



IRS DB Update

April 23, 2013



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Agenda

- Regulatory Update
- Section 415 issues
- Hybrid plan issues
- Multiemployer Report



IRC 436 & Notice 2012-46

- PPA added Code § 436
- Goal is to preserve & improve funding
- Also a Qualification issue – IRC 401(a)(29)
- IRC 436 restricts plan based on AFTAP %
- ERISA 101(j) requires notice when § 436 restrictions apply to plan
- \$1,000/day DOL penalty for failure



Notice 2012-46 requires ERISA 101(j) Notice if:

- AFTAP < 60% = UCEBs restricted [436(b)]
- AFTAP < 60% or < 100% if Bankrupt ER = Accelerated Bens restricted [436(d)(1) or 436(d)(2)]
- AFTAP >60%<80% = Partial Restriction [436(d)(3)]
- AFTAP < 60% = Freeze Accruals [436(e)]
- No notice required for 436(c) restriction on plan amendments AFTAP < 80%



Notice 2012-46 - Who?

- Notice must be provided to:
- Each participant covered by plan
- Each beneficiary entitled to benefits
- However – no notice required if it's reasonably anticipated the restriction won't apply
 - Example: Plant A has UCEBs, Plant B does not; AFTAP < 60%; Plant A EE's get notice
 - Example: Retired annuitants needn't get 101(j) notice when LS's are restricted



Notice 2012-46 - What?

- ERISA 101(j) Notice must state:
- Plan name, EIN, Plan #
- General description of the restriction on benefits that applies
- Plan's AFTAP % (presumed or certified)
- Description of the difference between restricted & unrestricted benefits
- Description of how the restriction may cease to apply (AFTAP > 80%)



Notice 2012-46 – What? (cont.)

- Effective date of benefit restriction
- The class of participants and beneficiaries affected by the benefit restriction
- Name, address, & phone #'s for plan administrator, trustee, or other contact
- Special rules for new annuity starting date



Notice 2012-46 – When?

- ERISA 101(j) notice must be provided:
- 30 days after restriction on benefits or accruals applies to the plan
- Restriction applies when AFTAP is presumed or certified at low threshold
- Restriction applies when plan UCEB event occurs that would cause AFTAP < 60%
- Restriction applies in the event of employer bankruptcy
- Other events determined by Treasury Secretary



Notice 2012-46 – How?

- The ERISA 101(j) notice can be provided in paper or electronic form
- Example is provided in Notice 2012-46
- Coordination of ERISA 101(j) and ERISA 204(h) notices
 - Example: Freeze of accruals due to AFTAP < 60% requires 101(j) notice;
 - If plan later is amended to permanently cease benefit accrual, 204(h) notice is required (but not another 101(j) notice).



Recent guidance

- Deadline for making § 436 amendments
 - Extended by Notice 2012-70
 - Last day of first plan year beginning on or after 1/1/2013
 - Last day of plan year for which § 436 is first effective for the plan, or
 - Due date (with extensions) for filing employer's tax return for the tax year that contains the first day of the plan year § 436 applies
 - Filing for determination letter may accelerate deadline



EPCRS for DB plans

- Revenue Procedure 2013-12 updates the IRS correction program for qualified plans. Some changes for DB plans include:
 - Delays in payment should be increased at Plan Actuarial Equivalence factors in use when distribution should have been made;
 - Corrective distributions for missed payments that were not subject to IRC 417(e) need not use 417(e) present value factors.



Failures Involving § 436 Restrictions

- Section 6.02(4)(e) was added to correction principles to reflect possible restrictions imposed by § 436, and to deal with a plan's failure to comply with § 436 restrictions in operation.
- Corrective contributions generally required to be made to the plan to pay for corrective distributions or corrective amendments while subject to § 436 restrictions.



Correction Principle

- Correction of distributions made without spousal consent – one option is to pay LS to spouse equal to survivor annuity.
- Section 6.04(2)(c) was revised to add a sentence for plans under § 436 restriction.
- If a plan is subject to 436(d) restrictions when spousal choice option discussed in this section is offered to the affected spouse, plan sponsor must contribute the applicable amount.



