

# *Smooth Sailing to a Successful Plan Termination*

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# Setting the stage

## Standard Plan Termination

- Preplanning
  - Complete participant information
  - Plan document up to date
  - Notify trustees
  - Work with insurers to provide annuities
  - Good documentation for audits
- Implementation
- Post – Distribution phase

# Setting the stage

- Corporate, single employer, defined benefit plan
  - Fully funded at termination date
  - All required amendments
  - Prescribed steps followed by plan administrator

# Steps involved

- Admin – organization is everything
- Timing
- Steps to closing out the plan
- When is it really over

# Cast of Characters

- Plan Sponsor
- Actuary/Consultant/Investment Advisor
- Attorney
- Insurer/Broker

# Cost of Termination

High level estimate will help in the budgeting & planning process

## Considerations

- Current plan provisions
- Is the plan going to allow lump sums?
- Will retirees be allowed to choose a lump sum?
- Factoring in the cost of annuities
- What is our experience with participant choices?
- Participants who cannot be located

# Other Termination Costs

- Attorney
- Actuary
- Consultant/Broker/Insurer
- User fee for IRS Form 5310
- Closing plan trust
- Post termination audits by IRS/PBGC

# Pre-termination activities

- Sponsor should consider risk reduction at this time
  - If Board of Directors authorized termination based on current “cost”  
(defined as economic liabilities – assets),  
lock in that cost
  - Sponsors may not realize volatility of funded status

***This is a complex task entailing fiduciary responsibility – providing investment advice is the role of the Investment Consultant***

# Pre-termination activities

- Illustrative Investment Strategy
  - Retirees -Immunize or PCFG
  - Non retirees –
    - Duration match those who will elect annuities
    - Cash match those who'll elect a Lump Sum
      - Complicating factor: actuary's selection of discount rate
      - Both of which are unknowns: estimates must suffice

# Before you terminate your pension plan

- Locate all participants
- Update all testing
- Locate details of accrued benefits
  - all vested termination benefit calculations and
  - retirees of less than one year
- Read PBGC instructions for a standard termination
- Draft a timeline

# What can be done before you terminate?

- Calculate accrued benefits as employees terminate
- If the plan is frozen or you are freezing it now
  - Keep dated copies of 204(h) notice
  - Precise calculations for actives
- If a takeover plan – make sure you have copies of final accrued benefit calculations
- Check your investment contract
- Request preliminary bid from insurance company

# So you want to terminate your plan

- Know where and who your participants are
- Gather spouse's dates of birth
- Prepare for government filings
  - Form 5310
    - Estimate non vested benefits for participants who terminated within the last five years and reason they left
  - Form 6088
    - Order participants by compensation
    - Service and FAE – for 415 testing

# So you want to terminate your plan – Additional Data Needed

- QDROs since the last valuation
- Marital status unknown – need to make an assumption and later may have to update
- Any participants not included in the valuation but should be in the plan termination?
- payment options
- Form 6088
  - Order participants by later of current compensation (even if frozen plan) or compensation at the time of termination
  - FAE and Service may be different from plan

# Missing Participants

- Diligent Search required
  - Searching internal records of other benefit plans
  - Mailing notice to last known address certified mail
  - Checking with designated beneficiary
  - Use commercial locator service
  - IRS and Social Security
- Once you have exhausted these methods, permitted to purchase an annuity for the missing participants or
- Turn benefit liability over to the PBGC
  - Prescribed instructions/assumptions
  - May be cheaper to purchase annuity
- PBGC Missing Participant Filing

# Next Steps: IRS and PBGC Filings

- IRS Notice to Interested parties prior to filing IRS 5310
- IRS Form 5310 “Application for Determination for Terminating Plan”
  - **ASAP** – the timing of “the D letter” controls the timing of the distribution
- PBGC Notice of Plan Benefits
  - **Less than 180 days after Termination Date**
  - To all affected parties
  - Prior to filing Form 500

# IRS and PBGC Filings (Continued)

- PBGC Notice of Plan Benefits (Continued)
  - Plan information including termination date
  - Normal retirement benefit
  - Optional retirement benefits
    - Including lump sum amount if offered
      - Spousal Consent required
      - Relative Value disclosures

# IRS and PBGC Filings (Continued)

- Actuarial Factors used to compute these benefits
- Data used to calculate benefits
  - Participant may contest this data
- Extraordinarily labor intensive
- Requires accurate data (why we suggest beginning data true-up “now”)
- Generally 45-60 days are allowed for benefit elections
- NOPB is Prepared by Plan Actuary and issued by the Plan Administrator

