Benefit Restrictions for Underfunded Single Employer Plans under the Pension Protection Act

The Basics

• Adjusted Funding Target Attainment Percentage ("AFTAP") is the ratio of:
  – fair market value of plan assets.
  – reduced by any funding standard carryover balance and pre-funding balance.
  – TO the plan's funding target.
  – Both assets and liabilities are increased by the amount of annuities purchased for all non-highly compensated employee participants for the preceding two years. Code Section 430(d).

The Basics

Plan cannot pay "prohibited payments" after valuation date (generally 1st day of plan year) if:
• AFTAP is less than 60%, or
• Plan sponsor is bankrupt and AFTAP is less than 100%.
• Exceptions for plans with no benefit accruals from 9/1/05 to date. Code Section 436(d).
Prohibited payments are (1) payments in excess of monthly benefit under single life annuity (plus qualified Social Security supplements) to any participant or beneficiary whose benefit commences when limitation is in effect; (2) payment to purchase an irrevocable insured annuity; or (3) other forms limited under regulations.
• If AFTAP is between 60% and 80%, preceding rule applies, except a one-time lump sum benefit payment may be made equal to lesser of present value of participant’s maximum PGBC guaranteed benefit or 50% of lump sum amount that otherwise payable.

The Basics

• If AFTAP is less than 80% (or would be less than 80% taking in account new liabilities), no benefit increases or new benefits or changes in vesting schedule permitted.
• Limitation ceases if plan sponsor contributes cost attributable to benefit change (if under 80%) and to AFTAP to at least 80% (if under 80% based on change). Code Section 436(c).
• Exception for benefit increases under formula not based on compensation, but only if rate of increase does not exceed contemporaneous increase in average wages of participants covered under amendment.
• If AFTAP is less than 60%, further benefit accruals are prohibited as of valuation date unless plan sponsor makes additional contributions to bring AFTAP to 60%. Code Section 436(e).

WRERA CHANGES

• Plans can use prior year’s AFTAP for determining if benefit accrual limits apply as a result of being less than 60% funded. (Does not impact the restrictions on distributions of lump sum benefits.)
• Applies for plan years beginning on or after 10/1/08 and before 10/1/09. (For plan years beginning 1/1/09, means using 2008 AFTAP.)
• Does not apply if AFTAP for current plan year is greater than preceding year.
Special Rules

• "Under 60%" restriction does not apply to first five years of new plan (taking into account any predecessor plan). Code Section 436(g).
• Transition Rules for 2008 to 2010 for some limitations/definitions.
• Rules about counting prefunding balance and funding standard carryover balance to avoid benefit limitations.
• Employer can count "security" – including security bonds, short-term (3 years or less) U.S. obligations held in escrow, or other Security IRS agrees to – as an asset under AFTAP. Code Section 436(f).
• Final regulations issued 10/15/09; applies to Plan Years on and after 1/1/10.

Unpredictable Contingent Event Benefits

• If plan provides "unpredictable contingent event benefits", that benefit cannot be paid if AFTAP for that plan year is:
  – Less than 60%
  – Would be less than 60% if taking into account that event
• Includes plant shutdown or similar events or an event other than payment for age, death, disability, performance of services, receipt of comp.
• Employer can "pay out" of limitation—by making additional contribution equal to amount attributable to occurrence plus amount needed to get AFTAP to 60%. Code Section 436(b)

Restrictions During Plan Year

• Limits generally apply after "valuation date" – generally, first day of plan year. Code Section 430(g).
• During period in plan year before AFTAP certified:
  – If benefits restricted last year -- assume last year’s AFTAP until later of new AFTAP or 10/1 (tenth month).
  – If benefits not restricted last year but would have been if AFTAP was 10% lower, and actuary not certified by 4/1, assume 10% lower than last AFTAP as of 4/1 (fourth month) until certification done.
  – If valuation not done by 10/1, AFTAP assumed to be less than 60% as of that date.
Code Section 436(h)

Notice of Benefit Restrictions

• Notice to participants under ERISA 101(j) within 30 days after plan is subject to benefit limitations under 436(b) and (d) or valuation date if AFTAP is less than 60%.
• Under final regulations (effective 11/25/09), timely notice under ERISA 101(j) treated as complying with ERISA 204(h) notice for amendment adopted to comply with Code Section 436.

Plan Amendments

• Need to reflect limitations in Plan document -- but how much should plan say?
• Notice IRS Notice 2009-97, issued on 12/28/09 extends deadline to last day of first plan year that begins on or after 1/1/10 for plans to meet requirements of Code §§401(a)(29) and 436 for funding-based limits on benefits.
• Notice also provides limited relief from anti-cutback requirements of Code § 411(d)(6) for retroactive amendments that are adopted by extended deadline for amending a plan to meet these requirements.

