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PBGC issues final rules on treatment of rollovers from defined contribution plans to defined benefit plans

On November 25, 2014, the Pension Benefit Guaranty Corporation (PBGC) issued final regulations clarifying the treatment of defined contribution plan rollovers to defined benefit plans if the defined benefit plan later terminates with insufficient assets to pay all benefits.

Under the final rules, benefits attributable to rollovers are not affected by the PBGC maximum guarantee limits or the PBGC's five-year phase-in limit that applies to benefit increases. The removal of these limits makes it easier for participants in defined contribution plans with rollover options to obtain lifetime income by transferring their account balances into defined benefit plans.

Background

Under ERISA, the PBGC administers the plan termination program for single-employer defined benefit plans. Covered plans that are underfunded may terminate in either:

- A distress termination; or
- An involuntary termination (a termination initiated by PBGC).

Mandatory contributions

When an underfunded plan terminates, PBGC is appointed trustee of the plan and is responsible for paying benefits. Plans trusteed by PBGC may include employee contributions that fund part of the plan's benefit. A plan may be funded by mandatory contributions, which are amounts, contributed to the plan by a participant as a condition of:

- Employment;
- Plan participation; or
- Obtaining benefits under the plan attributable to employer contributions.

In a distress or involuntary plan termination, each participant's plan benefit is assigned one or more of six priority categories. Participants' accrued benefits attributable to mandatory contributions are assigned to a priority 2 category (PC2). Benefits in this category have a higher claim on plan assets than nearly all other benefits when an underfunded plan terminates. Although PBGC generally pays benefits only in annuity form, PBGC rules do allow the return of mandatory employee contributions in a single installment or a series of installments if certain conditions are satisfied.

PBGC guarantees

PBGC guarantees the payment of all nonforfeitable benefits provided by a plan, subject to two limits:

- **The maximum monthly guaranteed amount**. The maximum monthly guaranteed amount is revised each calendar year and is applied as of the plan's termination date. If a plan terminates during a plan sponsor's bankruptcy, the maximum guarantee benefit is fixed as of the date the sponsor entered bankruptcy. For 2015, the annual maximum guaranteed benefit for a 65-year-old retiree in a single-employer plan is $60,136.
- **Five-year phase-in limit.** The five-year phase-in limit applies to a benefit increase that has been in effect for less than five years. Generally, 20 percent of a benefit increase is guaranteed after one year, 40 percent after two years, etc., with full phase-in of the guarantee after five years.

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Final rules

As part of its efforts to promote retirement security, PBGC has issued final rules providing guidance on the treatment of rollovers to defined benefit plans. The availability of a rollover of a participant's retirement savings in a 401(k) or other defined contribution plan to a defined benefit plan expands the opportunities for participants to elect lifetime annuity options.

The final rules provide for the following treatment of defined contribution plan distributions that are rolled over into a defined benefit plan, which later terminates and is underfunded:

- The final rules only apply to rollovers from defined contribution plans.
- Rollovers include both employee salary deferral contributions, additional employer contributions provided under the defined contribution plan and earnings on both.
- The annuity benefit resulting from a rollover amount is a pension benefit and is guaranteed.
- A benefit resulting from a rollover amount is treated as an accrued benefit derived from mandatory contributions in PC2, which has a higher claim on plan assets than nearly all other benefits.
- Unlike other PC2 benefits, a PC2 benefit resulting from rollover amounts will not be paid as a lump sum. The annuity resulting from rollover amounts will be payable at the same time and in the same form as the remainder of the participant's benefit under the plan to avoid administrative burden to PBGC. If a participant dies after the plan terminates, the PBGC will include the mandatory contributions attributable to rollover amounts in the value of the plan's qualified preretirement survivor annuity (QPSA) paid to the spouse. PBGC will not allow the participant's spouse to elect to withdraw the mandatory contributions attributable to rollover amounts in a lump sum.
- A participant's accrued benefit resulting from rollover amounts is not subject to the PBGC maximum guaranteed benefit limit and is not taken into account in applying that limit.
- A participant's accrued benefit attributable to rollover amounts is not subject to the five-year phase-in limit on the guarantee of benefit increases.
- For participants not in pay status as of the plan's termination date, the rollover amounts will be credited with interest payable under plan provisions to the plan termination date, and converted to an annuity payable at normal retirement age using the plan's interest rates and conversion factors.

Effective date and next steps

The final rules apply to plan terminations initiated on or after December 26, 2014. Plan sponsors that are interested in providing lifetime income options to participants should read this publication carefully. Before implementing any changes to their plans, they should carefully explore available alternatives with their document providers and recordkeepers, including Prudential Retirement.

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