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New Pension Relief Law a Mixed Bag for Plan Sponsors

Congress has passed, and on December 23 President Bush signed, legislation amending the 2006 Pension Protection Act ("PPA") to provide some limited relief from the drastic contribution increases that many plan sponsors are facing due to the severe financial market decline. However, the impact of the new law, called the "Worker, Retiree, and Employer Recovery Act of 2008," may vary significantly from one plan to the next.

The amendments also feature many technical corrections to PPA originally approved by the House of Representatives in 2007, but not by the Senate. The legislation also suspends (for 2009) the rules requiring individuals 70-½ or older to take minimum distributions from their defined contribution plan or IRA, to protect them from having to sell greatly depreciated assets. Finally, the legislation changes ADEA to allow government cash balance or pension equity plans to define a market rate of return so that they may comply with the new standards applicable to such plans.

This advisory summarizes the main changes the amendments make in PPA's minimum funding rules for defined benefit plans and describes the relief, if any, provided by those changes.

Multiemployer Plans

Congress made several important changes in the special funding rules for multiemployer plans that will give the plans more time to recover from the market decline. One of the most important changes was to allow Trustees to elect to have the plan's status for plan years that begin during the period from October 1, 2008 through September 30, 2009 be the same as the status for the prior plan year. This means that calendar plans that were endangered in 2008 and would fall to critical in 2009 can elect to maintain their endangered status.

Similarly, plans that were neither endangered nor critical in 2008 but would have fallen to one of those categories in 2009, can continue to be treated as safe in 2009 and need not follow the special funding rules requiring adoption of a funding improvement plan for endangered plans or a rehabilitation plan for critical plans until the 2010 plan year if they are still endangered or critical at that time.

A special rule allows fiscal year plans that first become subject to the special multiemployer funding rules on or after October 1, 2008 and prior to January 1, 2009, to also take advantage of the preceding year determination alternative. Trustees of such plans can elect to determine their status based on the preceding plan year by assuming that the special funding rules applied to that preceding year. For example, a plan whose plan year begins November 1, 2008 can apply the special funding rules to the plan year that began November 1, 2007 and if the plan would have been safe for that year, but would be endangered or critical for the current plan year, the Trustees may elect to classify the plan as safe.

For plans utilizing the special election, the table below illustrates various status change scenarios:

Alternative Certification Status Scenarios

For Plan Years beginning October 1, 2008 through September 30, 2009

Prior Certification Status*	Preliminary Certification Status**	Optional Certification Status***
Safe	Endangered	Safe
Safe	Seriously Endangered	Safe
Safe	Critical	Safe
Endangered	Seriously Endangered	Endangered
Endangered	Critical	Endangered
Seriously Endangered	Critical	Seriously Endangered

* For 2008 plan years beginning on or after October 1, 2008, use the status that would have been applicable had a certification been required for the 2007 plan year.

** Certification status without taking advantage of relief provision.

*** If Trustees elect to take advantage of relief provision.

CHEIRON OBSERVATION: Taking advantage of the special election to "freeze" a plan's certified status is a decision that Trustees need to review carefully with the actuary and fund counsel. In some circumstances, it may not behoove the plan to re-characterize its status for plan years beginning 10/1/08 through 9/30/09 if, in the long run, doing so could impair the fund by delaying possible long-term solutions to its funding challenges.

Following are additional highlights of the PPA amendments applicable to multiemployer plans:

- **Excise tax avoidance.** The amendments protect employers from a funding deficiency excise tax if their plan would be critical in 2009 even if the Trustees elect to use the preceding year rule to avoid being critical. If the fund actuary certifies for the plan year beginning in 2009 that the plan is critical, but the Trustees elect to use the preceding year rule for determining the plan's 2009 status to avoid being classified as critical, the plan will be treated as critical for purposes of the provisions that waive the excise tax on employers for funding deficiencies.

- **Suspending funding improvement and rehabilitation plan updates.** The amendments drop the requirement for a plan that was in endangered or critical status for 2008 to update its funding improvement or rehabilitation plan for 2009. This means that such plans will not be forced to take into account the asset losses due to the 2008 market decline.

- **Extending funding improvement and rehabilitation plan periods (correction period).** Specifically, the amendments extend the correction period from ten to thirteen years. Seriously endangered plans would be extended from fifteen to eighteen years. This change gives plans three more years to recover from the 2008 market decline and will reduce the benefit and accrual reductions, the increases in required contributions, or both needed to meet the statutory benchmarks applicable to endangered and critical plans.

CHEIRON OBSERVATION: The extension applies only to plans that are endangered or critical for their plan years that begin in 2008 or 2009. Thus, if the Trustees elect to keep the plan in the safe zone for 2009 using the plan's 2008 safe status, the three-year extension of the correction period would not apply. If a plan elects to lengthen the funding improvement or rehabilitation plan periods by three years, the negotiated increase in contributions or reductions in benefits needed to satisfy either plan would normally decrease as compared to the 10-year correction period. However, in certain situations the extension of the correction period may not provide any relief depending on the actuarial projections for the fund involved.