# Participant Communications

- Keep it simple and clear
- Must show in detail how benefit was determined
- Provide clear instructions

# For the Participant

1. Memo
2. Notice of Plan Benefits
3. Relative Value Notice
4. Pension Election Form (includes beneficiary designation form)
5. Notice of Intent to Terminate
6. Notice to Interested Parties
7. Notice of Annuity Providers
8. Special Tax Notice

# Notice of plan benefits

## *What's the challenge?*

- May be a lot more detail than usual benefit calculation provided to plan sponsor
- Must show the detail of how the benefit is calculated
- If offering a lump sum, must also offer an immediate annuity even if not eligible for retirement
  - Addressed in the plan document?
  - Common methods
- What to do if you don't know the marital status
- Calculating FAE for normally non-vested participants (all are vested at plan termination)

# Notice of plan benefits

## *What's the challenge?*

- Display Benefit Options
  - immediate annuity
  - Earliest retirement date
  - Normal retirement date
- Complications
  - Eligible for early retirement?
    - Meet service requirement
    - Look at service subsequent to freeze date
  - Is marital status known?
  - Past normal retirement date?

# Relative Value Notice

## *What's the challenge?*

- For benefits available at plan termination date
- Start with benefit calculation version
  - Eligible for early retirement?
  - Is marital status known?
- Lump sum basis may be different from basis for optional benefit forms so extra calculations are needed

# IRS and PBGC Filings (Continued)

- PBGC Form 500 (“Standard Termination Notice”)
  - **Also within 180 days of termination date**
  - Must include schedule EA-S, The Enrolled Actuary’s statement of Sufficiency
  - Receipt by PBGC begins a 60 day review period
    - PBGC audit trigger
    - Liabilities MAY NOT be settled while “the clock is running”
    - If no contact within 60 days, settlement is OK
      - Purchase annuities, distribute Lump Sums
- Sponsor may have chosen to wait for IRS “D” letter

BUT

# Distribution of Assets

- Deadline: Later of
  - 180 Days After Close of PBGC Review Period or
  - 120 Days After Receipt of IRS Determination Letter
- Preliminary bids solicited after close of election period
  - Goal: “no surprises” on finals day
  - Sponsor should notify well in advance:
    - Investment Managers (stand ready to liquidate)
    - Investment Committee
      - Update due diligence review
      - Schedule selection meeting
    - Trustee : (prepare to transfer assets to insurer)
    - BoD (possibly) for final approval

# Distribution of Assets

- Final bids – within month of distribution
  - Bid Analysis by Sponsor, Advisors
  - Insurer selected
  - Application Signed by Sponsor
  - Exchange of information, contacts
  - Wire Transfer of Assets
  - Payment of Lump Sums
    - Liability is now generally viewed by accountants and counsel as “settled”

# Distribution of Assets

- Final bids
  - Data, Premium Reconciliation
  - Missing Participants - either
    - Purchase an annuity from the insurer in that participant's name, with information on the missing person and insurer to the PBGC, or
    - Transfer the value of the participant's benefit to PBGC's Missing Participants Program
  - Certificate & Contract Issuance

# Post Distribution

- Notification of annuity provider
  - “Good-Bye” letter generally held to be sufficient notice
- PBGC Audit
  - All Plans with over 300 participants
  - Random sample of smaller plans
- Post Distribution Certification of Standard Termination
  - Form 501
  - Filed within 30 to 90 days of distribution
  - Affirmation that participants have been notified of annuity purchase
  - Sponsor certification that proper procedures were followed

# Post Distribution

- Final IRS Form 5500
- Final PBGC premium
- Organized files for easy accessibility upon audit

# Helpful Links

- PBGC Information on Standard Terminations
  - <http://www.pbgc.gov/prac/terminations/standard-terminations.html>
- IRS Form 5310
  - <http://www.irs.gov/pub/irs-pdf/i5310.pdf>
  - <http://www.irs.gov/formspubs/article/0,,id=244387,00.html>
- PBGC Standard Termination Filing Instructions
  - [http://www.pbgc.gov/docs/500\\_instructions.pdf](http://www.pbgc.gov/docs/500_instructions.pdf)

# Summary

- Upfront planning maximizes a smooth process
  - Complete and up to date participant information
  - Plan document up to date
  - Notify trustees of asset distribution
  - Work with insurers on timing of bids and implementation of benefit annuities
  - Good documentation for audits

Questions?

