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USER GUIDE

How to Handle a Lump Sum Window

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4 Reasons to Offer a Lump Sum Window

1. Lump sums generally cost less than annuity purchases.
2. Lump sums "de-risk" the plan by transferring investment and longevity risk to participants.
3. Lump sums reduce ongoing administrative costs for PBGC premiums, audit and actuarial fees, and HR resources used to maintain contact with former employees.
4. Lump sums make plan termination easier.

Best Practices to Increase Take-Rates

The success of a lump sum window is usually measured by the percentage of eligible participants that accept the offer (a.k.a., the "take-rate"). Those that don't respond end up receiving a deferred annuity and defeat the purpose of the window because the plan continues to carry their liability.

Best practices are to:

1. Send a generic announcement via certified mail to the last known address including a request to confirm contact information. Find the correct address and re-mail any letters returned to sender.
2. Mail personalized election forms including rollover notices, spouse waiver forms, and other IRS required disclosures along with a cover letter than emphasizes the limited time offer and communicates in layman's terms.
3. Set up a call center to answer any participant questions and follow up with participants until they make an election and submit all applicable forms. This is a critical step for success.
4. Cash-out participants (or set up an IRA) for those with lump sums that are less than $5,000 as allowed by law.
5. Force participants who are over the plan's mandatory retirement age to commence monthly benefits in the normal form if they don't respond.
6. Follow up with the trustee to reissue checks that aren't cashed, report lump sum takers on Form 8955-SSA, and update plan records to reflect payment.

A lump sum window is a temporary offer within a defined benefit plan to selected participants.

Eligible participants are allowed to take a lump sum in lieu of a monthly lifetime benefit. The offer is temporary rather than permanent, so it does not create another ongoing optional payment.

The offer may not be made to retirees in payment status, or active employees (unless the plan is being terminated). Generally, the offer is made to some, or all, terminated vested participants and most of them roll it over to another plan or IRA.

For More Information

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8 Things to Know Before Opening a Window

Common arguments for not offering a lump sum window:

1. Lump sum windows may not be offered by significantly underfunded plans. However, most plans can pass this funding threshold based on relatively high IRS-mandated interest rates.
2. Subject to exceptions, lump sums may not be paid to the top 25 highest paid employees.
3. Interest rates required for calculating lump sums are generally locked-in for the entire plan year. Thus, plan sponsors should consider reinvesting the assets needed to pay lump sums during the plan year.
4. Fixed income securities (e.g., bonds) and lump sums both go down as interest rates rise, and vice versa. So, waiting to offer lump sums may not be advantageous from a funded status perspective, even if rates go up.
5. Additional accounting charges may be required due to lump sum payments. For example, if 10% of the liability is paid in lump sums, then 10% of the unrecognized net loss must be expensed. However, the entire unrecognized net loss must hit the income statement eventually.
6. Additional cash contributions may be required for the plan year following the lump sum payments. However, if this is the case, then additional contributions will most likely be required eventually anyhow.
7. Administrative costs to implement a lump sum window could be significant depending on the number of eligible participants. However, most of these costs will be incurred eventually without a lump sum window as participants retire, so this is more of a timing concern.
8. Immediate annuities must be offered along with the lump sum to all participants including those who are not yet old enough to otherwise commence payments. However, very few younger participants (if any) will elect an immediate annuity in lieu of a lump sum.

Plan Administrator Challenges

Participants who are already eligible for early retirement, past normal retirement age, or past required beginning date, and surviving spouses and alternate payees, require special attention. Likewise, early retirement subsidies, late retirement increases, retro-active annuity starting dates, cash balance formulas, and automatic cost-of-living-adjustments add complexity to the IRS required relative value and failure-to-defer disclosures. In some cases, it may be prudent to include the early retirement subsidy in the lump sum to sweeten the deal. In all cases, plan administrators should take special care with lump sum windows because large sums of money will be changing hands.

Curcio Webb is an independent benefits administration consultant, helping companies choose the right employee retirement and health & welfare options. Our services are designed to create financial due diligence, increase participant engagement and mitigate risk.