Aon Hewitt Retiree Life Buyout:

Improve Risk Management and Results in Retiree Life Insurance

Employees consider workplace benefits to be the foundation of their financial safety net. At the same time, employers need to attract and retain key talent by providing the right mix of benefits during an employee's working years and into retirement. This includes Group Term Life insurance for an increasing number of retirees.

A Retiree Life Buyout plan can help a company remove its existing liability for post-retirement life insurance, strengthen its balance sheet, improve budgeting and financing flexibility, and virtually eliminate plan administration costs — all without affecting retirees or their benefits.

How Does a Retiree Buyout Plan Work?

A Retiree Life Buyout is a combination of a Retired Lives Reserve (RLR) and a Stop Loss life insurance policy for retirees. The employer pays the carrier a premium payment, usually in a lump sum. In exchange, the carrier agrees to honor the life benefit obligations of a distinct group of retirees and also assumes the plan's administration responsibilities.

A Stop Loss component guarantees the employer that they will not have to contribute any additional money to the carrier for the group of retirees. The retirees' coverage continues under the Group Term Life policy and is subject to the normal policy provisions.

Key Benefits for Employers

Properly designed and implemented, a Retiree Life Buyout plan can help employers:

Immediately reduce long-term liabilities

The buyout guarantees that the employer will never have to contribute any additional premium to insure the closed group of retirees. The carrier assumes the investment and mortality risk. This benefit is especially significant because Accounting Standards Codificiation 715-60 (formerly FAS 106) requires employers to accrue the projected cost of post-retirement benefits during an employee's working career including post-retirement life. The accrual method creates large liabilities for employers, but these liabilities can be removed by a Retiree Life Buyout plan.

Accelerate tax deductions and tax-free earnings

Employers may take a tax deduction on premiums associated with benefit amounts up to the Deficit Reduction Act (DEFRA) limit of $50,000. These tax advantages can improve earnings, lower the debt-to-equity ratio, and encourage lenders to offer more favorable terms to the company when financing capital activities.

Limit negative claims experience for the active Group Term Life plan

Removal of older insureds may help favorably impact the demographic mix of the overall plan, which may lead to an active rate reduction and an extended rate guarantee. Death claims paid by the carrier under a buyout do not affect rates set under the active Group Term Life plan.

Reduce administrative work

Once the buyout is implemented, the carrier maintains retiree life records, processes beneficiary changes, prepares claims for processing, and answers retiree life benefit questions. The employer's HR staff will spend less time dealing with former employees regarding their retiree's life insurance.

Is a Retiree Life Buyout Right for Your Organization?

Every employer situation is unique, and organizations need to carefully consider a variety of factors when determining whether to undertake a Retiree Life Buyout plan. These factors include the following:

Size of the liability: In most cases, a Retiree Life Buyout approach is appropriate when the liability is at least $5 million. The cost to transfer the liability might appear high compared to the employer's annual Group Term Life insurance premiums for the covered class, but this cost may be similar to the liability carried on its financial statements with respect to the obligation.

Cash management: Employers should consider the funded status of the plan, competing capital needs, and/or available cash to allocate toward the cost.

Accounting treatment: If treated as a settlement, any previously unrecognized gains/losses will be recognized in the year the liability is settled.

Cost of delaying until future date: A rise in interest rates would produce a lower price of a buyout. However, a delay means an older population. Thus, aging and higher mortality risk may actually increase the price if interest rates don't rise quickly or substantially.

Tax considerations for the employer: Tax laws typically limit prefunding to the first $50,000 along with certain requirements for key employees. Therefore, the employer must carefully consider the structure of the buy-out, tax laws, and whether or not costs of buying out coverage limits above $50,000 and/or on key employees could be deductible in the year paid and/ or may cause any unrelated business income tax or other issues.

Impact on retirees: If the benefit qualifies as group term life insurance under Internal Revenue Code (IRC) Section 79, retirees may receive favorable tax treatment of this employer-provided benefit, generally up to the first $50,000 of coverage. Therefore, employers must carefully consider the structure of the buy-out so as not to jeopardize the favorable tax treatment the retirees receive under Section 79 for this benefit and inadvertently cause the benefit to be immediately taxable to the retiree.

Insurance carrier: The insurance carrier should have the experience and expertise to help properly structure the buy-out, along with the financial strength and track record demonstrating its commitment to the plan.

Aon Hewitt Services

Aon Hewitt's professionals have the tools to evaluate an employer's Retiree Life Buyout plan in terms of employee population, demographics, financial requirements and business objectives. Consulting services include:

- Product analysis, including single premium, funding through assets and ongoing costs
- Management of the buyout process relative to timing and liabilities
- Contractual analysis, including the identification of best-in-class terms and conditions
- Outlining compliance considerations related to IRC Section 419, 419A and 79 to assist your own legal/tax review
- Management of future retiree benefit obligation process and transitions

Legal/Tax Disclaimer

Aon does not provide tax or legal advice. Therefore, no statement included in this document may be construed as such. The employer should always consult its own counsel regarding all tax or legal matters.

About Aon Hewitt

Aon Hewitt empowers organizations and individuals to secure a better future through innovative talent, retirement and health solutions. We advise, design and execute a wide range of solutions that enable clients to cultivate talent to drive organizational and personal performance and growth, navigate retirement risk while providing new levels of financial security, and redefine health solutions for greater choice, affordability and wellness. Aon Hewitt is the global leader in human resource solutions, with over 30,000 professionals in 90 countries serving more than 20,000 clients worldwide. For more information on Aon Hewitt, please visit www.aonhewitt.com.

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