# Appendix

# DB Corporate Market Size

- Overall market
  - About 28,000 plans
  - About \$2.4 trillion in assets
- Jumbo market
  - About 275 plan sponsors with over \$1 billion in assets (could be multiple plans)
  - About \$1.1 trillion in assets

# Consultants/Brokers and Insurance Companies

- “Big 7” Consultants/Brokers, over 80% of Pension Risk Transfer (PRT) Market
  - Consultants- AONHewitt, Buck, Mercer, Towers Watson
  - Brokers- BCG Terminal Funding, Brentwood Asset Advisors, Dietrich Associates
- 10 Insurance Companies, 100% of PRT Market
  - American General (aka AIG), John Hancock (parent company ManuLife-Canada), Mass Mutual, MetLife, Mutual of Omaha, New York Life, Pacific Life, Principal, Prudential, Transamerica (parent company AEGON-Netherlands)

# Why is a PRT Premium greater than the DB liability?

## ➤ Assumptions

- PRT premium - single price, can't change assumptions in future, need to use realistic assumptions
- DB liability – annual valuations, can change assumptions in future, possible future contributions

## ➤ Capital/Surplus

- PRT premium – insurance companies required to hold capital/surplus on asset risk, liability risk, interest rate risk, and business risk
- DB liability – no capital/surplus required

## ➤ Profit

## ➤ Expenses

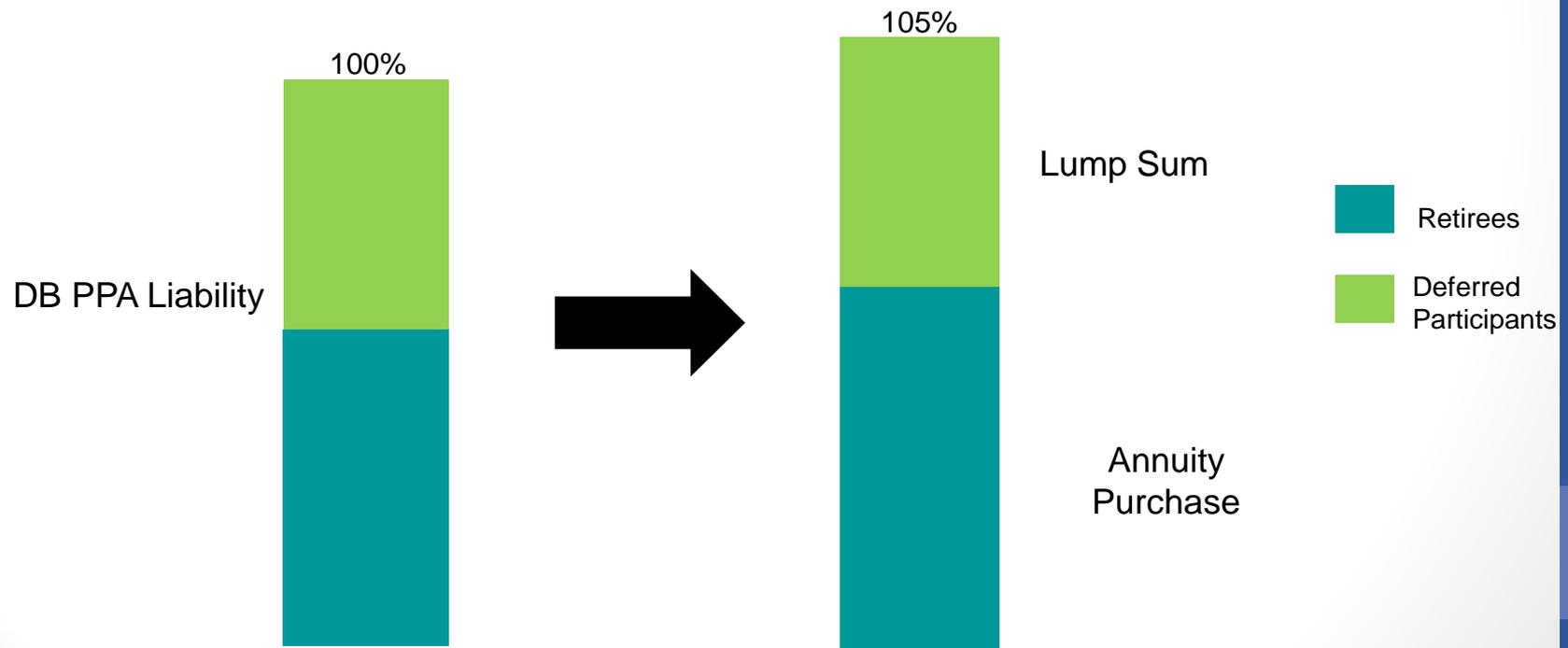
- PRT premium - includes PV of all future expenses
- DB liability – no expenses included

