Offering One-Time Lump Sums For Defined Benefits Plans

Defined benefit plans are attractive to employees because they offer the security of steady income after retirement. But these plans come with costs to the employer, as the company must manage investments and pay for administrative costs and government insurance protection. In some cases, it can make more sense for the employer to offer a one-time, lump sum payment that replaces the annuity payment. If the employee accepts the payment, the employer is free of the associated risks.

Things To Consider Before Offering

A defined benefit plan is supported by investments that maintain the pool of money from which pension payments are drawn. Like any other investments, no matter how conservative, there is an element of risk. Offering a lump sum payout program allows the employer to reduce that risk by shifting it to the participant. Pay the participant a large, one-time amount, and then they are responsible for investing that amount however they feel is best.

A lump sum also reduces the costs of managing your defined benefit plan by reducing administrative overhead and lowering PBGC premiums, since the payment cashes the participant out of the program entirely.

When making the decision whether to offer a lump sum payout program or not, certain factors must be considered. You should be aware of how upcoming changes in interest rates, PBGC premiums, or mortality tables will affect your plan and calculate if paying out lump sums will stave off negative impact. You must analyze which participants would most decrease your risk if they took the lump sum. You need to decide what plan assets you will use to pay out the lump sums. Lastly, how will this program affect the company balance sheet?

Of course, the process of collecting data and then making the actual offers has its own administrative and investment costs. If those costs overshadow the benefits of making a lump sum offer, then such a payout may not be in the employer's best interest.

Making The Offer

As with any change to your defined benefit plan, communication is critical. You should send a pre-election announcement to all affected participants outlining the payout offer. Participants may find the offer confusing or have trouble weighing the pros and cons of taking the lump sum versus staying with their annuity. Your announcement should encourage them to seek out a financial advisor who can help them make sense of it all.

You must also communicate to each participant the details of their election package. This should describe how the lump sum amount was calculated. You should also prepare reminders to be sent to participants during the election period, reiterating the process and informing them of their remaining time to choose.

Deciding to implement a lump sum payout program and managing it is complicated. Cowden Associates has the expertise to help you analyze the data, develop a payout plan, and communicate it to your participants clearly and efficiently. Contact us for more information on our actuarial and retirement services.