Pensions & Money Purchase Plans

In General: A pension is funded by changing the beneficiary designation to name the trust as either the primary or contingent beneficiary. Ownership of a pension can never be changed.

The term "Pension" is often confused with other types qualified retirement plans. Qualified retirement plans such as IRAs, 401(k)s, 403(b)s, and the like are known as "defined contribution" plans. Funding these types of plans is discussed in the technical bulletin for "Retirement Plans." These types of retirement assets should be entered into FundingPro™ in the Retirement Plans asset category.

Like IRAs, 401(k)s, and 403(b)s, pensions are qualified retirement plan benefits provided by an employer. Pension plans are considered "defined benefit" retirement plans and have different funding considerations from IRAs, 401(k)s, and 403(b)s.

Pension benefits are established in the plan, usually based on a formula, and are provided by the employer. The employer is required to pay the benefit from the pension trust fund or its own fund if the trust fund is inadequate. A variation on this type of plan is the *Money Purchase Plan*. In a *Money Purchase Plan*, the employer contributes an amount of money annually and those funds are used to purchase a small annuity each year. When the employee retires, the various annuities are combined together and added to calculate the employee's monthly benefit amount in retirement. Because a *Money Purchase Plan* is similar to a private pension, it is funded according to the private pension guidelines listed later in this technical bulletin.

The procedures followed in funding pension plans will vary based on whether the employer is a private or public entity, and in some circumstances, whether the employee has made an irrevocable election as to how they want to receive their pension benefits.

Public Pensions: When an employee works for a governmental entity, their pension is considered a public pension and a completely different set of rules apply when funding this type of a pension. Some examples of governmental entities would include both federal, state, and local governmental offices and agencies, the U.S. postal service, NASA, state government officials, police, firefighters, public school employees and teachers, and the like.

Public pensions typically become vested (guaranteed) to the employee after a period of time (i.e. five years). A public pension can be funded at any time regardless of whether the employee has begun to receive benefits.

Procedures for Funding Public Pensions: The first step in funding a public pension is to determine whether benefits have commenced (i.e. has the employee retired). Public pensions have different benefits that are extended based on whether the employee is retired.

> **Pre-Retirement:** When an employee is covered by a public pension, a decision will need to be made as to whether the employee's trust or the spouse should be named as the primary beneficiary. Many public pensions contain restrictions that require the employee's spouse be named as the primary beneficiary.
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> It is not uncommon for public pensions that permit a trust to be named as the primary beneficiary to contain provisions that result in a forfeiture of ancillary benefits if the spouse or family member is not named as the primary beneficiary. These ancillary benefits can include loss of medical, dental, prescription drug insurance coverage, and the like.
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> If there are no minor or dependent children who would be entitled to benefits under the pension, the preferred approach would be to name the spouse as the primary beneficiary and the employee's trust as the contingent beneficiary. This will enable the spouse to receive the full benefits provided under the pension. If this approach is adopted, a valid funding power of attorney should be in place to provide a means of funding the pension payments in the event of the spouse's disability.
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> If there are minor children, naming the spouse as the primary beneficiary is still the recommended approach; however, whom to name as the contingent beneficiary is a more difficult issue. A potential risk is involved if minor children are named as contingent beneficiaries. A probate guardianship may need to be initiated to

manage and control the pension payments on behalf of the minor children. However, the full benefits under the pension would still be available. Thus, the client will need to decide whether they are more concerned with avoiding the probate or the loss of ancillary benefits under the pension plan. The answer to this question will determine who will be named as the contingent beneficiary.

Thus the following steps should be followed when funding a public pension prior to the employee's retirement:

1) Ascertain whether the employee has retired. If the employee is still employed, contact the employee benefits or human resources department of the employer and request a copy of the pension plan agreement.

2) Review the pension plan agreement to determine whether a trust may be named as a beneficiary and if so whether there would be any loss of ancillary benefits. If no loss of ancillary benefits will occur, name the employee's trust as the primary beneficiary and the spouse as the contingent beneficiary.

3) If a loss of ancillary benefits would occur, determine whether there are minor children and identify exactly what the economic impact will be to the client and their family. The spouse should be named as the primary beneficiary. Explain the funding options related to the contingent beneficiary designation and the consequences of each choice to the client. Ask them for direction as to who should be named as the contingent beneficiary.

4) Contact the employee benefits or human resources department and request that they provide you with the appropriate form to change the beneficiary designation of a pension. Also inquire as to what documentation is needed to evidence the existence of the trust.

5) Send the completed Change of Beneficiary form, appropriate documentation to evidence the creation of the trust, and a Verification of Change of Beneficiary to the employee benefits or human resources department.

Post-Retirement: Once an employee retires, they will need to make an election as to how they want to receive their pension benefits in a single life pay-out or joint life pay-out. If a single life pay-out option is selected, a death benefit will be provided. The death benefits under the single life pay-out option can be funded by naming the employees trust as the primary beneficiary and the spouse as the contingent beneficiary. Note that naming a trust as the primary beneficiary of the death benefits under a single life pay-out option will generally not result in any loss of ancillary benefits to the employee or the employee's spouse. However, as a practical matter, it would be prudent to review a copy of the pension plan agreement to verify no penalty will result from naming a trust as a primary beneficiary.

Note that if a joint life pay-out option is selected, no death benefits will be extended and the pension is unfundable.

Take the following steps in funding the death benefits under a single life pay-out option:

1) Contact the employee benefits or human resources department and request a copy of the pension plan agreement.

2) If naming the trust as the primary beneficiary will not result in a loss of ancillary benefits, ask the employee benefits or human resources department to provide you with the necessary forms to change the beneficiary designation. Also inquire as to what documentation they require in order to evidence the creation of the trust.

3) Send the completed Change of Beneficiary form, appropriate documentation to evidence the creation of the trust, and a Verification of Change of Beneficiary to the employee benefits or human resources department.

Private Pensions: A private pension is offered by private employers. It typically provides the employee the option of receiving a monthly benefit for the life of the employee, or a smaller benefit for the joint lives of the employee and the employee's spouse. Regardless of which type of payment option is selected by the employee, the pension benefits will terminate on the death of the employee, or on the death of the employee and their spouse, depending upon what payment option the employee selected. When a private pension terminates, there is no vested balance in the plan and no benefits are paid to any surviving beneficiary.

On its face, it would appear that there would be little value in naming a trust as a beneficiary of a private pension. However, it may still be advisable to name the employee's trust as the beneficiary in order to maintain control of the pension benefits in the event of the employee's disability.

Note that not all private pensions will allow a trust to be named as a beneficiary. Thus, it will be important to make certain that a valid funding power of attorney is in place to provide a means for funding the pension proceeds in the event of the employee's disability.

If the private pension employee has already started receiving benefits from the pension, the beneficiary designation cannot be changed and the pension is unfundable.

Procedures for Funding a Private Pension: When funding a private pension, take the following steps:

1) Ascertain whether the employee has retired. If so, the pension is not fundable.

2) If still employed, contact the employee benefits or human resources department of the employer and request a copy of the pension plan agreement.

3) Review the pension plan agreement to determine whether a trust may be named as a beneficiary.

4) If the trust can be named as a beneficiary, contact the employee benefits or human resources department and request that they provide you with the appropriate form to change the beneficiary designation of a pension. Also inquire as to what documentation is needed to evidence the existence of the trust.

5) Send the completed Change of Beneficiary form, appropriate documentation to evidence the creation of the trust, and a Verification of

Change of Beneficiary to the employee benefits or human resources department.