CARLTON FIELDS

Terminal Funding Annuities Smooth Rough Seas for Defined-Benefit Plans

September 08, 2022

Current volatile market conditions and increasing interest rates are causing defined-benefit plan administrators and sponsors to consider purchasing annuity contracts (often called "terminal funding annuities") to fund retiree benefits. Since defined-benefit plans (including cash balance plans) guarantee benefits to employees without regard to actual market returns, plan sponsor financial burdens increase when investments lose value. In addition, increasing interest rates generally make annuities more affordable and attractive. Thus, annuity providers are now reaching out to defined-benefit plans and vice versa.

Defined-benefit plan administrators and sponsors can shift (i.e., eliminate) the risk for providing benefits onto an annuity provider for defined-benefit plan participants whose benefits are certain. In addition to former employees, this includes active employees in terminating and frozen plans that intend to terminate.

Defined-benefit plan administrators and sponsors will provide benefits data to potential annuity providers who will calculate the cost to purchase terminal funding annuities. Defined-benefit plan sponsors will largely base decisions on a comparison of the lump-sum cost to purchase the annuity to eliminate future financial risk with the likely or projected cost of continuing to make defined-benefit plan contributions.

Defined-benefit plan advisers and ERISA attorneys can help sponsors and administrators satisfy fiduciary obligations in selecting annuity providers and negotiating the final terms of the agreement between the parties. For example, the plan administrator should approve the use of defined-benefit plan assets to purchase an annuity, and since certain ERISA liabilities are shifting to the annuity provider, selecting an annuity provider is a fiduciary decision. The Department of Labor issued

guidance on the proper selection of annuity providers to mitigate the risk that a provider may default on its commitments under the terminal funding annuity.

Defined-benefit plan advisers, including the investment adviser and actuary, also can assist by, at a minimum, offering recommendations about fair investment earnings assumptions to use for the actuarial assessment of the likely cost to continue to fund defined-benefit plan liabilities. While defined-benefit plans already set forth assumptions as to returns, those plan assumptions are for different purposes and should not be used for this calculation without additional scrutiny.

Authored By

Lowell J. Walters

Related Practices

Life, Annuity, and Retirement Solutions
Financial Services Regulatory
ERISA Employee Benefit Plan Litigation
Labor & Employment

Related Industries

Life, Annuity, and Retirement Solutions
Life, Annuity, and Retirement Solutions

©2024 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.