# PRT Premium Estimates

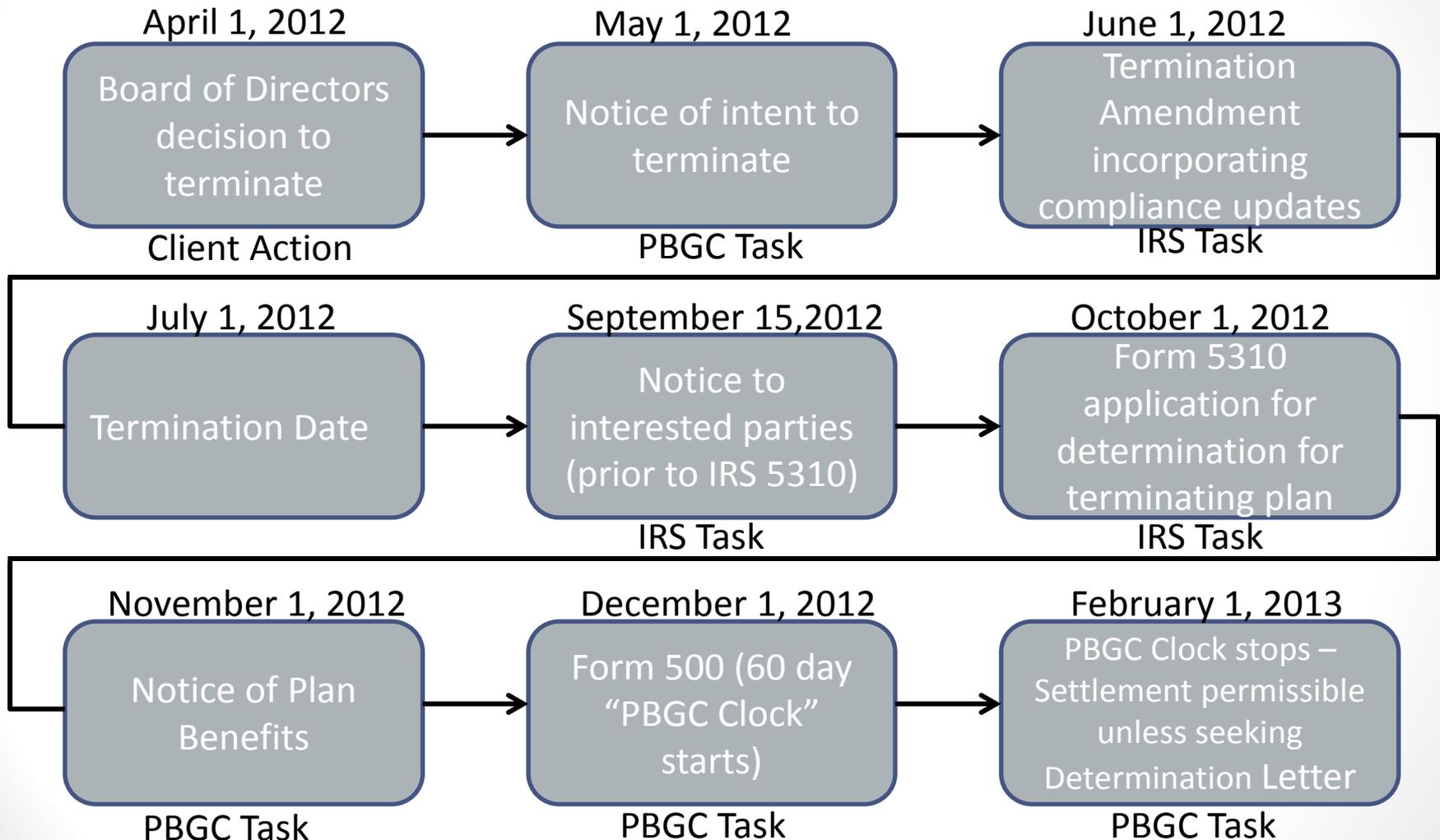
- Retirees 105%-115% of DB PPA liability
- Deferreds 110%-125% of DB PPA liability
- Example
  - Retiree only, duration 9
  - Start with A investment rate, subtract 100 basis points for risk/capital/profit
  - Historical spread between AA and A is 30 basis points
  - Discount rate is 70 basis points below AA, so 6.3%
  - Mortality difference is about 3%
  - Present value of all future expense is about 0.5%
  - PRT premium for retiree only is about 10% above DB PPA liability

