Lump-Sums "De-Risking" by Defined Benefit Plans: Why Full Actuarial Value Matters

Neil Gladstein
IAM Strategic Resources

Alliance for Retired Americans
"The American Pension Crisis"
November 19, 2019

"De-Risking" is Big News and Big Business

IRS Notice on Lump-Sum Windows for Retirees Creates More De-Risking Opportunities

Pension Derisking Strategies on the Rise
by Keith Panetta and Tobiah Mintz

Boise Cascade trims pension liabilities with $20 million buyout

It just became easier for employers to dump retirees' pensions
By Lydia DePillis, CNN Business

When your pension sponsor talks 'de-risking' - watch out

Pension buyout plan for state workers still being studied

United Technologies Announces Pension Buyout, Lump-Sum Window

Lockheed Martin Offloads $2.6 Billion in Pension Liabilities

INDUSTRY VOICES September 17, 2018
Pension Investment De-Risking Primer
Sterling Price, managing consultant at Findley, discusses how LDI and a dynamic investment policy help to de-risk pension plan assets

FedEx to ship $6 billion of pension obligations to annuity with MetLife

Pension Buyouts Likely to Be Bolder, if Not Bigger, in 2019

Illinois budget bill features pension buyout for state workers

AT&T, Warner Media offer lump-sum payouts to 59,000 DB participants

What is “De-Risking” or “Pension Risk Transfer” (PRT)?

Single-employer and government plans have, or are considering, one or more ways to reduce exposure to pension plan costs, PBGC premiums, and/or volatility by transferring risk:

- To workers by partial freezes (excluding new hires) or full freezes (no additional benefit accruals).
- To former employees in lump sum “windows”.
- To insurance companies by buying annuities to pay benefits (“buyout”) of buying insurance policies as hedge (“buy-in”).
- To PBGC by plan termination (private sector only).

Note: Not aware of multi-employer DB plans engaging in “de-risking” strategies.

Lump-Sum "De-Risking"
Complicated Issue for Unions

- Unions want to protect former bargaining unit members (deferred vested and retirees).
- Unions are no longer the bargaining representative for former employees.
- De-risking not a "mandatory subject of bargaining" for those no longer in bargaining unit (it is for future retirees still in unit).
- Plan documents typically give pension administrators ability to amend plan – including offering a lump-sum "window" or buying annuities.

Lump-Sum De-Risking "In Pay Status" (Retirees)

- Stopped by Obama Administration (IRS Notice 2015-49, July 9, 2015)
  Started process to amend regulations to "provide that qualified defined benefit plans generally are not permitted to replace any … annuity currently being paid with a lump sum payment …." Would apply retroactively to July 9, 2015.
- Allowed Again by Trump Administration (IRS Notice 2019-18, March 14, 2019)
  IRS will not amend regulations.

Limited Data Available

PBGC "Risk Transfer Study Plan Years 2009 – 2013"

(Analysis of Form 5500s with 1,000 or More Participants)

- 15% of plans (534 of 3,590) had "risk transfer events"(RTEs) of lump-sum windows and/or bulk purchase of annuities.
- Of which 71% (381 of 534) had large number of lump-sum payments.
- 22% of participants (5.9M of 27.4M) were in plans with RTEs.
- 1.15 million fewer plan participants due to RTEs.

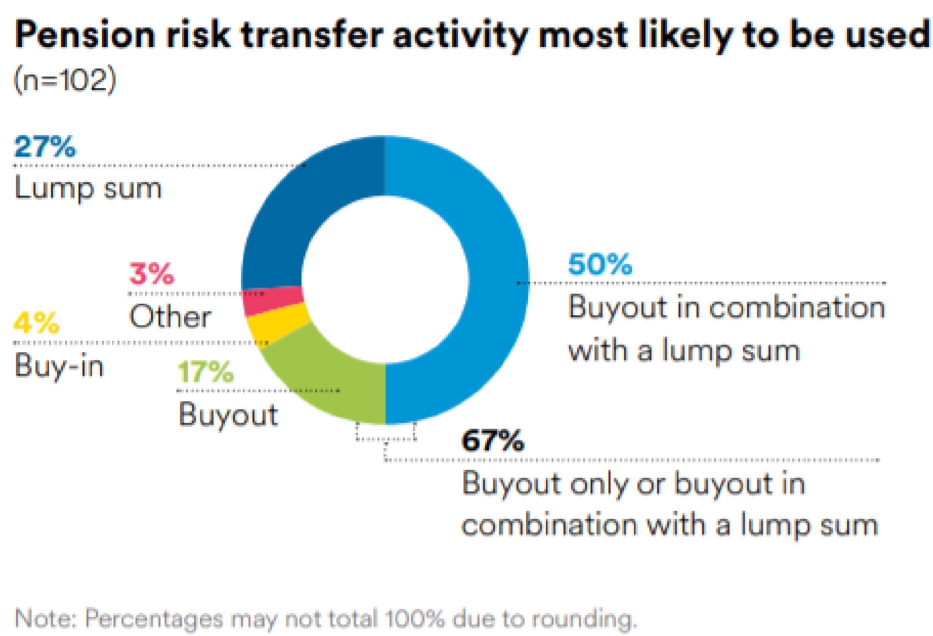
By Neela Ranade, Armando Saaverdra and Tim Rhodes, https://www.pbgc.gov/sites/default/files/legacy/docs/Risk-Transfer-with-Notes-December-2015.pdf

