PBGC Supports Lifetime Income

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The Pension Benefit Guaranty Corporation (PBGC) recently issued a proposed regulation designed to encourage participants in defined contribution plans (e.g., 401(k) plans) to roll over their account balances to their employers' existing defined benefit plans upon retirement and elect the plans' lifetime income option. The proposed regulation is consistent with recently issued Internal Revenue Service guidance and Department of Labor initiatives designed to encourage lifetime income options. The PBGC administers the single-employer pension plan termination insurance program under the Employee Retirement Income Security Act (ERISA). Generally, when the PBGC becomes responsible for paying benefits upon a plan termination, each participant's plan benefit is assigned to one or more of six categories specified in ERISA."Mandatory employee contributions" are accorded the second-highest priority. Due to this higher claim on plan assets, an under-funded plan's assets are usually sufficient to pay all accrued benefits derived from such contributions. **The proposed regulation would treat benefits attributable to rollover amounts as an accrued benefit derived from "mandatory employee contributions" thereby assuring, in almost all instances, that the entire accrued benefit will be paid even if the defined benefit plan later terminated and the PBGC became responsible for paying the plan's benefits.** ERISA also provides that the benefits guaranteed by the PBGC will not be fully paid if a plan has been in effect for less than 60 months or a plan amendment that increased the benefits under the plan became effective within 60 months of a plan's termination. In either situation, the PBGC guarantee is phased in over a five-year period at 20 percent of such benefit per year. The proposed regulation would exempt from this limitation the accrued benefit attributable to the rollover amount derived from "mandatory employee contributions." This proposal is also designed to assure participants who decide to roll over the defined contribution balances to their employers' defined benefit plans that such rollover amounts will largely be protected from the limitations that might otherwise apply if their employers' defined benefit plans later terminated. Studies show that participants must be encouraged to select a lifetime income option upon retirement. According to a recent Vanguard report, although nearly three-quarters of retirement-age participants kept their retirement savings intact, only about 20 percent of them still had plan account balances five years after termination, and only 20 percent of assets remained in the employer-sponsored plan after five years. The PBGC-proposed regulation mitigates the risk for participants who decide to preserve their defined contribution lump sum distributions by rolling them into their employer's defined benefit pension plan and electing a lifetime retirement income option.

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