Fidelity Benefits Consulting

Mandatory Cashout Provisions

Thresholds haven't kept pace with the real world.

July 2018

In 1997 the Dow was at 8,000, gas was $1.29 a gallon, and your pension plan's mandatory cashout threshold was the same as it is today.[1]

Is your pension plan stuck in the past? If your plan is using $5,000 as a maximum cashout threshold, it may be time to update your plan to better suit today's environment and ensure it reflects the needs of your organization.

What's Inside

Fidelity INVESTMENTS

Consider: Current regulations are "retro" regulations

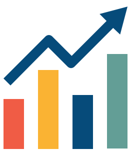
In 1997, the cashout threshold was raised from $3,500 to $5,000, where it has been stuck in limbo for over twenty years. A bill introduced last year in Congress to increase the amount –known as H.R. 4158 "The Retirement Plan Modernization Act"– has not moved forward.[2] Fidelity testified in front of Congress in support of H.R. 4158 on May 16, 2018, in hopes of moving the needle toward modernization of cashout provisions.

Key Takeaways

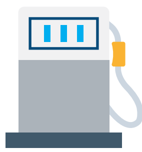
It may be time to modernize your plan's cashout provision to better suit today's environment and business objectives.

Amending your plan can reduce plan cost, mitigate risk and provide more flexibility for participants.

In 1997…



Dow Jones
8,000



Gallon of Gas
$1.29

Avg Tuition Plus Fees
$9,500

Source: Houston Chronicle, FedPrimeRate.com and National Center for Education Statistics

If the threshold were adjusted for inflation, it would be approximately $7,600 now. Although the threshold hasn't increased, the per-participant Pension Benefit Guaranty Corporation (PBGC) premium has gone up to $74 per participant.[3] The implication? The increasing premiums may start to outweigh the value of these smaller benefits.

Current State of Cashout Provisions

Mandatory cashout of benefits under $1,000	Mandatory cashout of benefits between $1,000 and $5,000	Lump sum provision for benefits $5,000 and over
Can be automatically cashed out and distributed to participant without their consent.	Your plan can provide for an automatic rollover into an IRA in the participant's name.	Your plan can be amended to allow a higher lump sum threshold, avoiding higher PBGC premiums and having to track terminated vested participants with small benefits.

Market trends: The voice for choice

With today's more mobile workforce, more and more participants prefer to consolidate their retirement savings for convenience and take control of their assets. Your plan can be modernized for more flexibility by allowing a higher lump sum payment. For example, you can amend your pension plan to set a higher threshold (such as $7,500, $10,000, or $25,000) to your departing employees and broaden the eligible population who take a lump sum versus a small monthly annuity.

Current market trends have many plan sponsors considering doing just that. Although amounts greater than $5,000 must be elective and offer an annuity option, Fidelity's analysis shows that most terminated plan participants will choose the lump sum. That allows a plan sponsor to avoid paying higher PBGC premiums and the cost and time of tracking terminated vested participants with relatively small benefits.

Crossing the threshold - Is it time to increase your plan's lump sum provision?

Power to the people – Benefits for your participants

Studies show that younger generations of employees don't just want to work flexibly; they want flexibility in managing their money as well. They want to make their own choices and manage their assets using the latest technology and digital tools.

Plan participants will experience key benefits:

- **More choice** – Participants will have an additional payment option to choose from.
- **Greater control** – Participants can manage their own retirement assets.
- **Flexibility** – Lump sum rollovers allow terminated vested participants to control the timing of their distributions during retirement and proactively manage taxation.

