

Benefit Restrictions

EP Phone Forum

February 23, 2012

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Basics

- Section 436 restrictions only apply to single employer plans
- There are four types of benefit restrictions
 - Unpredictable contingent event benefits
 - Amendments increasing benefits
 - Accelerated payments
 - Cessation of accruals

AFTAP

- FTAP = Funding Target Attainment Percentage
- FTAP =
 - Assets, reduced by funding standard carryover balance (FSCB) and prefunding balance (PFB),
divided by
 - Liabilities (excluding “at-risk” liabilities)
- AFTAP = Adjusted FTAP
 - Assets and liabilities are adjusted for irrevocable commitments purchased for NHCE in two prior years
- Special calculation options for 2008, 2009, 2010
- Special rule for plans that are fully funded without regard to subtraction of funding balances from plan assets
 - See 1.436-1(j)(1)(ii)(B)

AFTAP *(continued)*

- Plan only has one AFTAP at any time
 - AFTAP does not vary with restriction
- Presumed AFTAP
 - Applies until AFTAP is determined for the plan year
 - Based on prior year's AFTAP, with reduction after certain periods
 - Applies for all or for none of the possible restrictions
- Projections/estimates of AFTAP not allowed
 - “Range” certification is allowed

Assets Adjustment for Balances

- Do not subtract FSCB or PFB if the FTAP, without subtracting balances, is at least 100%
- Transition rule for 2008, 2009, 2010
 - Substitute 92%, 94%, and 96%, respectively, for 100%
 - Only applies for 2009, if applies for 2008
 - Only applies for 2010, if applies for 2008 and 2009

Funding Target

- Includes “at risk” liability only in narrow circumstance where
 - Plan is “at-risk,”
 - UCEB or increasing amendment restriction applies, and
 - Employer wants to pay for amendment
- “At risk” doesn’t apply for getting up to 60% or 80%, and never applies in denominator of FTAP

Prior Year's AFTAP

- 100%, if “new” plan
- Predecessor plan's AFTAP, if there was a predecessor plan (so not “new” plan)
 - If predecessor plan was terminated in a standard termination, AFTAP is deemed 100% for year predecessor plan was terminated
- Merger and spinoff rules reserved in regulations

Restrictions

- If $\text{AFTAP} \geq 100\%$
 - No restrictions
- If $80\% \leq \text{AFTAP} < 100\%$
 - No restrictions generally, except bankruptcy
 - Presumptions and operating rules can trigger the $< 80\%$ restrictions in Year 2 until Year 2 AFTAP certified

Restrictions *(continued)*

- If $60\% \leq \text{AFTAP} < 80\%$
 - No amendments increasing benefits
 - 50% of accelerated payments restricted (Limited by present value of the PBGC maximum for the participant's age based on a table published by the PBGC each year)

Restrictions *(continued)*

- AFTAP < 60%
 - No unpredictable contingent event benefits
 - No amendments increasing benefits
 - No accelerated payments
 - No future accruals

Restrictions *(continued)*

- AFTAP based on current year
- If no restriction in place for Year 1, then for Year 2, no limit on accelerated payments or cessation of accruals until
 - Year 2 AFTAP certified,
 - A presumption applies, or
 - October 1 of Year 2
- Restriction on unpredictable contingent event benefits and amendments increasing benefits applies as of January 1

Restrictions *(continued)*

- If restriction in place for Year 1, then “presumptions” apply for Year 2 until earlier of
 - Year 2 AFTAP certified
 - October 1
- Presumptions apply as follows:
 - From January 1 to March 31, Year 1 AFTAP
 - From April 1 to September 30, Year 1 AFTAP less 10 percentage points (if it matters)
 - From October 1 to end of year, < 60%
- Year 2 certification after September 30 does not affect Year 2 AFTAP, does affect Year 3 presumption