Correction of Overpayments

- Section 6.06(3) was revised to clearly address the correction of Overpayments made from defined benefit plans.
 - DB Overpayments must be corrected by following rules similar to those specified in Appendix B.



Correction of Overpayments

- Section 6.06(4) was added to specifically address the correction of Overpayments from defined contribution plans. In addition, it clarifies that a corrective employer contribution is not needed to fix premature distributions in some cases.



Modifications to Appendix A & B

- Contributions required if corrective distributions are made when the plan is subject to 436(d) restrictions:
 - If plan failed to timely pay required minimum distributions under 401(a)(9) (Appendix A, .06)
 - If lump sum paid to spouse to correct failure to obtain spousal consent (Appendix A, .07(2))
 - Must reflect 436(c) restrictions when making corrective amendments
 - Plan amendment used to resolve early inclusion of otherwise-eligible participants (Appendix B, 2.07(3))



436 Example Lump Sum Distribution

Plan's AFTAP is below 60% in plan year 2010, one participant received a lump sum distribution in 2010.

Failure:

Plan did not restrict lump sum distributions during the plan year 2010 when the plan was under 436 restriction.



436 Ex. Lump Sum Distribution (cont'd)

Additional facts: Sponsor discovers failure during plan year 2012.

- Plan allows for lump sum distributions
- What is the applicable correction under EPCRS?



436 Example Lump Sum Correction

Treat as an Overpayment

- Secure lump sum back from participant.
- If unable to secure lump sum back with earnings, employer contributes to the plan the amount of lump sum with earnings.



Recent guidance

- MAP-21
 - Relief in the form of stable (higher) interest rates
 - Interest rate
 - Notice 2012-55 – 2012 rates
 - Notice 2013-11 – 2013 rates
 - Notice 2012-61 – General guidance



Recent guidance

- MAP-21 – Notice 2012-61
- When MAP-21 rates do not apply
 - Plans using the full yield curve
 - Deductible limit under § 404(o)
 - Minimum PV under § 417(e)(3)
 - Excess assets available for transfer under § 420
 - Certain measurements subject to PBGC rules



Recent guidance

- MAP-21 rates apply to everything else
 - Calculation of MRC under § 430
 - Applying benefit restrictions under § 436
 - Prohibition against funding nonqualified plans if qualified plan is in at-risk status
 - Awaiting guidance on
 - High-25 rules
 - Hybrid plan interest crediting rates



Recent guidance

- Applying MAP-21 for 2012 plan year
 - Section 436 restrictions
 - Transition rules if pre-MAP-21 AFTAP certified before 9/30/2012
 - Change can be applied retroactively or prospectively



Recent guidance

- Applying MAP-21 for 2012 plan year
 - Prospective application, section 436 restrictions
 - Default
 - Deemed immaterial change – if recertified by 12/31/2012
 - Apply from earlier of 10/1/2012 or MAP-21 certification
 - May require retroactive correction for UCEB or plan amendments that “spring back”



Recent guidance

- Applying MAP-21 for 2012 plan year
 - Retroactive application, section 436 restrictions
 - Requires plan sponsor election
 - Applies retroactively, back to initial AFTAP certification



Recent guidance

- Applying MAP-21 for 2012 plan year
 - Limited ability to recapture reductions in funding balances made by 9/30/2012
 - Limited ability to recharacterize § 436 contributions made by 9/30/2012
 - But not if would cause unpaid MRC or new § 436 restrictions



Recent guidance

Election	Deadline
Defer MAP-21 to 2013	Form 5500 filing deadline
Apply AFTAP retroactively for 2012	Form 5500 filing deadline
Reverse elections to reduce funding balances	Last day of 2012 plan year
Move 2011 “grace period” contributions to 2012	Form 5500 filing deadline
Opt out of yield curve	July 5, 2013

NOTE: Some elections might have to be made earlier if affect § 436 benefit restrictions



Recent guidance

- DB LRMs
 - Model language
 - Posted on IRS website



Pending guidance

- PRA 2010 – supplemental guidance
 - Sequel to Notice 2011-3
 - Covers areas not fully addressed earlier:
 - Eligible Charity Plans
 - Plans with deferred PPA effective dates
 - Lookback rules under § 436
 - Rules expected to be flexible