Power to plan sponsors – Benefits for your plan

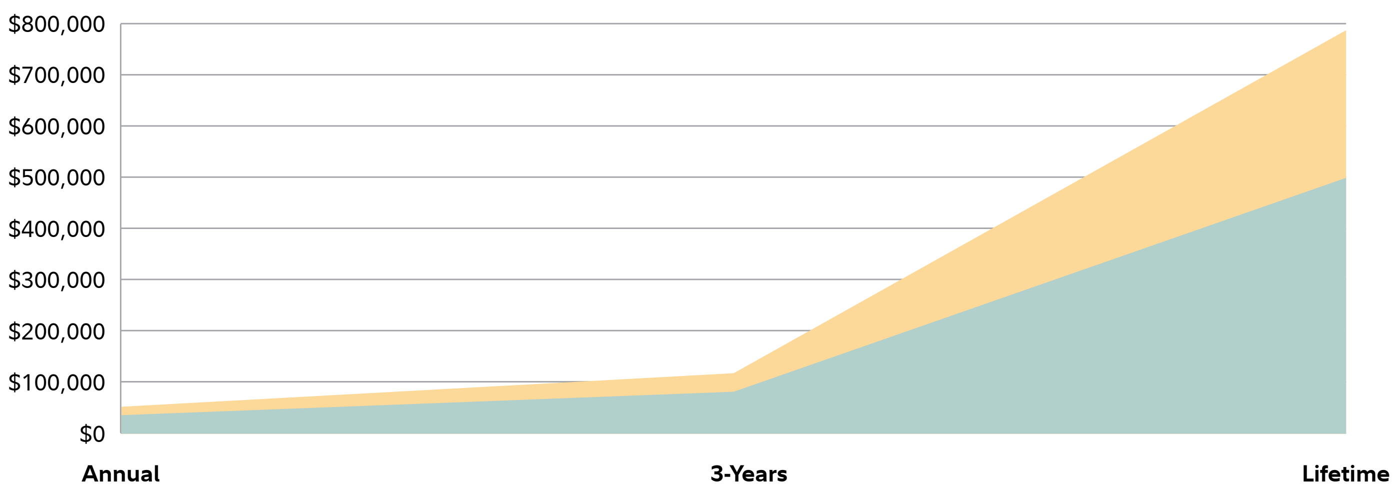
As a plan sponsor, there are distinct advantages to increasing your plan's lump sum provision:

- **Lower costs** – Beginning in 2019, there would be a minimum PBGC premium savings of $80 per participant annually, with potential for up to $600 in savings based on the plan's funded status and other assumptions.
- **Reduced risk and liability** – Allowing for accelerated payouts de-risks the plan by simultaneously reducing assets and liability.
- **Leaner and tidier plan** – A "one and done" approach may mean little to no retiree administration, and fewer participants to administer going forward.

Illustration: Potential Plan Sponsor Cost Savings

This hypothetical illustration assumes a target population of 500 using two scenarios.

Scenario	Annual	3 Years	Lifetime
Scenario 1: 40% Election Rate	$26,000	$80,000	$520,000
Scenario 2: 60% Election Rate	$39,000	$120,000	$780,000



Assumptions: $130 per participant includes both PBGC and administration costs. 3-year savings assumes 2.50% annual increase in administration costs. Present value of future savings is based on 2.50% assumed increase in administration costs, standard life expectancy tables and a discount rate of 6.50%.[4]

Increasing Your Plan Cashout Threshold: A Consideration Checklist

As with any plan design change, all factors, including the risks, should be weighed in your decision-making process. Here are a few things to consider:

Plan sponsor	Participant
✔ **Maintaining funding** - Plan must remain above 80% funding to continue the lump sum offer; otherwise restrictions would impose an additional administrative burden and place the employer in a negative light.	✔ **Early distribution penalty risk** – Participants are potentially subject to an additional tax penalty if they take it as an early distribution.
✔ **Longer view** - Full unrestricted lump sum offers can result in high annuity premium costs at plan termination for those that do not take the lump sum when they terminate employment.	✔ **Self-controlled destiny** - Participants must be responsible for managing and investing their money.
✔ **Variability** - Lump sum values will vary year to year based on mortality and interest rate assumptions.	
✔ **Plan leakage** – Will occur when participants take a taxable distribution for current spending rather than rolling over to a retirement account.	

How Fidelity can help

Fidelity Benefits Consulting can provide your organization with guidance around this issue, help you determine if it's time to update your plan's lump sum threshold and help you take the appropriate steps to amend your plan. We can guide you through all the details.

To learn more about this topic, please contact your Fidelity relationship manager or email the Fidelity Benefits Consulting group at **fidelitybenefitsconsulting@fmr.com**.

[1] Morin, Natalie, "Cost of gas the year you were born", Houston Chronicle, March 28, 2016, and "Dow Jones Industrial Average History, FedPrimeRate.com

[2] Manganaro, John, "House Bill Seeks To Increase Auto-IRA Cash Out Limit," planadviser, November 29, 2017

[3] "Premium rates", pbgc.gov, 2018

[4] Assumes an $80 PBGC per participant fee (in 2019, indexed with inflation thereafter) plus $50 average annual plan administration costs per participant