Restrictions *(continued)*

- Possible changes to AFTAP after Jan. 1 of the year
 - Required “burn” (deemed forfeiture) of FSCB and/or PFB if
 - Collectively bargained plan and would remove a restriction, or
 - Would remove a restriction on accelerated payments for non-collectively bargained plan
 - Elective burn of FSCB and/or PFB by 12/31 of Year 1
 - Election to make timely contributions for Year 1 (by September 15th of Year 2)
 - Security provided

Restrictions *(continued)*

- Failure to follow benefit restrictions violates
 - Code section 401(a)(29), a qualification requirement
 - ERISA section 206(g), a legal requirement

Plan Termination

- Generally, benefit restrictions apply after date of plan termination
- But, restrictions on accelerated payments do not apply to prohibited payments that are made to carry out the termination of a plan in accordance with applicable law
 - Can happen where AFTAP < 80%, but employer promises to make up difference and distributions are made after September 15 deadline
 - Allows purchase of irrevocable commitments and/or payment of lump sums

Multiple Employer Plans

- If established after 1988 (or ‘electing’)
 - Each employer treated as having own plan
- If established pre-1989 (and ‘non-electing’)
 - Applied on a plan-wide basis

Collectively Bargained Plans

- Definition of “collectively bargained plan”
 - 25% of participants in plan are members of a collective bargaining units for which benefits are specified in the plan,
or
 - 50% of current employees are in such collective bargaining units (this is aimed at plans with lots of terminated vested and retired)
- If collectively bargained plan
 - Deemed “burn” rule applies to all restrictions
 - Different effective date of section

Unpredictable Contingent Event Benefits (UCEBs)

- Benefit resulting from
 - Full or partial shutdown (or similar event), or
 - An event other than
 - The attainment of any age,
 - Performance of any service,
 - Receipt or derivation of any compensation, or
 - The occurrence of death or disability

UCEBs *(continued)*

- Restricted if AFTAP < 60%
- Can 'buy' way out of restrictions if
 - AFTAP < 60% at time of event, cost is cost of the benefits (even if brings AFTAP > 60%)
 - Cost includes “at-risk” liability if plan “at risk” even though target liability never includes “at risk” for AFTAP
 - AFTAP < 60% only because of event’s liabilities, cost is cost to get AFTAP to 60% (ignoring “at-risk” liability)
- There are special calculations necessary to determine the payment amount when
 - The actuary has not yet certified the AFTAP for the year, or
 - There is more than one unpredictable event in a year

UCEBs *(continued)*

- Different participants may have a UCE at different times and thus be affected at different times (e.g., one laid off later than another or one attaining a triggering age later than another) and AFTAP changed in interim
- If multiple events trigger, then last necessary event is the relevant event
- If participant becomes eligible for benefit when no restriction in place, later restriction does not affect participant
- If presumed AFTAP $< 60\%$ so UCEBs cannot be paid, but certified AFTAP later in same year (taking into consideration unpaid UCEBs from earlier in the year) $\geq 60\%$, then plan must retroactively pay earlier UCEBs

Plan Amendments Increasing Benefits

- Basic rules are similar to those for UCEBs, but here use 80% test
- Basic rule
 - If AFTAP < 80%, can ‘buy’ out restriction by paying cost of amendment (including “at risk” if plan is “at risk”)
 - Notwithstanding, target liability denominator of AFTAP never includes “at risk” liability
 - If AFTAP < 80%, but only because of cost of amendment, can buy out restriction by paying enough to get AFTAP = 80% (ignoring “at-risk” liability)

Plan Amendments Increasing Benefits *(continued)*

- If plan amendment goes into effect, not affected by later AFTAP decline to $< 80\%$
- If presumed AFTAP $< 80\%$ so amendments increasing benefits cannot be effective, but certified AFTAP later in same year (taking into consideration non-implemented amendments from earlier in the year) $\geq 80\%$, then plan must make earlier amendments retroactively effective
- Later in year calculations consider earlier UCEBs, amendments, Section 436 Contributions

