EP Phone Forum
Funding-Based Benefit Restrictions

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Topics covered

- Background
- Funding rules for single-employer plans
- Benefit restrictions

Background
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Pre-PPA concerns about underfunded plans
- Costs amortized over periods as long as 30 years
- Too much difference between actuarial and market value of assets
- Perceived abuses, assumptions and methods
- Use of credit balances in underfunded plans
- Plan amendments, large distributions exacerbate underfunding

Congress’ response (single-employer plans)
- All costs amortized over 7 years
- Restrictions on actuarial value of assets
- One funding method
- Mandated assumptions
- Restrictions on use of credit balances
- Expansion of deductible limits on contributions
- Benefit restrictions

WRERA changes
- Technical corrections
- Funding relief
- Pending pension legislation would provide temporary relief
  - Extension of time to amortize costs
  - Ease restrictions on actuarial value of assets
  - Lookback to determine whether credit balances can be used to offset MRC
  - Delay in applying certain benefit restrictions to collectively bargained plans
Guidance issued:

- Proposed regulations, quarterly contributions
- Final regulations on sections 430 and 436
- Notice 2009-22 – interim guidance, actuarial value of assets
- Announcement 2009-97 – extension of time to amend plan for section 436
- Notice 2010-03 – automatic approval for certain changes in funding methods
- 2009 instructions, Schedule SB of Form 5500

Guidance in progress

- Final regulations, section 430(a), 430(j) (including quarterly contributions)
- Proposed regulations, sections 430 and 436
  - WRERA changes
  - Issues that have not yet been available for public comment
- 101(j) notice

Benefit restrictions
Overview

- Compliance is qualification issue
- Compliance is fiduciary issue
- Provisions must be reflected in plan
- Restrictions based on funding level
- High-25 restriction still applies

Overview

- Funding level based on AFTAP = Adjusted funded target attainment percentage
- Actuary must certify based on actual valuation results as reported on Schedule SB
- Based on assets reduced for credit balances
- May need to recertify for subsequent changes
- Final regulation expanded information required in certification

Overview

- If AFTAP is:
  - 100% or over - no restrictions
  - Over 80% but under 100%
    - Restriction on accelerated benefits if plan sponsor in bankruptcy
  - 60% but not 80%
    - Partial restriction on accelerated benefits
    - Plan amendments cannot take effect
Overview

If AFTAP is:
- Under 60%
  - No accelerated benefits paid
  - Accruals cease
  - No unpredictable contingent event benefits paid
  - No amendments even if make 436 contribution
  - WRERA change - use 2008 AFTAP if larger than 2009 when testing whether accruals continue

Overview

Before actual AFTAP available, can use
- Presumed AFTAP
- Range certification

Presumed AFTAP (for calendar year plan)
- January 1 - certified AFTAP for prior year
- April 1 - generally decrease prior-year AFTAP by 10%
- October 1 - conclusively presumed under 60% -- all restrictions apply

Overview

Range certification
- Used before valuation results available, but actuary is certain of the range
- Treated as actual certification - disqualification if range certification is wrong
- Treated as lowest value in range
- Must have actual certification by end of plan year or retroactively presumed under 60%
Avoiding restrictions

- Elect to reduce credit balances
  - Works because assets are reduced by credit balances for AFTAP calculation
  - Deemed election (required) for
    - Restriction on accelerated distributions (all plans)
    - All restrictions for collectively bargained plans
    - But only applies if credit balances large enough to avoid restrictions
    - Collectively bargained if 25% participants or 50% employees covered by plan are covered by CBA
  - Voluntary reduction for other restrictions

Example

- Assets = $90,000
- Carryover balance = $10,000
- Prefunding balance = $10,000
- Funding target = $100,000
- Annuity purchases = $0
- Funding ratio for benefit restrictions (AFTAP)
  - Reduced assets = $90,000 - $20,000 = $70,000
  - Funding target = $100,000
  - AFTAP = $70,000 / $100,000 = 70%

If plan sponsor elects to reduce COB by $10,000

- Reduced assets = $90,000 - $10,000 = $80,000
- Funding target = $100,000
- AFTAP = $80,000 / $100,000 = 80%
Avoiding restrictions

- Reduction in credit balances can affect minimum funding requirements
  - Affects calculation of MRC
  - Amount waived is not available to offset MRC
  - Reduction deemed to occur on first day of plan year - may retroactively "trump" amounts used to offset quarterly installments
  - Need to consider implications

