

Session 27:

“The Good, The Bad, and The Ugly”

PPA-Unanswered Questions

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Topics for Discussion

- Reasonable Interpretation
- Plan Expenses
- Funding Balances
- Administration
- AFTAPs
- “Answers” from Final Regulations
- What’s Still Unanswered?

Reasonable Interpretation

- Per Notice 2008–21, proposed §430 and §436 regulations were proposed to be effective for plan years beginning in 2009
- Final regulations on measuring assets and liabilities and benefit restrictions published October 2009
- Final regulations on minimum required contributions still pending
- Certain sections have been reserved for future guidance
- Interim guidance has been provided through special editions of *EP News*

Reasonable Interpretation

- For 2008 and 2009, must apply a “reasonable interpretation” of statute
 - Can rely on proposed regs for this purpose
 - Can also apply an alternative reasonable interpretation
 - But must follow proposed regs in certain areas including mortality assumption and asset method
 - Asset guidance was modified by Notice 2009–22
 - Can rely on final regulations
 - §430 regs may be applied on a section by section basis

Plan Expenses

- WRERA requires that target normal cost include “plan-related expenses” expected to be paid from plan assets
 - Effective beginning with 2009 plan year, but plan sponsor can elect to apply for 2008
- Big question: What exactly is “plan-related expenses”?
 - Unclear whether expenses are just administrative, or also include investment management fees

Plan Expenses

- Proposed legislation (H.R. 2989 and Pomeroy proposal) would clarify that only administrative expenses are included
- Examples of administrative expenses that could be included:
 - Valuation fees
 - Nondiscrimination testing fees
 - PBGC premiums
 - Trustee fees
 - Audit fees
 - Outsourcing fees

Plan Expenses

- Including investment management fees could significantly increase target normal cost
 - Should underfunded plans pay expenses out of trust if it just means that the minimum will be increased next year? Could provide more contribution flexibility or ability to use credit balances.
- Final §430 regulations reserve a section for future guidance on this issue, so it will likely be addressed in future proposed regulations

Plan Expenses

- Under smoothed asset approach, assets must be adjusted at each determination date for future contributions and distributions (including administrative expenses, per Notice 2009-22 and final §430 regulations)
- Again, do “administrative expenses” include investment expenses?
 - Should there be consistent treatment with Target Normal Cost? i.e. should investment expenses be part of the expected return on assets?
- Probably didn’t consider too heavily, since, in 2009, most smoothed values were 110% of market value either way

Plan Expenses

- Investment expense issue also applies when calculating return for adjusting FSCB/PB
 - Must be rolled forward using actual rate of return on plan assets

If investment expenses are part of return for purposes of calculating TNC and VPA, then use return net of investment expenses for adjusting FSCB/PB

If investment expenses are “administrative expenses” for TNC and VPA, then use gross return for adjusting FSCB/PB

- Further IRS guidance on this issue is not anticipated, so do something reasonable and document rationale for your approach

Establishing Carryover Balance

- Literal reading of PPA indicates election needed to establish COB
 - Proposed regulations supported this reading
- Final regulations indicate establishment of COB is automatic if plan had FSA credit balance at end of 2007 plan year
- What happens in 2010 to a plan that did not make an election **not** to establish COB in 2008 plan year?
 - Does the old pre-PPA credit balance (adjusted for investment earnings in 2008 / 2009) re-appear?

Waivers of Funding Balances

- A waiver of funding balances for the current plan year is effective before any application of funding balances against the MRC
- Amount of funding balance available to meet remaining MRC for a prior year is reduced by the discounted value of election to waive or use in the current year
 - So a plan sponsor cannot use a funding balance to cover quarterlies if the funding balance will later be waived
 - Includes both voluntary and deemed waivers

Waivers of Funding Balances

- A plan sponsor may have late quarterlies for 2008 / 2009 if:
 - A funding balance was used to cover quarterlies;
 - No deemed waiver was required based on the balance remaining after the first two quarterlies; and
 - A deemed waiver would have been required based on the balance before quarterlies
- Will the IRS/PBGC provide any relief from late quarterlies in this situation?