- **Application of a default schedule to funding improvement and rehabilitation plans.** The amendments apply the default schedule if the bargaining parties do not adopt a funding improvement or rehabilitation plan, whichever is relevant, within 180 days after the expiration of the collective bargaining agreement in effect when the plan was certified as endangered or critical. The amendments also make clear that any contribution increases due under the default schedule are treated as contributions due and owing under the plan. The plan may sue to collect those contributions under ERISA in the same manner and under the same rules that apply to bargained contributions, and would be entitled to collect contributions plus interest plus a penalty.

- **Limiting lump-sum distribution restrictions.** The amendments apply the restriction on lump-sum or other accelerated forms of distribution only to participants whose benefits commencement date is after notice of critical status has been provided.

Single Employer Plans

The amendments to PPA make several modifications to the single employer funding rules that may reduce, for some plan sponsors, the funding burden that would otherwise apply under PPA. The key provisions of the legislation would:

- **Modify asset averaging rules.** The new rules would allow the plan's actuary to include an amount equal to expected earnings for the plan year. The actuary may not assume earnings in excess of the third segment rate defined for funding purposes (currently a little over 6%). This means that a plan would effectively be allowed to smooth assets by up to 24 months. This change would be retroactive to the original enactment of the PPA, so it could be applied to the plan's first year under PPA (2008 plan year). However, smoothed assets are currently limited to 110% of market value, so the potential impact may be diluted somewhat unless additional modifications are granted.

- **Temporarily ease funding shortfall payments.** Specifically, the legislation changes the funding rules so that if a plan fails to meet the shortfall funding base exemption, the shortfall amortization base will be based on the transition rule target (92% in 2008, 94% in 2009 and 96% in 2010), for that year, instead of 100% of the funding target. Thus, a plan that is 90% funded in 2009 will have its shortfall amortization base calculated on 4% of accrued liability instead of 10%. The ability to use the reduced shortfall amortization base is available to all plans that did not have a deficit reduction contribution in 2007. This change is also retroactive to PPA's enactment.

- **Delay plan freeze due to funding percentage.** For purposes of determining if PPA's restriction on future benefit accruals applies, plans can, for one year, use the funded percentage of the prior plan year if this percentage is greater than the current plan year. For example, if the plan's adjusted target funding percentage was not less than 60% for the 2008 calendar plan year, the plan will not be forced to cease accruals for the 2009 calendar plan year. This provision is effective for plan years beginning during the period from October 1, 2008 through September 30, 2009.

- **Correct the impact of small lump sum payments under PPA.** The legislation clarifies that involuntary cash-outs are not considered prohibited payments. This means that small amount lump sum payments (those not requiring participant consent for distribution) are not restricted payments under PPA. Thus, plans may make these involuntary cash-out payments regardless of funding level. This change is retroactive to PPA's enactment.

- **Require target normal cost to include "plan-related expenses."** The amendments clarify that "target normal cost" (i.e., the present value of benefits expected to be accrued during the current plan year) must include all "plan-related expenses" expected to be paid from the plan assets. As a result of this change, some single employer plan sponsors could see their required annual funding obligations increase. If investment fees normally accounted for in the investment return assumption are treated as plan expenses, the increase to funding requirements could be quite large. The amendments also clarify that mandatory employee-paid contributions reduce the target normal cost. This clarification is effective for plan years beginning after December 31, 2008, although it may be elected for the preceding plan year.

The net effect of all these rules will vary for each single employer plan. For most plans, the funding requirements may be reduced, but for plans with significant expenses paid through the trust, the minimum required contribution may actually increase.

Conclusion

These amendments make needed technical corrections to PPA and provide varying degrees of relief to multiemployer and single employer plans. The relief for multiemployer plans seems more substantial, but for the most part it will only last through the 2009 plan year. If the markets do not recover substantially before the beginning of the 2010 plan year, multiemployer plans will be forced to take the unpalatable actions they avoided in 2009.

For single employer plans, the combination of the technical corrections and relief provisions may help some plans and hurt others. In particular, the requirement to take plan expenses into account may increase required contributions, while the reduction of the funding target to the phase-in percentage will provide some relief with respect to contributions required under the shortfall amortization charge. The asset smoothing provision may also provide some relief. The net result will depend on the specific circumstances of each plan. Because many financial analysts do not expect a rapid recovery in the markets, it is likely that more relief will be needed next year to avoid substantial increases in required employer contributions.

Cheiron is a full-service actuarial consulting firm assisting Taft-Hartley, corporate and public plan sponsors manage their benefit plans proactively to achieve strategic objectives and satisfy the interests of plan participants and beneficiaries. To discuss how these PPA amendments impact your plan, please contact your Cheiron consultant or email your request to speak to a consultant at info@cheiron.us.