# Lump Sum Strategy

- Purchase Annuities for retirees and pay lump sums to deferred participants
- Assume 10% additional cost (above DB PPA liability) for retirees

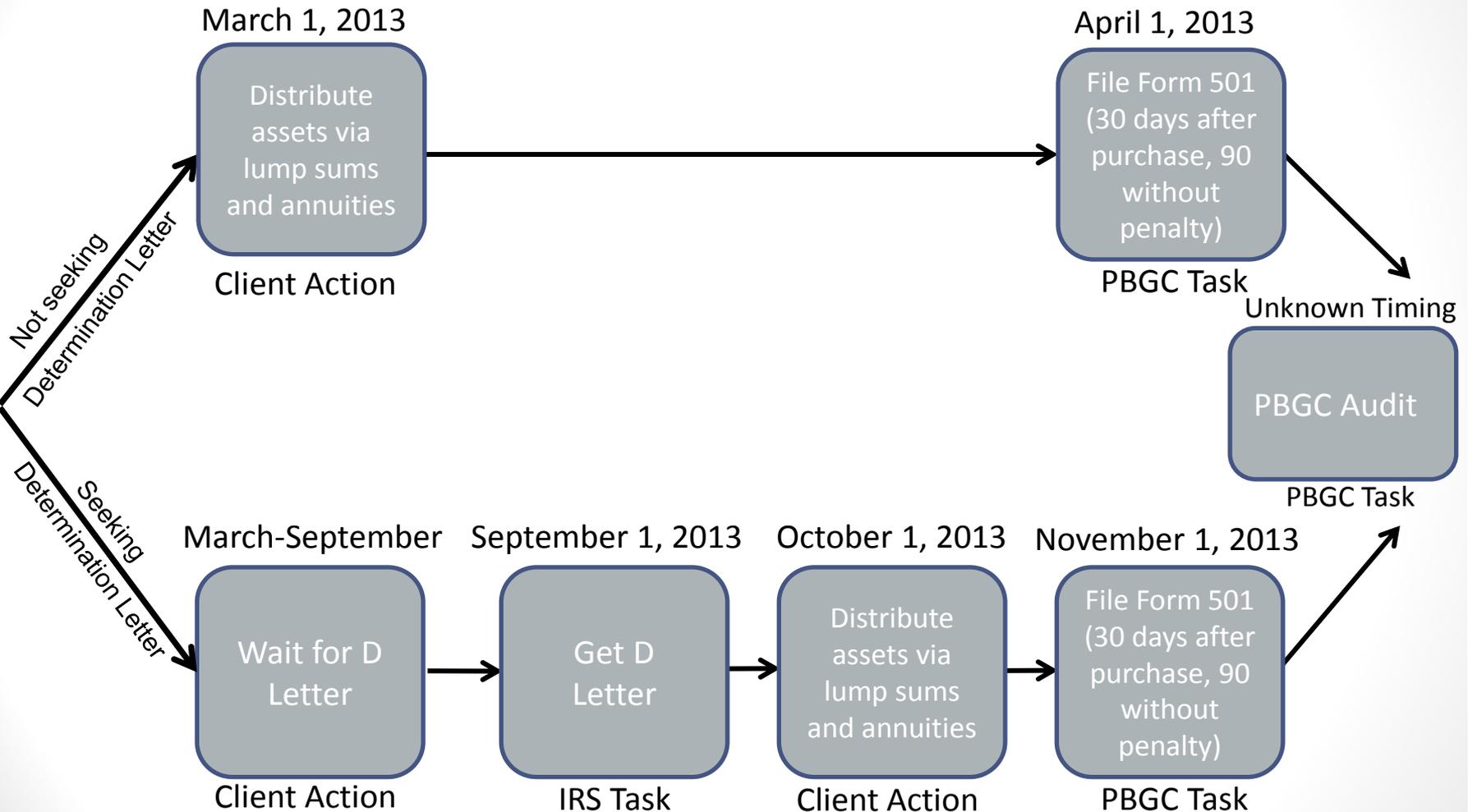


# Steps in the Plan Termination Process



Note: Dates are for illustrative purposes only.  
Real-life terminations will vary.

# Steps in the Plan Termination Process Cont.



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