Funding Balances When Prior Year Election Follows Current Year Elections

- Current year elections are discounted to prior year valuation date using (1) this year's effective rate then (2) last year's return on assets
- Prior year's remaining funding balance is then increased to election date using last year's effective rate to determine amount available

Funding Balances When Prior Year Election Follows Current Year Elections

- Applying less than the full amount available results in a remaining balance not equal to the amount available minus the amount applied
 - Amounts applied grow at last year's effective rate
 - Amounts not applied grow at last year's actual return, then this year's effective rate
- Depending on last year's return and the change in EIR, it can be advantageous to time prior year elections relative to current year elections

Standing Elections

- Final regulations allow standing elections to use COB / PFB to avoid unpaid MRC and to add to PFB
 - Will standing elections be allowed for quarterlies?
 - Is it reasonable to use a standing election for quarterlies absent final regulations?
- Standing election applies only to the EA named in the election
 - When is the change in the EA deemed to occur?
 - Can a change be avoided by naming the firm or all EAs in the firm?

New Definition of Eligible Excess Contributions for Prefunding Balance

- Final regulations allow plan that elects to use COB / PFB to pay quarterlies and later pays full MRC to recoup lost credit balance (as PFB)
 - Must the 2008 Schedule SB be re-filed to reflect the new definition of excess contributions (line 38)?

Prohibited Payment

- Per 436(d)(5), poorly funded plans are restricted in their ability to pay lump sum benefits
- Originally, a “lump sum benefit” was any payment in excess of the monthly single life annuity
 - A purchased annuity would have been classified a lump sum payment
- New regulations add transfers to another plan intended to avoid benefit restrictions as a prohibited payment

Prohibited Payment

- Any “benefit which under section 411(a)(11) may be immediately distributed without the consent of the participant” (WRERA)
- 411(a)(11) allows a plan to mandatorily distribute a lump sum of up to \$5,000 without participant consent
 - If a plan has mandatory cash-outs up to \$1,000 and require participant consent for larger amounts, if the plan restricted at the \$1,000 level or the \$5,000 level (if restrictions apply)?
- 411(a)(11) applies to nonforfeitable accrued benefits
 - Some plans provide for the payment of a lump sum not related to a nonforfeitable accrued benefit
 - What about lump sum death benefit that is not available as an annuity (\$5,000?, \$10,000?)

Prohibited Payment

- Suppose a participant has a present value of \$8,000, and the plan is restricted so that only partial lump sums can be paid
 - Participant receives \$4,000 as a lump sum and defers annuity to future date
 - Participant comes in one day later and requests payment of deferred annuity. Present value of deferred annuity is \$4,000.
 - WRERA amended the code to say that involuntary cashout is not considered a prohibited payment.
 - Does WRERA allow you to pay out the entire \$8,000 lump sum?

Age 62 In-Service Distributions

- PPA allows DB plan to offer in-service distributions starting at age 62 (§401(a)(36))
- Notice 2007-8 solicited comments on what guidance should be provided in this respect
 - What benefit should be payable before NRD for a plan that provides subsidized early retirement benefits?
 - If subsidized benefits are paid, how are they characterized for §411 purposes?
- No further guidance has been issued to date

Form 5500 Postings

- PPA requires DOL to post 5500's within 90 days of filing, and sponsors to post on Intranets per DOL regulations
 - Some readers interpret the 90 days to apply to sponsors too
 - Others think posting isn't required until DOL issues regulations
- Unknown what constitutes an Intranet, how to deal with subsidiary sites, sites solely for benefits enrollment or updating employee data, etc.

