Is it Time to Give Your Pension Plan a Lift-Out?

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While pension plans can provide much needed retirement benefits to an employer's workforce, the associated liabilities of defined benefit and cash balance plans also can have a number of negative impacts on the employer, including on its financial statements. One method to reduce these negative impacts is to remove some of the liabilities from the plan by using a pension "lift-out." Essentially, a "lift-out" transfers risk and certain liabilities (usually for retirees or beneficiaries in pay status) to an annuity provider outside of the plan. For the past few years, the value of doing a lift-out has been reduced because of the high cost of the annuities. However, the recent increase in interest rates has made annuities much more affordable, which makes a lift-out a more attractive option in the current market.

Plan sponsors considering a lift-out should design a plan to implement the lift-out, which should include, without limitation, the following:

1. Deciding what group of liabilities the plan sponsor wants to lift-out. Typically, this is retirees and beneficiaries in pay status, but the group can be even further refined. For example, the plan sponsor could only lift-out those with accrued benefits under a set dollar amount or limit it to deferred vested participants.
2. Considering the impact that the removal of these assets and liabilities from the plan will have on the plan's funding status. While a lift-out is ideal for removing liabilities, the assets associated with those liabilities are also removed from the plan (which reduces the assets available in the plan to invest in the market).
3. Reviewing all committee charters and delegations of authority to ensure they are broad enough to allow for committee level approval of any amendments required to effectuate the lift-out (for instance, does the charter/delegation limit the approvals of the committee to amendments that are under a specific economic value).
4. Clearly designating which functions associated with the lift-out are being performed in a settlor capacity and which functions are being performed in a fiduciary capacity. Generally, the decision to do the lift-out is a settlor function; however, the purchase of the annuities is a fiduciary decision and must comply with the requirements of DOL Interpretative Bulletin 95-1 for the purpose of obtaining the safest available annuity.
5. Considering the appointment of an independent fiduciary or independent expert to assist with or make the annuity purchase decision.
6. Because the transfer of the liabilities to the annuity provider moves the assets outside of the plan, the plan committee should evaluate and understand the difference in protections from the PBGC versus the applicable state guaranty association (which is the entity that will govern the annuities). In addition, the plan sponsor should analyze whether to purchase annuities from multiple providers, considering, among other things, the size of the lift-out, the cost of using multiple providers, the demographics of the population of the lift-out, and whether multiple providers are needed to address different benefits provided under the plan. Of course, costs will increase with multiple annuity providers, so the plan sponsor needs to weigh the potential benefits against the increased cost.
7. Designing a timeline and strategy for participant communication. As always, clear communication to impacted participants and beneficiaries regarding such plan changes and what they should expect should reduce the risk of litigation or complaints.

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Lift-outs typically take less time (generally, three to six months) than a plan termination and do not require either a 204(h) notice or PBGC approval. Furthermore, a lift-out decreases the amount of pension assets resulting in a potential decrease in PBGC premiums, which makes lift-outs even more attractive. While lift-outs may be the right approach for plan sponsors and committees in the current environment as compared to a plan termination or other de-risking strategies, there are still possible pitfalls that could arise. Therefore, engaging legal counsel and an outside consultant to navigate the process is extremely important once the plan sponsor begins to consider the lift-out.

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