

Lump Sum Pension Payouts and Bankruptcy

On September 11, 2001, we held our first educational seminar addressing Lump Sum Pension payouts in a hotel across from the Polaroid headquarters. Given the events of that day, we were surprised when someone showed up. We presented the material anyway, given the importance of understanding how Lump Sum Pension payments might be affected in bankruptcy.

Polaroid filed for bankruptcy on October 11, 2001. Existing Polaroid retirees petitioned the court to prohibit any further Lump Sum Pension payments to new retirees in January 2002. As of July 1st, 2002, the court had indeed prohibited them. On July 31st, 2002, the plan was terminated in distress. It was \$324 million short of what was needed to make good on all retiree's pensions. The Pension Benefit Guarantee Corporation (the Federal "FDIC" for failed pensions) took over the Polaroid Pension on September 12th, 2002.

During the period between Bankruptcy filing and the order prohibiting them, retiring employees were able to request and receive their lump sum payouts. It took over 8 months for the process to be stopped.

Since 2006, the ballgame has changed.

In 2001, the process by which a Pension Plan could revoke a previously granted privilege was long and cumbersome. It took both a bankrupt company and a severely underfunded Pension Plan before the PBGC would take over the plan and curtail benefits. Only when it became obvious that a Pension Plan would fail and be assumed by the PBGC were the accelerated payments known as "lump sum payouts" prohibited.

In 2006, Congress passed the Pension Protection Act. This far reaching legislation made many changes in how pensions are funded and accounted for, and it profoundly changes the way distressed Pension Plans handle Lump Sum Pension payouts.

For those with Lump Sum Pension payment options, provisions in The Act make it much easier, and more likely, that this Lump Sum privilege can be curtailed. Simply put, if the Pension Plan doesn't have enough investments to pay its expected obligations to all past and future retirees, the plan may be restricted in making certain payments. One such restriction is the Lump Sum Pension payout for a retiring employee.

Three Tests and Three Limits

There are three tests to determine if a pension plan can honor its Lump Sum payout requests. The first two tests are funding levels. The Act talks in terms of the AFTAP, which is an acronym for a complex term meaning; "What percentage of the employees pension obligations are funded by investments." 100% funded means there is one dollar of investments for each dollar the plan owes to retiring or retired employees.

In normal (non bankruptcy) situations, if the plan is at least 80% funded, full payouts can be made. If the plan is less than 80% funded, only half payouts can be made, and if the funding level is less than 60%, no payouts can be made.

What about bankruptcy?

The Pension Protection Act includes a third test for companies that file for bankruptcy. For a company in bankruptcy, the requirement is 100% for any payments to be made. In other words, once a company files for bankruptcy, its pension plan is restricted from making Lump Sum payouts unless it can be certified by an Actuary (the plan's accountant) to be fully funded.

What happens when a pension is taken by the PBGC?

In the rare cases where a Pension Plan is taken by the PBGC, Lump Sum Pension payouts of retirement benefits are permanently curtailed. If an under-funded plan is ultimately abandoned to the PBGC, the only payments made are in the form of an annuity; in monthly amounts. In addition, the PBGC has limits, much like the \$100,000 bank deposit guarantee of the FCIC. Depending on the age of a retiree, and the year the Pension is taken by the PBGC, these limits can result in a permanent "haircut" for long tenured employees with substantial benefits. A shortened schedule of these limits, as applicable to 2008, follows:

PBGC Maximum Monthly Guarantees for 2008*

Age	2008 Straight-Life Annuity	2008 Joint and 50% Survivor Annuity**
65	\$4,312.50	\$3,881.25
64	\$4,010.63	\$3,609.57
63	\$3,708.75	\$3,337.88
62	\$3,406.88	\$3,066.19
61	\$3,105.00	\$2,794.50
60	\$2,803.13	\$2,522.82
59	\$2,630.63	\$2,367.57
58	\$2,458.13	\$2,212.32
57	\$2,285.63	\$2,057.07
56	\$2,113.13	\$1,901.82
55	\$1,940.63	\$1,746.57

As shown, the limits for younger, early retirees can be significant, compounding the loss for a new retiree expecting a large cash payment, instead.

What do we need to know?

To assess the viability of Lump Sum Pension payments, the operative data is the funding status of the plan. (That percentage described as the AFTAP) We would want to insure

that at least 80% of the Plan's obligations are covered by investments, unless we felt the company was at risk of filing for Bankruptcy. If that scenario was a distinct possibility, then our comfort level would require the Plan to be at least 100% funded.

Pension Plans are required to file annual reports and provide their funding status to employees, at least annually. At the end of 2007, most Pension Plans were adequately funded. Whether their assets and investment strategies were adequate to sustain the extraordinary economic difficulties in the investment markets in the last half of 2008 is unknown. Given the investment market declines of 30 to 40%, more recent information should be obtained.

This article was written in November 2008