-Avoiding restrictions

- Increase AFTAP by making additional prior-year contributions
- "Section 436" contributions
  - Not available to avoid restrictions on accelerated distributions
  - Cannot count toward MRC
  - Cannot use credit balances
  - Post security by valuation date

UCEB restriction

- Applies to plant shutdown benefits, other unpredictable contingent event benefits
  - Applies based on AFTAP at time of event
  - Applies on participant-by-participant basis
  - If permitted later in plan year, additional benefits automatically paid
  - Section 436 contribution depends on AFTAP before event
    - If under 60% - cost of additional benefits
    - If over 60% -- amount needed for 60% AFTAP
Restriction on plan amendments

- Applies when amendment affects plan operation
- If permitted later in plan year, amendment automatically takes effect
- Limited exception for amendments not based on compensation
- Section 436 contribution depends on AFTAP before amendment
  - If under 80% - full cost of amendment
  - If over 80% - amount needed for 80% AFTAP
  - Not available if AFTAP under 60% (frozen accruals)

Restriction on accelerated distributions

- Applies at annuity starting date
- Presumed AFTAP doesn’t count if sponsor is in bankruptcy - need actual certification
- WRERA exception for automatic cashouts

Restriction on accelerated distributions

- Partial restriction
  - Applies to ½ benefit or PBGC guaranteed benefit if less
- Mandatory options
  - Bifurcate benefit
  - Defer benefit
  - Elect unrestricted option
- Voluntary options
  - Defer restricted portion of bifurcated benefit
  - Additional optional forms of payment available only when restrictions apply
Restriction on accelerated distributions

- Bifurcation of benefits
  - Based on PV of total distribution
  - Apply minimum present value rules separately to each portion
  - Special rules for Social Security leveling option
- Plan termination
  - Restrictions continue to apply after termination
  - Exception for distributions made to complete standard termination

Benefit accrual freeze

- Applies when AFTAP under 60%
- 436 contribution is amount needed for 60% AFTAP
- WRERA “lookback” rule
- Restoration of missed accruals if:
  - Plan language provides for automatic restoration
  - AFTAP is at least 60% including cost of restored accruals
  - Freeze in effect no more than 12 months
- Otherwise, restoration treated as amendment (80% threshold)

Changes in AFTAP

- Material changes
  - Change operation of plan
  - Revert to presumed AFTAP
  - Possible disqualification
- Exceptions
  - Additional contributions
  - Election to reduce or apply credit balances
  - Subsequent plan amendments or UCE
  - Assumption or method changes requiring IRS approval (after approval granted)
Recertification of AFTAP

- Actuary must recertify AFTAP if subsequent changes
  - If material change – including effect on next year’s presumed AFTAP
  - If would be material but for exception
  - If 436 contribution to bring AFTAP to 60% or 80%
- Can recertify even if not required
- Must reflect any amendments, UCEB, 436 contributions after previous certification

Changes in presumed AFTAP

- Presumed AFTAP based on prior-year AFTAP
- Modify presumed AFTAP if
  - Election or deemed election to reduce credit balances
  - 436 contribution to increase AFTAP to 80% (amendments) or 60% (UCEB, benefit accruals)
- No modification for
  - UCEB or amendments permitted to take effect automatically
  - Section 436 contributions to pay full cost of amendment or UCEB
  - Voluntary reductions in credit balances that don’t result in removal of restrictions

Inclusive presumed AFTAP

- Used to test whether plan amendment or UCEB is restricted
- Reflects:
  - Cost of current and prior plan amendments and UCEBs and
  - Any prior-year 430 and current-year 436 contributions made through effective date of amendment or UCEB,
  - Even if not in modified presumed AFTAP
Section 436 implications

- Section 436 affects:
  - Plan administration
  - Document language
  - Collective bargaining
  - Employee communications

Section 436 implications

- Plan administration
  - Coordination between plan sponsor, actuary, administrator
  - Need advance game plan
  - Communicate expected timing and effect of certification
  - Make tentative decisions

Section 436 implications

- Plan administration
  - Conform systems
    - Adapt programming to restrict affected benefits
    - Calculate restricted/unrestricted portions if applicable
    - Calculate benefits, any special optional forms available when restrictions apply
  - Election forms
  - Employee notices
Section 436 implications