Pending guidance

- Finalizing proposed regulations
 - § 430
 - Mechanics of constructing MRC
 - Quarterly contributions
 - Excise taxes
 - § 417(e)(3) – proposed bifurcation rules
 - Hybrid plan regulations



Pending guidance

- Other projects
 - Ongoing – Schedule SB updates
 - Additional proposed regulations, § § 430 and 436
 - WRERA rules
 - Mergers / spinoffs
 - Year-end valuations
 - Miscellaneous updates



Pending guidance

- Other projects
 - Guidance on funding method changes
 - Automatic approvals - successor to RP 2000-40
 - Procedures for requesting approval – successor to RP 2000-41
 - Updated mortality tables



2013 Dollar Limits

- DB Dollar limit: \$ 205,000 - \$5,000 Δ
- DC Dollar limit: \$ 51,000 - \$1,000 Δ
- 401(k) Deferral: \$ 17,500 - \$ 500 Δ
- 401(k) Catch-up: \$ 5,500 - Unchanged
- 401(a)(17): \$ 255,000 - \$ 5,000 Δ
- HCE: \$ 115,000 - Unchanged
- Key EE: \$ 165,000 - Unchanged



415 Limits Accrued Benefits

- 415 Regulations updated in 2007
- 1.415(b)-1(a)(3) provides: In order to satisfy the limitations on benefits under this section, the plan provisions must preclude the possibility that any annual benefit exceeding these limitations will be accrued, distributed, or otherwise payable in any optional form of benefit (including the normal form), at any time.



415 Limits Accrued Benefits

- 1.415(b)-1(a)(3) provides: Thus, for example, a plan that is subject to the requirements of section 411 will fail to satisfy the limitations of this section if the plan does not contain terms that preclude the possibility that any annual benefit exceeding these limitations will be accrued or payable in any optional form (including the normal form).



415 Example

- 415 \$ limit = \$205,000
Plan benefit prior to 415 - \$400,000 payable at 65
Plan reduction factors at age 62:
 85% for early commencement
 90% for 100% QJSA

Incorrect Application:

- Benefit payable at age 62, 100% QJSA
= $\$400,000 \times .85 \times .90 = \$306,000$. The plan restricts the benefit to the dollar limit of \$205,000, and thus would pay \$205,000 at age 62 as a 100% QJSA benefit.



415 Example

- 415 \$ limit = \$205,000
Plan benefit prior to 415 - \$400,000 payable at 65
Plan reduction factors at age 62:
 85% for early commencement
 90% for 100% QJSA

Correct Application:

- Accrued benefit is first limited to \$205,000.
- Plan benefit payable at age 62 as a 100% QJSA benefit = $\$205,000 \times .85 \times .90 = \$156,825$
- Note that if the plan provides for an unreduced 100% QJSA, there would be no adjustment for form.



415 Applied to Hybrid Plans

- Some plans try to construct a fail safe schedule of principal credits. Each principal credit is the lump sum equivalent of $1/10$ of the 415 dollar limit measured at some point in time.
- These plans claim to always satisfy 415 based merely on this basis.
- However, hybrid plans are defined benefit plans and must satisfy 415 on the basis of an annuity form of payment, not on the basis of allocations.



415 Applied to Hybrid Plans

- Assume that the schedule of principal credits is based on:
 - 415 dollar limit = \$205,000
 - No pre-retirement mortality
 - Pre-retirement interest discount of 5%
 - Age 65 annuity conversion factor = 120
- Principal credits are: age 31; \$39,022, 32; \$40,973...64; \$195,238, 65; \$205,000.



415 Applied to Hybrid Plans

- Principal credits received from age 31 through 65, at 5% interest will accumulate to almost \$7,200,000 at age 65, which is equivalent to an annual benefit of \$720,000 at age 65.
- Clearly not a fail safe design w.r.t. 415
- Remember, one may not fund for a benefit in excess of the current 415 dollar limit.



415 Applied to Hybrid Plans

- Limiting the accrued benefit to the 415 limit does not mean that hypothetical account balance may not produce a benefit in excess of the 415 limit.
- The hypothetical account balance is akin to the benefit formula in a traditional DB plan. The 415 limit applies to the accrued benefit calculated based on the hypothetical account.



