REDUCING PENSION RISK THROUGH ACTIVE SPIN TERMINATIONS

Q&A WITH SEAN BRENNAN

Q: WHY MIGHT A PLAN SPONSOR BE INTERESTED IN AN ACTIVE SPIN TERMINATION?

Sean Brennan: Plan sponsors who have the cash and are willing to prioritize it can get an outsized return from the active spin off termination. Because actives tend to be the youngest plan participants, the liabilities related to them are usually more sensitive to interest rate changes, making them a much riskier group for plan sponsors than retirees. So the active spin/ termination allows sponsors to shrink their liability and risk, and in many cases at a very attractive cost.

In addition to the financial benefits, many plan sponsors view this as a way to give actives control over their retirement savings when they're in a frozen plan – actives can roll the lump sum over to a 401(k) or IRA or even take it as cash, giving actives control of their retirement savings and the ability to invest it the way they think best for them. Active spin/ terminations are increasingly popular because a lot of plan sponsors like the ability to offer this benefit and also reduce their risk and cost.

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Q: WHAT CHALLENGES DO SPONSORS FACE IN DOING ACTIVE SPIN TERMINATIONS?

SB: The active employee population is the group least focused on by plan sponsors when it comes to plan de-risking, not because they are less important but because sponsors may offer active participants a lump sum cash out only if they terminate the plan that actives participate in. Neither a buyout for retirees nor a cash-out for vested terminated participants requires a plan termination.

Once the decision is made to terminate the plan, participants have the choice whether to take their benefit as a lump sum. For participants who choose not to take that lump sum, the sponsor must find an insurer to take on responsibility for those participants' benefits as part of the termination, which often requires an acceleration of cash from the plan sponsor. Because it is much more expensive to buy annuities for actives than it is to offer them lump sums, active spin/terminations are most attractive financially if sponsors believe that a large percentage of their actives will choose the lump sum option.

Q: SO HOW CAN PLAN SPONSORS ADDRESS THIS CHALLENGE?

SB: There are a couple different paths they can take. One is to survey the active population to ask about their interest in receiving a lump sum, and make a decision whether to spin off based on the responses. Another is to use the survey results to identify a subset of the population interested in receiving a lump sum, rather than the entire active population, to spin off. Doing so will reduce the risk of purchasing annuities as part of the termination for the spun-off plan, which will reduce costs.

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