- **Plan drafting**
  - Document must reflect 436 restrictions
  - Must be definitely determinable
  - Must specify options when partial restrictions apply
  - Does not have to specify whether plan sponsor will take steps to avoid restrictions
  - Per Announcement 2009-97 not required until end of plan year beginning in 2010

- **Collective bargaining**
  - Perceived “gotcha” if negotiated increases don’t take effect
  - Required reduction of credit balances if large enough to avoid restriction
  - But 436 contributions voluntary
Section 436 implications

Collective bargaining
- May see bargaining agreements with:
  - Funding commitments
  - Amendments with “spring-back” provisions if prevented from taking effect
  - Alternate arrangements for restricted benefits

Employee communications
- General caveat, possibility of restrictions
- Notice when restrictions apply
  - No guidance yet – might include:
    - Description of restriction and how it will affect specific benefits
    - Options available to employee – especially when bifurcation applies
    - Effective date of restriction, conditions under which it would be lifted

Election forms -- options
- Reflect no restrictions – require another election if restrictions apply to elected form
- Provide regular and “back-up” election if restrictions apply
- Reflect current restrictions, permit another election if restrictions change
- Implications for descriptions, calculation of amounts under optional forms of payment, relative value disclosures
Funding rules – single-employer plans
- Simplified in many ways
  - One actuarial cost method
  - One amortization period
  - Fewer choices, actuarial assumptions
- But will require more involvement of plan sponsor
- Elections are generally irrevocable for plan year
- May require IRS approval to change in future years

Miscellaneous changes – final regulations
- Change allocation of certain benefits - tends to decrease funding target
- Clarify effect of 436 restrictions on funding target
- Allow replenishment of credit balance
- Clarify ordering rules, use of credit balances
Plan sponsor elections – interest rates

- Interest rate assumptions
  - Minimum funding requirements no longer based on single interest rate
  - Use yield curve concept

- Default
  - Segment rates (simplified yield curve, 3 interest rates)
  - No lookback
  - Transition rule for 2008-2010

Plan sponsor elections – interest rates

- Optional interest rates
  - Full yield curve
  - Segment rates
    - Lookback up to 4 months
    - Transition rule
  - Interest rate assumptions
    - Generally need IRS approval to change election
    - Exceptions
      - 2008 - 2010 plan years
      - First election away from default

Plan sponsor elections – interest rates

- Making interest rate election
  - No specific format or deadline
  - Written notification to enrolled actuary
  - Must be established before Schedule SB filed
  - May need to elect earlier to avoid material change in AFTAP
Plan sponsor elections – credit balances

Before PPA
- One credit balance
- Automatically used toward minimum funding requirements (including quarterly contributions)
- Automatically increased with excess contributions
- No ability (or need) to reduce credit balances

After PPA
- Two credit balances
  - Pre-PPA – Carryforward balance (COB)
  - Post-PPA – Prefunding balance (PFB)
- Credit balance cannot be used to offset MRC unless plan is at least 80% funded
- Elections are required to:
  - Use credit balances to offset minimum required contribution
  - Add excess contributions to prefunding balance
  - Reduce credit balance

Assets are reduced by one or both credit balances when calculating key measures.
Decision to reduce or use credit balances can affect calculation of MRC.
Change in election may mean retroactive change in valuation results.
Late / unpaid quarterly contributions.
Plan sponsor elections – credit balances

- Standing elections
  - Use credit balances to offset MRC
  - Not available for quarterly installments
  - Add excess contributions to PFB
  - Effective on last day for making specific elections
  - Remain in effect until
    - Revoked in writing to enrolled actuary
    - Actuary signing Schedule SB is not actuary named in election

- No specific format
- Must include specific amounts involved (other than standing elections)
- Must be provided in writing to enrolled actuary and plan administrator
- Generally irrevocable
  - May revoke “use” election if amount greater than full MRC
  - Standing election may be revoked before date deemed effective

Timing of elections

- No earlier than first day of plan year (except for standing elections)
- "Use" election -
  - No later than deadline for contributing MRC
  - May need to elect earlier to cover quarterly installment
- "Reduction" election – last day of plan year
- Election to add excess contributions to PFB – deadline for contributing MRC
Plan sponsor elections – credit balances

- Timing of elections
  - Election to revoke “use” election in excess of MRC
    - If valuation date is first day of plan year – end of plan year
    - Otherwise, due date for contributing MRC
  - Standing election
    - No later than deadline for contributing MRC
    - Replacement election (for change in actuary) – due date for filing Schedule SB

Questions?