Contribution Deduction Timing

- Can employer claim prior year tax deduction for grace-period contributions reported on current year's Schedule SB (tax year = plan year)?
 - Some authority for claiming deduction
 - Regs. §1.404(a)-14(d)(2)(ii) and §11.412(c)-12
 - Rev. Rul. 77-82
 - PLRs/TAMs 7945115, 8210014 (TAM 200604040 revoked for contributions for hours worked in current tax year), 8714008
 - Current IRS ruling position apparently ties deduction to reporting on prior year Schedule B/SB
 - Rev. Rul. 76-28 (plan must treat contribution as if actually received on last day of employer's tax year)
 - PLRs/TAMs 199935062, 200311036, 200523033, 200526022
 - How to apply when tax year \neq plan year?

Contribution Deduction Timing

Pre-PPA – No Big Deal

- Amend prior year's Schedule B to report all contributions deducted in prior year
- Use resulting credit balance to cover current year quarterlies
- Negligible interest charges for late quarterlies

Post-PPA – Big Deal!

- Denied deduction means taxes underpaid or late quarterlies (if contributions moved to prior year on amended Schedule SB)
- Credit balance complications
 - Written elections with fixed deadlines required to create or use
 - Must be 80% funded to use
 - Deemed waivers
- 5% additional interest

Pension Benefit Statements

- When do you need to have the pension benefit statements issued? 12/31/09? Sometime in 2010? When? Does it matter what the “as of” date is?
 - DOL notice indicates statements must be “for” 2009
 - If statements are “as of” 12/31/08 or 1/1/09 it would not be reasonable to delay issuance until 2010.
- Will there be a frozen plan waiver?
- What is expected in the description of permitted disparity.

Plan Amendments

- 1.436-1(g)(5)(ii)(D) reserves an ordering rule for multiple plan amendments and unpredictable contingent events
- Immediately after the rules that require previously restricted amendments/UCEBs to take effect if an AFTAP certification allows them (due to Sec. 436 contributions)

Timing of AFTAP Certifications

- Is it legitimate for plan administrator to ask EA not to issue AFTAP certification until 10/1 so as to delay implementation of benefit restrictions?
 - Is this acceptable for the plan administrator?
 - Should the actuary warn the plan administrator?
 - Should the actuary comply with the plan administrator's instructions?

Timing of AFTAP Certifications

- Requested delay is a possible violation of duty of impartiality
- Actuary is not a fiduciary but may be exercising fiduciary powers when making discretionary decisions that affect payment of benefits
- PPA does not require that certifications be made by any specific time
- Deliberate delay may put PBGC at risk and potentially harms the participants who do NOT take lump sums
 - Issue will become live when underfunded plan terminates and PBGC refuses to pay lump sums

Timing of AFTAP Certifications

- Academy's Pension Committee issued guidance note in September 2009
- Final regulations do not address timing issues
 - May be the subject of future proposed regulations
 - IRS, Treasury and DOL will discuss whether issuing an AFTAP certification is fiduciary act or strictly ministerial function

Mergers and Spinoffs

- How do you determine the AFTAP and the assumptions to use (if different for the two plans)?
 - Assume Plan 1 is 1/1, Plan 2 is 5/1. On 5/15, Plan 1 is merged into Plan 2. Surviving Plan is 2.
 - When do benefit restrictions start and based on which plan's AFTAP?
 - What if Plan 1's AFTAP was 50% last year and Plan 2's AFTAP was 102%?
 - What if Plan 1 has 50,000 participants and Plan 2 has 200 participants?

How many AFTAPs are there?

- Is there only one presumed AFTAP applied to determine if any of the four types of restrictions apply?
- Example:
 - AFTAP > 80%, so lump sums not restricted
 - Plan amendment would lower AFTAP to below 80%
 - Current year contribution made to improve AFTAP to 80%, allowing amendment to take effect
 - Are lump sums restricted?

