Benefits Brief

GROOM LAW GROUP

PBGC Proposes Change to Lump Sum Assumptions

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On September 30, the Pension Benefit Guaranty Corporation ("PBGC") issued proposed regulations under section 4022 of the Employee Retirement Income Security Act of 1974 ("ERISA"). 84 Fed. Reg. 51494. This proposed regulation would change the actuarial assumptions that PBGC uses for calculating the lump sum present value of benefits in plans that undergo either distress or involuntary terminations. If this lump present value is below $5,000, then the benefit from the terminated plan is considered *de minimis* and may be paid as a lump sum in lieu of an annuity.

Additionally, a small number of private-sector defined benefit plans use the PBGC lump sum assumptions for the purpose of calculating lump sum benefit amounts under the terms of the plans. These plans may be affected by the proposed regulation.

Background

When a single-employer pension plan goes through either a distress or involuntary termination, PBGC generally pays all plan benefits as annuities. However, the benefit may be paid as a lump sum if the present value of the benefit is $5,000 or less. This present value calculation uses the 1984 Unisex Pensioners Mortality Table and interest rates that the PBGC publishes monthly.

The methodology that PBGC uses to generate these interest rates typically results in rates that are lower than other interest rates that serve a similar purpose, such as those published under section 4044 of ERISA or the rates published under section 417(e) of the Internal Revenue Code ("IRC" or "the Code"). Notably, PBGC's interest rate methodology under ERISA section 4022 produced an immediate annuity rate of 0% for October of 2019, which appears to have prompted PBGC to consider changing the methodology.

Prior to 1994, private sector pension plans that paid lump sum benefits to participants were required to ensure that the lump sums were at least as large as the amount determined using the PBGC lump sum assumptions under ERISA section 4022. The Retirement Protection Act of 1994 specified new actuarial assumptions under IRC section 417(e) for this purpose, and most pension plans were amended at this time to reference the new applicable interest rates and mortality tables in place of the PBGC assumptions. However, a few plans have continued to use the PBGC assumptions, typically paying lump sums that are equal to the greater of those determined under the PBGC 4022 assumptions and the new 417(e) assumptions.

Proposed Change

Under the proposed regulation, PBGC would cease publishing actuarial assumptions under ERISA section 4022. In place of those assumptions, going forward PBGC would determine the lump sum present value of benefits in distress or involuntarily terminated plans using the assumptions published by the Internal Revenue Service under section 417(e) of the Code.

Since 2000, PBGC has actually published two sets of interest rates for lump sum calculations under ERISA section 4022. One set is contained in Appendix B of the regulations, and applies to actual plan terminations. The other set is contained in Appendix C of the regulations, and applies to private sector plans that reference the PBGC assumptions. PBGC adopted this approach in case it ever wished to make a change to the assumptions that are used in plan terminations, without disturbing the assumptions that are used by ongoing plans. However, such a change was never adopted, and the rates in the appendices have always been identical. Under the proposed regulation, Appendix B would be eliminated, and Appendix C would contain a final set of discount rates that would apply to all future periods.

Impact of Proposed Regulation

At the core of the proposed regulation is a change in the actuarial assumptions used to calculate the lump sum value of benefits in certain contexts. The proposal would change the mortality table for these purposes from the 1984 Unisex Pensioners Mortality Table to the applicable table published by the IRS under section 417(e) of the code. The new table contains lower rates of mortality than the prior table, which will result in larger lump sums. At the same time, the new interest rate methodology will generally result in higher interest rates, which will in turn result in smaller lump sums. Thus, the impact of the new interest rates and the impact of the new mortality table will tend to offset each other, and the aggregate impact on benefit amounts is expected to be minor.

The primary impact of the proposed regulation would be on pension plans that undergo either distress or involuntary terminations. The lump sum present value of participant benefits will be different, which would affect which participants are eligible for lump sum payments (i.e., the participants whose benefits have a present value of $5,000 or less), as well as the amounts of the lump sums. As discussed in the previous paragraph, the impact on the calculations is likely to be small.

A secondary impact of the proposed regulation would be on the small number of ongoing plans that use the PBGC lump sum assumptions for the purpose of calculating participant lump sum benefits. It is likely that these plans contain a diverse range of provisions that reference the PBGC assumptions, and the impact of the proposed regulation could vary based on the specific language.

Next Steps

Pension plan sponsors should review their plan documents to determine whether the PBGC lump sum assumptions are used for any purposes. It is likely that a majority of plans do not contain any such references, but it is necessary to confirm this in order to determine if the proposed regulation would have any impact on lump sum payments.

For plans that are affected, the impact may depend on the exact wording of the relevant plan provisions. Depending on the plan language, the proposed regulation could result in the plan only using the 417(e) assumptions prospectively, or it could result in a comparison of the 417(e) assumptions with the final section 4022 assumptions published by the PBGC – or the language might not clearly support either of these approaches. In some cases, it may be appropriate to adopt a clarifying amendment to ensure there is no ambiguity as to how lump sum benefits are calculated, though care needs to be taken to avoid violations of the anti-cutback rules.

The PBGC is accepting comments on this proposed regulation through November 29, 2019.