Aon Hewitt "2014 Lump-Sum Windows"

- Lump-sum offers frequently used in pension de-risking.
- More prevalent after Pension Protection Act (PPA) changed calculation to corporate bond rate which lowered lump-sum present value.
- Survey of 70 lump-sum windows (2014):
  - 58% of 290,000 participants took lump-sum.
  - Total payments over $4 billion.

https://www.aon.com/attachments/human-capital-consulting/lump-sum-window-experience.pdf.

MetLife "2019 Pension Risk Transfer Poll"



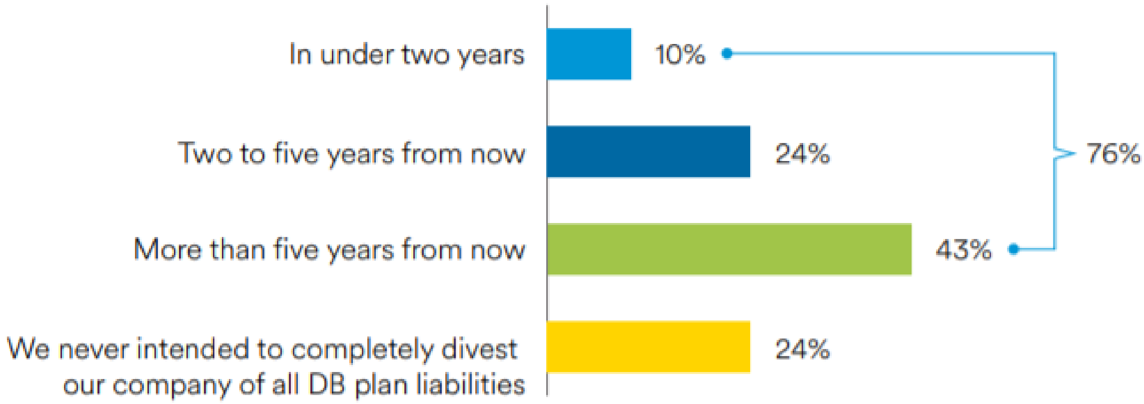
Under a pension "buy-in" trustees buy an insurance policy to cover a group of their members. The trustees hold the policy as an asset and remain responsible for paying the pensions. This differs from a pension "buyout" where the assets and liabilities are transferred to an insurer.

Chart from https://www.metlife.com/content/dam/metlifecom/us/homepage/institutionalRetirement/insights/PensionRisk/2019-PRT-Poll-Report-exp2-2020.pdf.

MetLife "2019 Pension Risk Transfer Poll"

(Continued)

