments could be lower.

WHAT IS A LUMP SUM BUYOUT OF MY DEFINED PENSION PLAN BENEFITS?

A lump sum buyout of your defined benefit pension plan benefits means you would receive a check (fully or partially taxable unless rolled into a 401(k) plan or IRA) that represents the present value of all payments due over your actuarial life valued as of the time you accept payment. This

present value formula is the inverse of what you might know as the projection of a future savings value or goal that is based upon how much one invests and what interest rate or growth rate is required to achieve a savings of “x” over a period of “y” years.

For example, if you are currently 62 and receive a pension of \$24,000 per year, the following would apply: The Social Security Actuarial Life Table predicts a 62 year old male will live an additional 19 years (until age 81; a female until age 84). It would be projected that you would receive an additional amount of pension equaling \$456,000 (\$24,000 X 19). However, the Net Present Value (or Lump Sum) you would receive based on a 7% interest rate discount would be approximately \$258,000. So, in order to receive the same amount as your projected pension would have yielded, you would have to accumulate an additional \$198,000 (\$456,000 - \$258,000). This means you would have to grow the \$258,000 lump sum amount significantly in order to cover the shortfall between the lump sum and your projected pension. These data would be slightly different for a female living to age 84. In addition, if you live longer than the actuarial table predicts, you will have probably out-lived your lump sum funds at age 81 (or at age 84 for a female). Had you opted to continue your pension plan instead, you would still be receiving your \$24,000 pension after reaching age 81 (or age 84 for a female). THIS IS A DEMONSTRATION EXAMPLE ONLY!

IMPORTANT CONSIDERATIONS TO THINK ABOUT BEFORE ACCEPTING A LUMP SUM OFFER:

- Taking a lump sum buyout offer would:
 - o eliminate future company pension financial obligations and issuance of pension plan statements as stipulated in ERISA.
 - o eliminate any future chance to receive a 100% voluntary termination annuity payment mentioned above.
 - o eliminate eligibility for PBGC insured benefits if the plan were to be involuntarily terminated after your acceptance of a lump sum pension buy-out.
 - o transfers all risk for growing the lump sum to satisfy your financial needs from the company to you.
- It is critical to understand which discount (interest) rates and actuarial assumptions (including expected longevity) were made in calculating your lump sum offer (the present value). Any overstatement of the discount rate or error in the actuarial assumptions could seriously understate the amount of your lump sum offer.
- As people live longer their actuarial life lengthens and the plan sponsor must increase funding (and/or grow the invested value) in your current plan to cover the extra months you may live. When you take a lump sum, you must find a way to pay yourself for any amount of extended life beyond the actuarial amount inherent in the lump sum calculation at the time you accept it. The plan sponsor is off the hook.
- A lump sum buyout places full accountability for all future income in your hands and those of any financial advisors or money managers you may contract with. In effect, a

buyout acceptance shifts all risks of longevity and investment return to you. **See example above.** Based upon the present value example above, you must be confident that you can hold onto and grow enough income from a lump sum payout over your actual lifetime to replace the pension payments you would have been eligible to receive if you had not accepted the buyout.

- If you have or would elect a survivors option, make sure to check to that your lump sum offer includes survivor benefits – if not, you may need an alternative plan.
- You should always consult with your financial advisor and / or tax advisor to make sure you are aware of the economic consequences of taking a lump sum buyout.

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