"Fully Insured" Plan Overview & EE FAQ 2015

Q What is a "Fully Insured" Plan?

A A "Fully Insured" plan is simply a defined benefit pension plan where all forms of benefit are guaranteed by a single insurance company whose annuity and life insurance contracts are exclusively used to fund the plan.

Q Why are these plans popular?

A Insurance contract plans are an exception to the usual funding rules of IRC sections 412 and 430 as, by statute, the value of the accrued benefit always equals the cash surrender value of the contracts. The guaranteed returns remove investment market risk and create large tax-deductible contributions for the plan sponsor.

Q How much life insurance can I put in a "fully insured" plan?

A Despite its "fully insured" name, the amount of whole life insurance that can be acquired is limited in all defined benefit plans, including these insurance section plans, to that which is purchasable by a premium not to exceed 66 2/3 percent of the theoretical contribution. This actuarial calculation most often results in a premium that is less than 50 percent of the employer's total contribution and satisfies the incidental death benefit rules

Q When does the life insurance need to be removed?

A The life insurance held by the Plan is used to fund the pre-retirement survivor benefit. Thus, upon retirement or separation from service, it needs to be removed from the plan. Generally, the policy may be: 1) surrendered for its cash value, 2) distributed to the participant, 3) purchased by the participant, or 4) exchanged for a policy outside the plan.

Q Can a "lump sum" distribution be taken from a "Fully insured" plan?

A Yes. However, as with all defined benefit plans, the lump sum limit is defined by IRC 415(b)(2)—not the insurance company. Stated another way, all defined benefit plans share the same limit—a "fully insured" plan will simply guarantee that the lump sum will be there at Normal Retirement Age. Plan guarantees are derived from the life insurance and/or annuity contracts and are dependent on the financial strength and claims-paying ability of the issuing insurance company.

Q How does the IRS view "Fully Insured" Plans?

A Insurance section plans entered the Code in 1974 along with ERISA, and NPP has designed, and serviced these plans for many years. The Internal Revenue Service has an active compliance program looking for "abusive" plans. Our understanding is that an abusive plan is generally one whose life insurance form or amount is inappropriate, including "springing cash values," or whose insurance coverage is not incidental to the Plan benefits or one whose benefits exceed the lump sum limits of IRC 415(b).

Q Is there vesting in a "Fully Insured" Plan?

A Yes, just like all ERISA Plans there is a vesting schedule. A typical plan has one year of full time employment *(1000 hours or more)* requirement for participation. After meeting the plans participation requirement and being enrolled in the plan there is usually a vesting schedule like the following example: after enrollment and 1 year of participation 0%, 2 years of participation 20%, 3 years 40%, 4 years 60%, 5 years 80%, 6 years 100%. ***Vesting schedules can vary so you should examine the summary plan description for your plan for the exact details.***