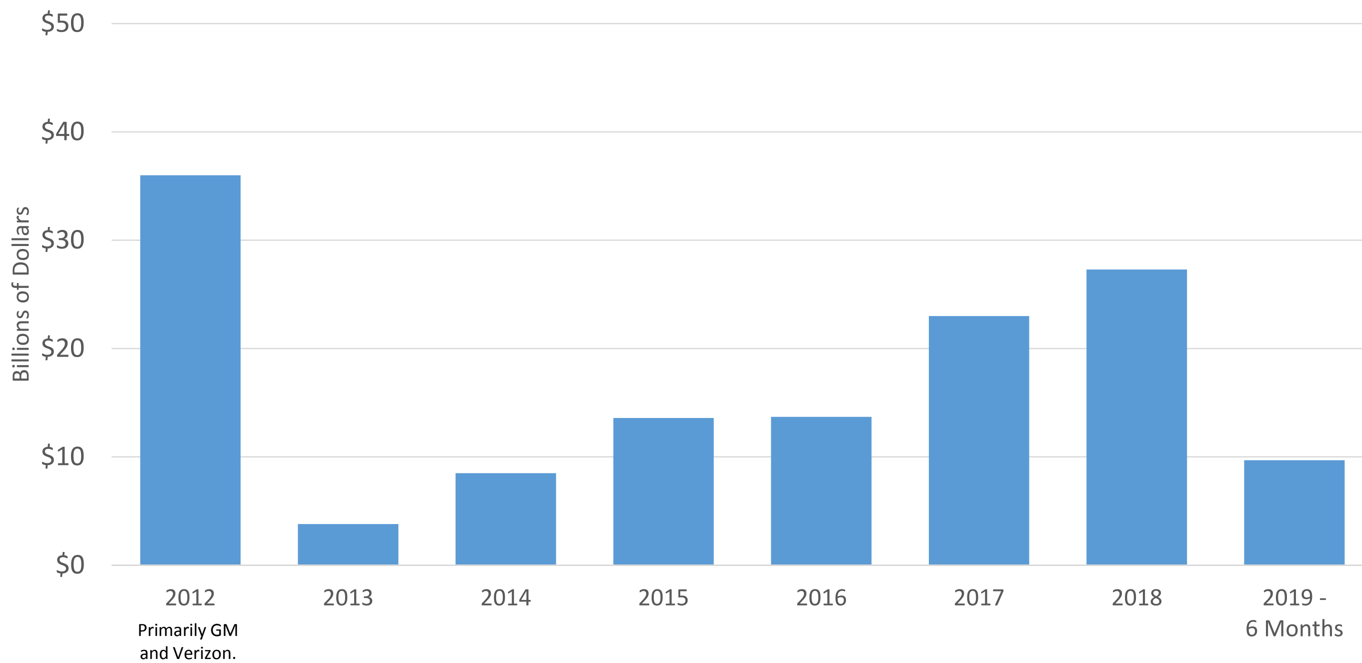
When do you think your company will have completely divested all of its defined benefit pension plan liabilities?
(n=102)



Note: Percentages may not equal totals or add to 100% due to rounding.

Chart from https://www.metlife.com/content/dam/metlifecom/us/homepage/institutionalRetirement/insights/PensionRisk/2019-PRT-Poll-Report-exp2-2020.pdf.

LIMRA Data on DB Plans Purchasing Annuities



LIMRA was formerly know as the Life Insurance and Market Research Association.

PBGC

- PBGC started (2015) requiring reporting of "risk transfer activity" in its Comprehensive Premium Filings related to:

a. If Lump Sum Window(s) Offered:
   1) Number Persons Eligible
   2) Number of Persons Who Elected to Take

b. If Annuity Purchased:
   1) Number of Persons Not In "Pay Status"
   2) Number of Persons In "Pay Status"

- Not collecting data on dollar amounts.
- PBGC analysis of 2015 – 2017 data is "release pending."

Lump-Sum Annuity Value: ERISA Loophole

Lump-Sum Values can Exclude Some Plan Benefits

- ERISA only requires lump sum actuarial value to be based on the “normal retirement” benefit; not the full actuarial value.
- Sponsors can exclude additional plan benefits, such as subsidized early retirement and joint-and-survivor benefits.
- GAO warned about this “longstanding rule that provides an incentive for offering a lump sum window … allows sponsors to exclude certain additional plan benefits”. (GAO-15-74, Jan. 2015)
- Some employers will offer full actuarial value (above what is legally required).

Note: State laws govern how public pension lump-sum values are calculated.

Example of Lump-Sum Rip-Off: General Electric (GE)

General Electric (GE) Proposal to Multi-Union Coordinated Bargaining Committee (CBC)

(June 2019 Negotiations)

"In its sole discretion, the Company may amend the [pension] plan … as it determines to offer to terminated participants (including retirees) and beneficiaries the opportunity to elect during one or more window periods an immediate lump sum distribution …."

CBC Unions' Counter-Proposal

"The lump-sum value will include the actuarial value of all supplements the participant is eligible for, such as 100% of Normal Retirement at age 60 …."

GE's Response

- Rejected including full actuarial value.
- Claimed value of lump-sum previously offered in 2017 as part of a limited buyout met legal requirement.
- Claimed participants in 2017 were warned in cover letter that lump-sum did not include value of early retirement subsidy.

CBC Requested a 2017 Letter

To see:

- How lump-sum was described?
- How was fact that early-retirement subsidy was not included in lump-sum explained?
- Was it reasonable to assume those taking lump-sum understood value of forfeiting early retirement subsidy?

GE's Aug. 2017 Lump-Sum Letter

Page 1, 1st Sentence:

"GE is offering a limited-time option for certain GE Pension Plan … participants to take their entire benefit on December 1, 2017, as a lump sum or to initiate monthly payments ahead of normal schedule."

