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Annuities

More Plan Sponsors Intend to Offer Pension Cash-Out Option, Survey Finds

Nearly four in 10 employers with defined benefit plans say they are at least somewhat likely to offer terminated vested participants and/or retirees a lump-sum option during a specified time period in 2013, compared with 7 percent that actually made such a move in 2012, according to survey results released Feb. 13 by Aon Hewitt.

In fall 2012, Aon surveyed 428 employers on their current and future retirement benefit strategy, including 230 employers with defined benefit plans representing nearly 5 million employees, Aon said in announcing the results of its *2013 Hot Topics in Retirement: Focusing on Financial Wellness* survey.

Pension ''de-risking'' strategies have been defended as necessary for businesses to reduce their pension liabilities but criticized as putting retired and former employees' retirement security at risk (212 PBD, 11/2/12; 39 BPR 2077, 11/6/12). Ford Motor Co., General Motors Co., and Verizon Communications Inc. are among the prominent companies to have taken steps to accelerate the settlement of pension obligations by paying lump sums or purchasing annuities—or both—and others are considering similar strategies, pension consultants have said (239 PBD, 12/14/12; 39 BPR 2389, 12/18/12).

Lump Sum Favored Over Plan Changes. In this recent survey, Aon said that 39 percent of employers with defined benefit plans are likely to add or liberalize a lump-sum option, with 25 percent saying they were ''somewhat likely'' to do so and 14 percent saying they were ''very likely'' to do so. About one-third of employers (34 percent) said they were at least somewhat likely to add a lump-sum option permanently, Aon said.

On the other hand, defined benefit plan sponsors have little interest in closing, freezing, or changing the benefit formula, Aon said. Some 84 percent of defined benefit plan sponsors indicated they are either somewhat or very unlikely to reduce benefits, Aon said. Most plans that are open to new participants will continue to be so, employers said, with only 17 percent saying they were at least somewhat likely to close the plans to new entrants.

Rather than modifying their pension formulas or changing their plans in other ways, ''respondents are focusing their de-risking efforts on the asset side of the equation,'' Aon said. Thus, 50 percent of employers are likely to perform asset-liability studies in 2013, and 60 percent of plan sponsors intend to adjust the plan's investments to better match its liabilities through, for example, liability-driven investing, it said.

Defined benefit plan sponsors showed some increased interest in purchasing annuities for terminated vested participants or retirees in 2013, with 7 percent indicating they are at least somewhat likely to take that step this year, Aon said. This compares with 1 percent that took that action in 2012, Aon said.

Annuity Is More Expensive Option. Asked why comparatively few defined benefit plan sponsors said they are likely to purchase annuities for terminated vested participants or retirees, Rob Austin, senior retirement consultant in Aon's Charlotte, N.C., office and co-author of the report, said that an annuity is the more expensive option.

''Annuity contracts are priced at a lower interest rate, which is different than what a lump sum would use,'' he told BNA Feb. 15.

In addition, he said, an insurance company would use its own mortality tables versus what a plan sponsor would use to calculate the lump sum, which is based on the Internal Revenue Service's published mortality table.

''Generally, the annuity would be more expensive and have profit margins built in,'' he said.

Austin said that, when the question was asked during the survey, it was before companies began making major lump-sum announcements. If the question were asked of plan sponsors now, Austin said, the percentage of sponsors indicating an interest in purchasing a group annuity contract to cover their pension liabilities might be higher. Nevertheless, he said, ''companies are still looking for the most cost-efficient way to minimize and transfer liability off their balance sheet, and that would typically be the lump sum.''

When, Not If. ''The trend toward de-risking by defined benefit plan sponsors is fundamentally a question of when, not if,'' Matt Herrmann of Towers Watson in St. Louis told BNA Feb. 15. Herrmann, who heads the company's retirement risk management group, said his company has advised more than 110 plan sponsors and implemented about 80 terminated vested window programs during 2012.

''The initial window of opportunity to offer lump-sum windows closed for many plan sponsors at the end of 2012,'' because of how the basis for paying lump sums is set, Herrmann said. ''Whether 2013 activity will be the same or exceed the volume in 2012 will depend on factors such as the level of plan funded status and the overall market environment,'' Herrmann said. ''But the trend toward employers deciding to offer lump sums will continue as a way to reduce the size and volatility of their pension obligations,'' he said.

Karen Friedman, executive vice president and policy director at the Pension Rights Center in Washington, which in October called for a moratorium on de-risking strategies such as lump-sum offers, told BNA Feb. 15 that, ''once retirees are in pay status, it's unfair for employers to try to persuade them to take lump sums.'' She said that many retirees in pay status may be scared that the retirement plan is not financially healthy and, therefore, be tempted to take the lump sum, ''even though most people won't be able to invest the money to make it last for a lifetime and would be better off staying with the annuity instead.''

By Joe Lustig

The survey report is at http://www.aon.com/attachments/human-capital-consulting/US_2013_hot-topics-in-retirement.pdf.

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