Providing Security to Avoid Benefit Restrictions

- When determining AFTAP, may include in plan assets any security posted by the valuation date for the plan year
 - How can you determine how much security to post before the other asset and liability amounts for the current year are known?
 - Final regulations allow for security to be replaced if the new security is in at least the same amount as the old security
 - So undesirable to “overestimate” amount needed since it cannot be reduced once final valuation results are available

Small Plan Benefit Restriction Issues

- Benefit restrictions based on AFTAP as of the beginning of the plan year
- Key benefit restriction dates are first day of 4th and 10th months of the plan year
- What do you do if you have an end of year valuation date?

Small Plan EOY Valuation Issues

- Discounted value of late quarterly contributions
 - If installment paid (or COB/PFB election made) after quarterly due date, must discount at EIR+5% from date paid to due date, then at EIR from due date to valuation date
 - No guidance on quarterly contributions due before valuation date
- Application of first segment rate
 - For beginning of year vals, applies for the 5-year period following the valuation date
 - No guidance on the applicable first segment rate period for end of year valuation date

Special Assumptions for At-risk Plans

- Final regulations expand application of special at-risk assumptions
 - Special early retirement assumption applies to all participants not in payment status
 - All participants are assumed to elect the most valuable form of benefit at assumed retirement
 - Applies to special early retirement assumption as well as those to who that provision does not apply

Special Assumptions for At-risk Plans

- What if readily available electronic data does not have earliest commencement date or years of service for VTs and beneficiaries?
- How do you handle updates in actuarial equivalence basis not applied retroactively?
- How do you handle subgroups with different optional forms of payment when determining most valuable form?

Funding Method Changes

- The big question has been answered
 - Automatic approval to change assumptions / methods for 2008, 2009 and 2010
- Will there be an automatic approval mechanism for 2010+?
 - How do you get approval? ‘Formal request’ is only answer so far
 - What if you change actuaries, or systems?

Funding Method Change

- Allocation method for benefits not a function of accrued benefit or years of service changed in final regulations
 - Valuation of certain ancillary benefits (e.g. projected disability benefit) will be more consistent with past valuation practices
 - Can the 2009 FT be recalculated using new method?
 - Watch material change in AFTAP

Collectively Bargained Plan

- Final regulations answered question about union plan designation
- Proposed regulations: plan is “collectively bargained” if at least 25% of plan participants are members having benefit levels under the plan that are specified under a CBA
 - Did “participant” mean just actives?
- Final regulations: a plan is “collectively bargained” if at least 50% of the employees benefiting under the plan are members CBA
 - Final regulation also allow proposed regulation threshold to apply

Unpredictable Contingent Events

- Final regulations require the actuary to take into account the probability of future benefits that become payable due to an Unpredictable Contingent Event
 - Predict the unpredictable?
 - Will actuary rely too heavily on input from the client such that impartiality is clouded?
 - How else will the actuary develop the assumption of future UCEs?
 - Will you need to assign UCE probabilities for all future years?
 - Should this be done on a division by division or location by location basis?
 - Do you need to make the same assumption for accounting?

What's Missing?

- Calculation of minimum required contribution
- Calculation of required quarterly installments
- Cash balance regulations
 - Proposed regulation on market rate of return
- Correction for AFTAP certifications that retroactively create disqualifying administration

What's Missing?

- Maintaining funding balances when quarterly contributions are due before the valuation date
- For mergers and spinoffs
 - 80% FTAP requirement to apply funding balances
 - At-risk rules
 - Plan amendment restriction for underfunded plans
- 411(d)(6) relief for PPA Sec. 1107 amendments
- WRERA asset averaging and plan-related expenses

What's Missing?

- Exception for small amounts cash-out when accelerated payment forms are restricted
- Rules for DOL and participant notices/penalties when quarterly installments are retroactively late due to a deemed waiver of funding balances
- WRERA substitution of prior year AFTAP for plan years beginning 10-1-08 to 9-30-09, to allow continuing benefit accrual