A Look at Fully-Insured Defined Benefit Pension Plans

Pension plans come in all shapes and sizes. Long favored by employers for a variety of reasons, the **defined benefit plan** allows an employer to make contributions to a plan that guarantees to pay employees a defined benefit at retirement.

Employers appreciate the fact that they can make tax-deductible contributions that grow income tax deferred. In addition, significant retirement benefits can be provided to all employees without concern over *when* a particular employee entered the plan. Finally, defined benefit plans generally provide older, more highly compensated employees (HCEs) with the highest level of tax-deferred contributions.

Despite these apparent advantages, a number of factors have caused defined benefit plans to lose some of their luster. For example, the Pension Benefit Guaranty Corporation has dramatically increased the premiums it charges to insure defined benefit plans. In addition, the design, installation, and administrative costs associated with defined benefit plans are often much greater than for other types of pension plans. There has been, therefore, more activity in **Simplified Employer Pension (SEP), 401(k),** and **profit-sharing plans**, particularly among employers with 25 or fewer employees.

Despite the trend away from defined benefit plans and toward the less complicated plans, some pension professionals believe that ***fully-insured*** **defined benefit plans** could result in increased employer interest in defined benefit plans. What is a “fully-insured” defined benefit plan? The name

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provides a clue: These types of plans are funded exclusively with individual or group insurance policies which must, at all times, contain cash values sufficient to provide the benefits guaranteed under the plan.

While fully-insured plans were originally funded with retirement income or retirement annuity contracts, the insurance industry has designed a line of “second generation” products to fund fully-insured plans. **Whole life** or **universal** policies are typically blended with some variation of a high cash value, guaranteed annuity contract.

While this may sound a bit too complicated, pension professionals agree that these plans can offer attractive benefits to employers. For example, the employer’s setup and maintenance costs are significantly reduced because the services of a pension actuary are generally not needed. While investment options are eliminated, so are some of the more pressing investment headaches; the benefits are guaranteed by the carrier that issues the policies that fund the plan. Finally, fully-insured plans should not result in a balance sheet liability under the rules employers must follow when accounting for pension plans.

Fully-insured plans may not be the right fit for all employers. In fact, loans aren’t permitted and flexibility in the form of investment choices is nonexistent. Despite these concerns, employers may want to take a closer look at this time-tested option.

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