Choices Under Early Retirement Option

2017 Letter Page 3 (Sample Letter Example)

	Year	Age	Choice	Benefit
Special Offer	2017	45	A	Lump-Sum of $15,468
	2017	45	B	$68.51 Monthly Pension
Wait to Retire	2032	60	C	$267.27 Monthly Pension ($3,207 per year)
	2037	65		

“NOTES ABOUT THESE CALCULATIONS”

2017 Letter Page 3 (Emphasis in Original)

“As you consider these choices keep in mind the Plan allows you to begin your Company-provided benefit at age 60, before the Plan’s normal retirement age of 65. The benefit available at age 60 is not reduced to account for the extra five years of payments. The benefit that begins between age 60 and age 65 is therefore more valuable than the age 65 benefit and the extra value is called an early retirement subsidy. **This subsidy is <u>not</u> included in the amounts in Choices A and B, which are based only on your benefit at age 65. Accordingly, if you wait to receive your benefit until age 60, your benefit is expected to be worth more.”**

Other Explanation (2017 Letter Page 3 and Repeated on Page 6)

"For this Company-provided benefit, the lump sum amount is the total value at December 1, 2017, of your Company-provided benefit payable beginning at age 65, determined as follows. Each monthly payment that you would have received is valued based on the chance that you would live until that payment date (based on average life expectancy) and an interest assumption. Your lump sum amount is the sum of each of these values. These values are calculated using the applicable interest rates and mortality table required by section 417(e) of the Internal Revenue Code. The applicable mortality table is the 2017 mortality table under the Pension Protection Act. The applicable interest rates used are 1.79% for payments during the first five years, 3.80% for payments during the following 15 years and 4.71% for payments made more than 20 years in the future."

What was Missing from 2017 Letter

- A lump-sum dollar value for the early retirement subsidy is never explained.
- How much lower (either in $ or %) the lump-sum offered is due to early retirement subsidy not being included.
- An explanation that this early retirement subsidy is different than the "Regular Supplement" and "Special Supplement" some early retirees receive under the Plan until eligible for 80% of Social Security.

Key Facts Missing from 2017 Letter

Special Offer (In 2017 Letter)	**Lump-Sum of $15,468**
Total Value (Not in 2017 Letter)	**Lump-Sum of $24,016**
GE Pension Plan Saved if Offer Accepted (Not in 2017 Letter)	**$8,548 in Lump-Sum Value**
	36% of Total Lump-Sum Value

Why 5-Years of Early Retirement Subsidy is 36% of Total Lump-Sum Value

- Five additional years of benefits (Ages 60 to 64)
- Pension for Ages 60 to 64 has Fewer Years of Discounting
- Lower Interest Rate in Subsidy Years = Greater Value
  - 3.80% for payments discounted in future years 6 to 20
  - 4.71% for payments discounted in future years 21 & Over
- Example Using 2017 Letter – One Year of Benefits
  - Present Value of $3,027 from 2032 (age 60) = $1,833 in 2017
  - Present Value of $3,027 from 2042 (age 70) = $1,015 in 2017

What is Excluding Actuarial Value of Early Retirement Worth to GE in its Proposal?

If Terminated Vested Participants Choose Lump-Sum		Total Funding Target	33% Kept by Plan if Participants Accept Lump-Sum Offer (*)
50%	73,250	$4.8 B	$1.6 B
75%	109,875	$7.2 B	$2.4 B
100%	146,500	$9.6 B	$3.2 B

Source: GE Pension Plan 2018 Form 5500 Schedule SB, 1/1/2018 Valuation Date.

Note: (*) Using 33% since average deferred vested may be older than 45 in letter example.

GE's Response

- June 2019 - Withdrew proposal in negotiations.
- October 2019 – GE makes new lump-sum offer to about 100,000 deferred vested plan participants. Cover letter includes:
  - Same "entire benefit" claim as 2017 letter.
  - Same "subsidy is not included" warning without any dollar amount.
  - Same technical language about IRC 417(e).

IAM President Martinez Letter to GE CEO Culp

"… I am greatly disappointed that GE is not providing the full actuarial value of pension benefits … the Unions negotiated in good faith …. This is grossly unfair to people that dedicated years of their lives generating huge profits for GE…. There is still time for GE to do the right thing for its former employees and include the full actuarial value of their pension. At a minimum, GE should send out a corrected offer letter that clearly explains the dollar amount of … early retirement benefit that is not included in the offer, clarify the misleading statement about 'entire benefit,' and give them an opportunity to revise their selection …."

Lump-Sums and "De-Risking" by Defined Benefit Plans: Why Full Actuarial Value Matters

Neil Gladstein
IAM Strategic Resources

Alliance for Retired Americans
"The American Pension Crisis"
Nov. 2019