Bolton

Alert

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IRS LIFTS MORATORIUM ON RETIREE LUMP SUMS

The IRS recently issued Notice 2019-18 which may allow plan sponsors to provide current retirees the option to convert their annuities to lump sums without having to terminate the plan. This adds another risk management tool to plan sponsors' risk management toolbox. While this may be a good strategy for plan sponsors, there are many reasons to be cautious before implementing this strategy.

Reasons for Considering

Plan sponsors have successfully lowered their liabilities and risk by implementing lump sum settlements for former employees who have not started their benefits (i.e., vested terminated cashouts). The minimum lump sum you would have to pay retirees will be significantly less than the cost of purchasing annuities for these retirees, resulting in significant savings to the plan. The strategy also allows you to save on PBGC premiums and reduces the overall risk to your pension plan.

Reasons to be Cautious

While this can be a great strategy for reducing your current and future liability as well as reduce your risk in the pension plan, there are several reasons to be cautious before implementing this strategy, some of which include;

- Negative selection: Retirees with terminal diseases will generally elect the lump sum over healthier retirees, which may result in an overall increase in plan costs.
- More expensive annuity purchase: Insurance companies are well aware of the negative selection that occurs with a retiree lump sum offering and will adjust the price of an annuity purchase accordingly, which may eliminate most or all of the savings you realized with the retiree lump sum offering.
- Social responsibility: Lump sum offerings sometime receive negative publicity because they take away the longevity protections from retirees.
- The IRS is not granting explicit approval: The IRS did not specifically approve retiree lump sums under Notice 2019-18 and mention many other hurdles a plan sponsor must meet to execute this strategy. The IRS also commented that they will not provide private letter rulings for this strategy and will only give a determination letter at plan termination.

While there are good reasons for implementing this strategy, you need to ask yourself if your advisor is giving you feedback of all of the disadvantages of this strategy, as well as the advantages. If you would like additional advice on this issue, please contact Jim Ritchie at 443-573-3924.