Hybrid Plans Accrued Benefit

- Code section 411(a)(13) provides that a hybrid plan will not fail the requirements of 411(a)(2), (a)(11), (c), or 417(e) solely because the PVAB **under the terms of the plan** is expressed as:
 - the balance of the hypothetical account, or
 - the current value of the accumulated percentage of final average compensation.



Hybrid Plans Accrued Benefit

- Code section 411(b)(5)(A)(iv) provides that for purposes of comparing benefits to a similarly situated younger individual, the accrued benefit may be expressed as:
 - an annuity payable at NRA,
 - the balance of the hypothetical account, or
 - the current value of the accumulated percentage of final average compensation.



Hybrid Plans Accrued Benefit

- Code section 411(a)(7)(A)(i) provides that for the purposes of section 411 the term “accrued benefit” means, in the case of a defined benefit plan, the accrued benefit determined under the plan and, except as provided in (c)(3), expressed in the form of an annual benefit commencing at NRA.



Hybrid Plans Accrued Benefit

- Code section 411(c)(3)(A)(i) provides that if the plan determines the accrued benefit as an amount other than an annual benefit commencing at NRA, the accrued benefit for section 411 shall be the actuarial equivalent of such benefit.



Hybrid Plans Accrued Benefit

- Sections 411, 415, 416, and 417 (J&S) all apply to an accrued benefit as described in 411(a)(7)(i).
- So...a hybrid plan must contain provisions describing how the hypothetical account or accumulated percentage of final average compensation is converted to an annual accrued benefit so the accrued benefit is definitely determinable.



Offset Cash Balance Plan

- Many cash balance plans provide that benefits are offset by benefits provided in a profit sharing plan.
- Revenue Ruling 76-259 provides the rules for offset plan designs.
 - The defined benefit plan must provide the actuarial basis that will be employed to determine the benefit deemed to be provided by the profit-sharing plan.



Offset Cash Balance Plan

- The defined benefit plan must specify the time as of which such determination is made (the determination date) in a manner which precludes discretion on the part of the employer
- The offset to the benefit otherwise payable from the DB plan is equal to the amount deemed provided on the determination date by the vested portion of the account balance in the profit-sharing plan.



Incorrect Offset Design

- A cash balance plan provides the definition of principal credits as $(a) - (b)$ where:
 - (a) = 10% of compensation
 - (b) = the employer discretionary allocation in the Profit Sharing Plan for the same plan year
- This type of benefit offset is not allowed because per Rev Ruling 76-259, the offsetting accrued benefit has to be related to the account balance, NOT the annual allocation of the DC plan.



Correct Offset Design

- A cash balance plan provides the definition of principal credits as 10% of compensation.

However, the annuity benefit payable is defined as (a) – (b) where:

(a) = annuitized value of cash balance account

(b) = the actuarial equivalent annuity based on the vested account balance of the profit sharing plan that is attributable to the discretionary employer contributions.



Multiemployer Reports

- In January 2013, PBGC issued 3 Reports to Congress re: the Multiemployer Insurance Program
 - 1) The “3 Agency Report”
 - 2) The “5 Year Report”
 - 3) The Annual “Exposure Report”
- The reports may help Congress address future challenges in multiemployer plans



“Three Agency Report”

- PPA § 221(a) required PBGC, DOL, & Treasury to study effects of PPA on Multiemployer plans
- The 2008 market crash: BOY 2008, 77% “green”; BOY 2009 32% “green”
- With PPA options, PRA 2010, & improving markets = 60% green by 2011
- Serious challenges remain, however
- No policy recommendations



“5 Year Report”

- Required by ERISA § 4022A(f)(1)
- Per PBGC:
 - Current premium structure will not support multiemployer plan benefit guarantees in the long run
 - Sunset of PPA multiemployer provisions may be opportunity for broad review of policy & premium structure
- No requests or recommendations



“Exposure Report”

- Stochastic Modeling System projects future of multiemployer program
- Significant deterioration in a few large plans is a big part of the problem



Multiemployer Summary

- If nothing changes, PBGC says their multiemployer insurance program will face financial challenges
- 2014 sunset of PPA provisions may cause a re-think of policy by Congress
- Labor, employers, and Government all have an interest in solving the problem
- Are challenges opportunities in disguise?