THREE CONSIDERATIONS BEFORE OFFERING A RETIREE LUMP SUM

You have probably heard by now that the IRS has reversed course and is allowing pension plans to offer lump sums to retirees in pay status. Under IRS Notice 2019-18, a **lump sum offer** would give current retirees the opportunity to switch from a monthly annuity to a single lump sum payment.

Many plan sponsors are contemplating whether to take advantage of this limited opportunity to offer lump sums to retirees. As you weigh the possibility, consider the three key issues below:

1. **The IRS has re-opened the lump sum window *for now*, but will issue no letter rulings. An opinion letter from counsel may provide legal reassurance.**

   First, consider whether a lump sum offer is a good idea for your company's circumstances. It's not mandatory. Plan sponsors do not have to offer lump sums to retirees, and, even if they do, retirees do not have to take them. The news media has created some confusion among retirees on this point. Also, a lump sum window must offer other options too – such as joint and survivor annuities.

   There may be a limited window of opportunity to offer lump sums to retirees. In 2012, IPB submitted the first IRS private letter ruling allowing retiree lump sums (PLR 201228051) for General Motors, followed by a second ruling for another client (PLR 201434028). A handful of rulings for other companies soon followed. Retiree lump sums were put on hold in 2015, however, when key Treasury officials stepped in and put the kibosh on the issuance of private letter rulings allowing the practice. This Treasury moratorium was a response to political objections to lump sums paid to retirees. See IRS Notice 2015-49. The Treasury recently reversed its position – now allowing retiree lump sums to proceed – in a similarly politically-motivated move. Depending on the outcome of the 2020 election, retiree lump sums could again be outlawed by a new administration.

   Although Notice 2019-18 indicates that the IRS "will continue to evaluate" related qualification issues (such as nondiscrimination and benefit limitations), the IRS had included the same caveats in its earlier rulings. This language alone should not preclude plan sponsors from relying on Notice 2019-18. At present, the law clearly supports a plan sponsor's ability to offer a lump sum to retirees. Assuming the proper design and structure, IPB is comfortable providing a favorable opinion letter on these offerings.

   If accepted and properly implemented, a lump sum offer can be an effective de-risking strategy. It will reduce uncertainty with respect to the longevity of benefit payments and the performance of investments, and it will reduce PBGC premiums and other administrative costs. Not every retiree will accept a lump sum, of course. Some retirees will stick with the original benefit election, while others will seize the opportunity to switch from a single life annuity to a joint and survivor benefit (or vice versa).

2. **Consider to whom, and when, you will provide the lump sum offer.**

   A lump sum offer is a significant undertaking with legal implications. We can help you think carefully about who is invited to participate. Will the offer be extended to all retirees, or a subset of retirees?

If a subset, consider the criteria used to divide your retiree population. You might limit the lump sum to participants with smaller benefits (e.g., < $50K), or to a particular division or union group. Some plan sponsors have limited the lump sum offer to retirees who commenced their pension after a certain date. This is intended to minimize adverse selection, since the oldest retirees have the clearest insight into their mortality status, but it can raise age discrimination concerns.

If the lump sum offer will be made in tranches, consider the order and duration of each window. Which group goes first? How will you handle the serious consideration issues? Offering a series of windows (and/or extensions) also can raise concerns about establishing a protected benefit based on a pattern and practice of amendments.

Should any categories be excluded altogether? For example, some plan sponsors elect to exclude retirees for whom a lump sum is administratively impractical. These might include retirees with QDROs – or certain types of QDROs – to avoid having to reopen a messy QDRO file. Any group that is excluded should be carefully defined in an objective and non-discriminatory manner.

In all cases, we can help you examine your plan design for potential age discrimination concerns, as well as nondiscrimination issues under Code section 401(a)(4).

3. **Make it happen with an effective, ERISA-compliant communication and implementation strategy.**

As an original architect of the retiree lump sum, we have extensive experience with its implementation. One of the most critical – and risky – steps involves participant communications. There are significant fiduciary issues implicated when a plan sponsor presents a lump sum offer to retirees. It's important to get it right. You need the communications to be even-handed and clear.

We can create or help review the messaging in your participant letters, town hall meetings, press releases and public statements, call center scripts, and intranet postings. It's important to consider the tone of the message as well as the numerous disclosures about the value of each option.

We can assist in strategically addressing other concerns as well. If you have qualms about retiree decision-making, you might consider offering financial education in the communications package. (Both GM and Ford offered financial counseling.) Another way to address this concern is to condition a lump sum distribution upon rollover to the company savings plan.

A significant aspect of the participant communication package is the spousal consent form. This is tricky. Treasury considers the lump sum offer to be a new annuity starting date, which triggers a new spousal consent requirement under Code section 417. For a participant whose marital status has changed since the initial annuity starting date, it may be necessary to obtain the consent of the former spouse, or *both* the former spouse and current spouse, in order to convert the annuity to a lump sum. (Good luck with that!) It can get even more complicated if the former spouse or current spouse had waived their right to a joint and survivor annuity in the past, or if a contingent beneficiary is involved. Working closely with experienced counsel can reduce your litigation risk.