

CASE OF THE WEEK**w/o 10.16.2011 Defined Benefit Plans and Restricted Lump Sums**

Our ERISA consultants on the Columbia Management Learning Center Resource Desk regularly receive calls from financial advisors on a broad array of technical topics related to IRAs and qualified retirement plans. For example, we routinely guide Columbia Management's financial advisor partners through the roll over steps for a lump sum distribution from a defined benefit plan to an IRA or 401(k) plan.

A recent call with UBS advisor in New York is representative of a common inquiry regarding lump sum distributions from underfunded defined benefit plans. The advisor asked: **"One of my clients is in a defined benefit plan that is less than 100 percent funded. Are there any restrictions on her ability to take a lump sum payout?"**

Highlights of Recommendations

- The Pension Protection Act of 2006 (PPA) put in place some restrictions on the ability of an underfunded defined benefit plan to pay "prohibited payments" (e.g., lump sums) if the plan's adjusted funding target attainment percentages (AFTAP) drops below certain levels.
- If the plan's AFTAP for a plan year is less than 60 percent, the plan may not make any prohibited payments after the valuation date for the plan year.
- If the plan's AFTAP for a plan year is 60 percent or greater, but less than 80 percent, the plan may not pay any prohibited payments exceeding ***the lesser of***
 - (1) 50 percent of the amount otherwise payable under the plan, and
 - (2) The present value of the maximum Pension Benefit Guarantee Corporation (PBGC) guarantee with respect to the participant (determined under guidance prescribed by the PBGC, using the interest rates and mortality table applicable in determining minimum lump-sum benefits).
- If a participant or beneficiary elects a lump sum in the above mentions circumstances, the plan must allow that individual to either
 - 1) Defer payment to a later date; or
 - 2) Split the benefit into unrestricted and restricted portions, with the unrestricted portion payable under any optional form of payment otherwise available under the plan.

Conclusion

Although a defined benefit plan participant may have a lump sum distribution option available under the terms of the plan document, it is important to look to the defined benefit plan's funding status and AFTAP to be aware of any restrictions on the payment of lumps sums. Financial advisors who understand the need to go beyond just determining whether a defined benefit plan allows a lump sum distribution option set themselves apart from the average advisor and, thereby, win more clients and retirement plan business. As always, the Columbia Management Learning Center is available to help.