Plan Amendments Increasing Benefits *(continued)*

- Amendment counts if plan provisions adopted before start of the plan year and taking effect before the end of the plan year
- Amendment is 'effective' on the first day any individual who is or could be a participant or beneficiary would obtain a legal right to the increased benefit if the individual satisfied the conditions for the amendment (e.g., age or service)

Plan Amendments Increasing Benefits *(continued)*

- Amendment also counts if
 - Plan provisions adopted after the start of the plan year, and
 - Effective before the end of the plan year for which a Section 412(d)(2) election is made
- May have to count above, even if no election is made
 - Special rule to fix “gaming” potential
 - Recalculate AFTAP with increase in normal cost of amendment treated as increase in funding target for year
 - If AFTAP would prohibit, then plan must take amendment into consideration properly allocating liabilities to normal cost and funding target

Plan Amendments Increasing Benefits *(continued)*

- Not considered amendment increasing benefits if:
 - Flat benefit plan increase not in excess of average contemporaneous increase in wages of participants covered by the plan
 - Can calculate separately for different groups such as active and retired or terminated vested
 - Statutorily required vesting increases, or
 - Restoration of restricted accruals, where
 - Automatic restoration provided for in plan,
 - Restricted period less than 12 months, and
 - AFTAP \geq 60% taking into consideration any restored accruals from the part of the prior year within the restricted period (current year would be in normal cost and thus not affect AFTAP)

Plan Amendments Increasing Benefits *(continued)*

- If plan operation changes to provide benefits and amendment only made later during the remedial amendment period, the AFTAP at operational change governs
- Contrast this to retroactive amendment where no participant's benefit increases until the amendment is adopted

Accelerated Payments

- Any payment
 - For a month that is in excess of the monthly amount paid under a straight life annuity
 - For the purchase of an irrevocable commitment from an insurer to pay benefits (*i.e., annuity purchase where there is a full transfer of risk*)
- Any transfer of assets and liabilities to another plan within the same controlled group if done with an intent to avoid restrictions
- See 1.436-1(j)(6)(i)