Funding Relief Under Proposed Legislation

Preserve Benefits and Jobs Act of 2009 ("PBJA")
  – Can base benefit accrual restrictions for 2009 and 2010 on greater of (1) current AFTAP or (2) AFTAP for plan year beginning after 10/31/07 and before 11/1/08. Section 103.
  – Special rules for Plans with valuation date other than first day of plan year.
  – WRERA relief applies if gives higher AFTAP.
Proposed Funding Relief

- Delays restrictions under Code Section 436(c) (benefit increases) for collectively bargained plans until plan years after 12/31/11, except for plan amendments made under CBA ratified after PBJA introduced (10/27/09). Section 107.

Proposed Funding Relief

- Adds new limitations on “ad hoc” benefit enhancements. Section 111.
  - “Ad hoc” amendments (1) increase benefits to only a subset of participants who terminate employment during a limited period (window) and (2) are paid in a form of a “prohibited payment.”
  - Lump sums to limited groups of participants must be immediately funded if AFTAP is less than 120% or would be less after cost of amendment considered.
  - This does not apply to collectively bargained plans.
- Clarifies that Social Security Level Income Options treated like qualified Social Security supplements in exception to prohibited payments. Section 108.

Update on Retirement Benefits for Tax Exempt Employers

Section 403(b) Tax Sheltered Annuities
IRS Review of Plan Documents

Announcement 2009-34

Draft revenue procedure for proposed IRS 403(b) opinion letter program for prototype plans
- Procedure would provide retroactive remedial amendment period for years after 2009 for 403(b) prototype plans.
- Determination letter program for individually designed 403(b) plans will be established.

Automatic Contribution Arrangements
Final Regulations on QACAs and EACAs

- Issued on February 24, 2009 and generally effective for plan years beginning on or after January 1, 2008.
- 403(b) plan that contains a qualified automatic contribution arrangement (“QACA”) is deemed to satisfy ACP test.
- 403(b) plan with an eligible automatic contribution arrangement (“EACA”) may refund elective deferrals if a participant so requests within 90 days after his or her first elective deferral.

Proposed Regulations on Suspension or Reduction of Safe Harbor Nonelective Contributions

General

- Issued on May 18, 2009, and effective for amendments adopted after May 18, 2009, but may be relied on until final regulations are issued.
- An employer that has a “substantial business hardship” may amend its 403(b) plan to suspend safe harbor nonelective contributions.
- “Substantial business hardship” exists if employer is operating at an economic loss, there is substantial unemployment or underemployment in the industry, or the industry has depressed or declining sales or profits.
**Proposed Regulations on Suspension or Reduction of Safe Harbor Nonelective Contributions**

**Specific Requirements**
- amendment adopted before end of plan year;
- plan provides that ACP test is satisfied for entire plan year;
- supplemental notice provided to eligible employees;
- reduction or suspension effective no earlier than 30 days after provision of notice, or the amendment’s adoption date, if later;
- employees are given a reasonable period after receipt of notice to change salary deferral elections; and
- the maximum compensation limit is prorated.

**Minimum Distributions**

**Notice 2009-82**
- Provides guidance on waiver of 2009 required minimum distributions (“RMDs”) as a result of WRERA, and includes two sample amendments plans may adopt to either stop or continue 2009 RMDs.
- Provides transitional relief for plans that were unable to timely modify procedures relating to 2009 -.
- Explains that individuals who have received a 2009 RMD have until the later of November 30, 2009 or 60 days after receipt of the distribution to roll over the distribution.

**Rollovers to a Roth IRA**

**Notice 2009-75**
- Describes federal income tax consequences of rolling over an eligible rollover distribution from a 403(b) plan to a Roth IRA.
- Provides that a rollover from a 403(b) plan to a Roth IRA is taxable in the year of distribution.
- Provides that there are no restrictions based on modified adjusted gross income limits and joint filing requirements for distributions made on or after January 1, 2010.

**QDRO Developments**

- Posthumous QDRO’s
  - Trial court exceeds its authority to nunc pro tunc an order granting Alternate Payee interest in former spouse’s pension where underlying judgment evinced no intent to award or recognize spouse’s interest in former spouse’s pension
  - Decision rests on state law
- Plan administrator’s review of DRO confined to 4 corners of the order. Plan administrator may not “disqualify” DRO on grounds that DRO arose from sham divorce.
• DRO that awards former spouse 50% of employee spouse’s pension and restrains former spouse from collecting interest until former spouse complies with child support and other non-plan property issues is enforceable QDRO.