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Korn Ferry Retirement Benefits Alert

IRS Opens the Door for Cashing-Out Retirees in Pay Status

Reversing a position taken in 2015, the Internal Revenue Service (the IRS) has announced that it no longer intends to assert that plan amendments offering retirees a limited period of time to cash out annuity benefits already in pay status violate the minimum required distribution requirements of IRC § 401(a)(9). Instead, in Notice 2019-18, issued March 6, 2019, the IRS indicated it would continue to study retiree lump sum window programs.

Many plan sponsors have already amended their plans to offer terminated vested participants lump sum windows or raise cash-out limits on an ongoing basis as a way to reduce pension plan liabilities and the PBGC premiums and other administrative expenses related to those liabilities. Before July 2015, some plan sponsors also offered retirees a window of opportunity to cash out the annuities they were already receiving as a way to transfer longevity and investment risks out of the plan. The IRS ended this practice when it published Notice 2015-49, challenging the validity of retiree lump sum window amendments under IRC § 401(a)(9).

In view of Notice 2019-18, sponsors of ongoing defined benefit pension plans may want to consult their actuaries as to whether retiree lump sum windows make sense for their plans. It may not be the best option; commercial annuity rates are rising, which could make an annuity purchase less expensive than paying lump sums. In addition, retiree lump sum windows can lead to adverse selection. Retirees in poor health are likely to choose lump sums while those in good health remain in the plan, increasing the cost of maintaining the plan or terminating it.

Even though the IRS will not challenge retiree lump sum windows under IRC § 401(a)(9), a plan sponsor that wishes to amend its plan to adopt a retiree window program must still consider other plan qualification rules, including spousal consent requirements, funding-based benefit restrictions and nondiscrimination requirements. Plan sponsors that decide to move forward have a fiduciary obligation to ensure that they clearly disclose to participants the consequences of accepting a lump sum offer.

Contact Kyuman Lee (212.692.3348), Steve Catone (215.861.2333) or Melissa Rasman (215.861.2350) if you have any questions about this *Alert* or would like additional information about defined benefit retirement plans.