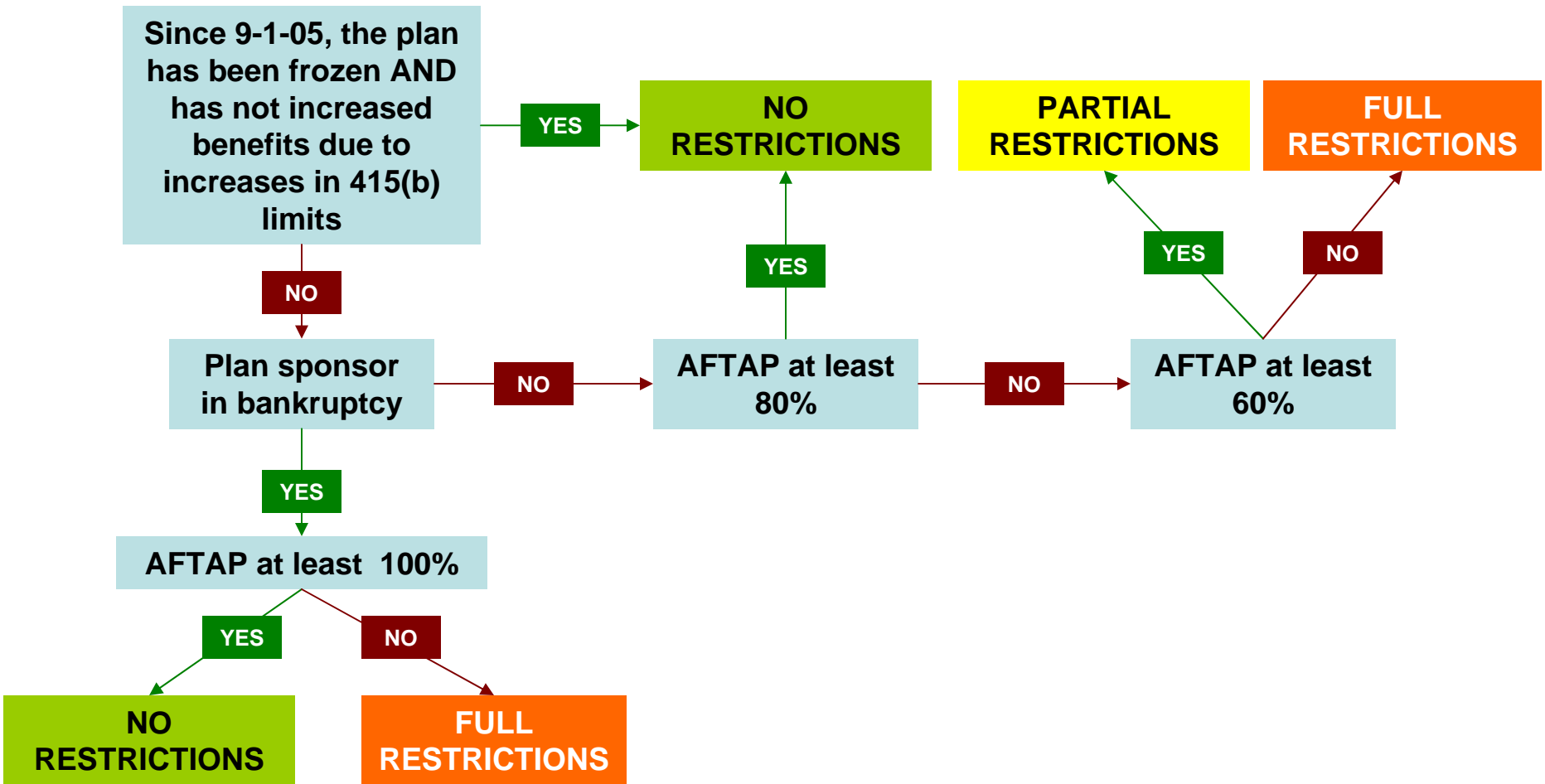
If Beneficiary Is Not an Individual

- Convert the benefit that is payable to the beneficiary to a monthly installment paid over a 240 month period
- Apply rules for prior slide, but substituting above for the straight life annuity
 - Any payment for a month that is in excess of this amount is considered a Prohibited Payment
- See 1.436-1(j)(6)(ii)

Restrictions

Situation	Restriction on Accelerated Payments
Plan frozen since 9-1-05 , including section 415(b) annual increases	None 1.436-1(d)(4)
AFTAP is under 100%, and sponsor is in bankruptcy	Cannot be paid 1.436-1(d)(2)
AFTAP is 80% or higher, and sponsor is NOT in bankruptcy	None
AFTAP is at least 60%, but under 80%, and sponsor is NOT in bankruptcy	Limited to lesser of <ul style="list-style-type: none"> a) 50% of payment, or b) Present value of PBGC maximum guaranteed benefit at time of payment for the participant's age (PBGC annual table) 1.436-1(d)(3)
AFTAP under 60%	Cannot be paid 1.436-1(d)(1)

The Road to Restrictions



Benefits Under Partial Restrictions

RESTRICTED

**Cannot pay as a
prohibited payment**

UNRESTRICTED

**Can pay in any form
allowed by the plan**

1.436-1(d)(3)(ii)

Bifurcating the Benefit



- STEP 1:** Determine the restricted portion
- Annual payment for the actuarial equivalent straight life annuity, plus
 - Annual Social Security Supplement (*if any*)

STEP 2: Remaining portion is unrestricted

1.436-1(d)(3)(ii)

Determining Prohibited Payments

- Determined on a monthly basis
- Applies if any payment is greater than the payment for the actuarial equivalent straight life annuity (*plus monthly Social Security Supplement, if any*) with same ASD
- If yes, determine:
 - A)** Monthly payment under optional form of benefit
 - B)** Smallest monthly payment under the payment form during life expectancy of participant
(For most accelerated forms, the smallest monthly amount is \$0)
- Portion of payment being paid as a Prohibited Payment = excess of **A** over **B** **1.436-1(d)(3)(iii)(B)**