

**ALLIED PILOTS ASSOCIATION  
POINTS REGARDING  
DEFINED BENEFIT PLAN LUMP-SUM DISTRIBUTIONS**

- Defined benefit plans are promises of delayed compensation from employer to employee that a certain level of income will be available at the end of the employee’s career. To deliver that promise, the employer recognizes that specific levels of capital must be invested along the career of the employee. From the date the employee is hired, the employer can project the future cost of providing either an annuity, or a lump sum based on a conservative discount rate. The “target” obligation is achieved by levels of contributions invested and compounded over the employee’s career.
- A company can justify use of a conservative discount rate for calculation of lump sums because a retiring employee has a different risk profile than that of the corporation. The employee has a finite lifespan beyond retirement and must invest for capital preservation using conservative, low-risk instruments. Therefore, the lump-sum equivalent to the annuity should be calculated using the conservative discount rate to enable the retiree to generate sufficient income under the most conservative investment assumptions along the expected mortality profile.
- Again, a company, knowing that it must fund to allow for lump sums using conservative discount rates, needs to properly plan for adequate contributions at conservative market returns. If a company overestimates market returns, under contributes, or over projects the discount rate to be used for a lump sum, the obligation to the employee will exceed the net investment. Conversely, other combinations of the above could cause a condition in which the net investment exceeds the obligation to the employee. By nature of a DB plan, the employee receives only the lump-sum amount as directed by the plan’s formula.
- Claims that “any disconnect between the discount rate used for lump sums and that used for funding cause plan distributions to either exceed or fall short of estimates used in the plan” are myopic and depend on a number of factors, including contribution levels, length of investment period, and market returns.
  - Example - company XYZ can pay the lump sum equivalent of a 22-year, \$24,000 annuity for \$315,912 based on a discount rate of 5.0%. That same obligation can be funded over a 30-year career with market performance of 8.5% and annual contributions of \$2544.
  - If market returns for the 30-year period are less than 8.5%, the required contributions will need to be greater. If returns are greater than 8.5%, contributions will need to be less.

<b>Target Amount</b>	<b>Interest Rate</b>	<b>Annual Contribution</b>
\$315,912	5.0	\$4,755
“	6.0	\$3,996
“	7.0	\$3,344
“	8.0	\$2,789

The employer expects that for a given target obligation, lower investment returns drive higher the contribution requirements and vice versa.

- Claims that lump-sum discount rates need to equal funding discount rates are misrepresentations of the truth. For any projected lump-sum discount rate, the employer must use proper combinations of contribution vs. projected investment returns.
- Employers that claim lump-sum interest rates need to be the same as funding rates are disingenuous. Arguments that lump sum rates need to be the same as funding rates merely masquerade cost reductions and increased risks at the expense of retirees.