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IRS Regulations on Pension Funding and Benefit Restrictions

The Internal Revenue Service (IRS) and the Treasury Department recently published final funding regulations for single-employer pension plans, which will generally first take effect for the 2010 plan year.[1] Employers can also rely on these regulations for 2008 and 2009, if they choose. The regulations contain a large amount of technical details. This *Bulletin* gives a high-level summary of key provisions that might be of interest to private sector employers.

MINIMUM FUNDING

The regulations lay out rules for determining minimum required contributions. Highlights follow:

- ***Automatic Approval of Certain Method Changes*** As the IRS previously announced, automatic approval is granted for changes in interest rate method and asset method for the 2009 and 2010 plan years.[2] In particular, plans using the spot interest rates in 2009 will *not* be locked into this election, and will be permitted to adopt the 24-month average rates starting in 2010.

- ***Benefits upon Plant Shutdown or Layoff*** Plans that provide special benefits upon plant shutdown or layoff must reflect the possibility of these events occurring in the future, based on information as of the valuation date, unless there is a negligible likelihood of these events occurring.

- ***At-Risk Plans*** Plans with a funding percentage below certain levels are considered *at-risk*. At-risk plans are valued using more conservative assumptions, which are phased in over five years. These required assumptions must now apply to all participants who have not commenced payments.

- ***Credit Balance Elections*** Credit balances resulting from excess contributions — now classified as either "funding standard carryover balances" if built up before 2008 or "prefunding balances" if established later — are now highly regulated. For instance, the employer must make a formal election either to draw on those balances or to add to them. The regulations detail how these elections are made, and include several changes from the proposed regulations. In particular, instead of making a separate election each time a credit balance is to be used to pay the minimum required contribution, the employer can make a *standing election* to do so to the extent necessary every year. However, the regulation does not authorize a standing election to cover quarterly contributions, which suggests that an explicit election is needed prior to each quarterly due date, stating the amount that will be drawn down. (The preamble says that quarterly contributions, including application of the credit balances, will be addressed in future regulations.)

BENEFIT RESTRICTIONS

The Pension Protection Act of 2006 prevents underfunded plans from providing certain benefits. Briefly, plans that are less than 80 percent funded generally cannot be amended to increase benefits, unless the entire cost of the amendment is immediately funded. A terminated participant cannot take more than 50 percent of his or her benefit (or, if lower, the present value of the maximum Pension Benefit Guaranty Corporation guaranteed amount) as a lump sum or similar accelerated payment from a plan that is less than 80 percent funded. If the funding is below 60 percent, the plan cannot pay lump sums or other accelerated payments at all, and must freeze benefit accruals. In addition, these plans cannot pay shutdown or layoff benefits.

The regulations detail how these restrictions are administered. The following are some highlights:

- ***Optional Forms that Might be Restricted*** A key question is what is considered an accelerated

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[1] The final regulations were published in the October 15, 2009 *Federal Register*: http://edocket.access.gpo.gov/df/E9-24284.pdf

[2] For information about this announcement, see Sibson Consulting's September 30, 2009 *Compliance Alert*: http://www.sibson.com publications-and-resources/compliance-alert/archives/?id=1316

payment that might be restricted. The final regulations generally follow the proposed regulations. The accelerated payments subject to restrictions include: (1) refunds of employee contributions; (2) Social Security level income options (annuities that provide a greater benefit up to Social Security eligibility and a smaller benefit thereafter); (3) annuities for a fixed period that do not continue for the participant's life; and (4) retroactive annuity starting dates (annuities that include make-up payments for prior periods because of a participant's delayed retirement). Many plan sponsors had hoped that the IRS might use a *de minimis* concept to allow these payment forms, but that did not happen. ***Note:*** The fact that these optional forms could be subject to restriction may have funding implications. To avoid these restrictions, credit balances might be automatically waived. This could increase required contributions for the current year or for a future year.

- ***Collectively Bargained Plans*** A collectively bargained plan may have a delay in the effective date for the benefit restrictions. In addition, a collectively bargained plan may have its credit balances automatically waived to avoid benefit restrictions in some cases where a non-collectively bargained plan would not. The regulations define a collectively bargained plan as a plan in which at least 25 percent of the participants (or 50 percent of the employees accruing benefits) are members of collective bargaining units for which the plan benefits are collectively bargained.

- ***Delaying Certification of the Funding Percentage*** The preamble to the regulations discusses whether the actuary could intentionally delay a certification of the funding percentage, or whether the plan administrator could direct the actuary to do so. This delay could postpone or accelerate the restrictions, in some cases. The preamble warns that future regulations might constrain employers' flexibility on this, but definitive guidance is not provided in these rules.

- ***Participant Notice*** Plan documents need to be amended before the end of the 2009 plan year, to provide for the implementation of benefit restrictions if and when they are triggered at some future point. A participant notice is required within 30 days after benefit restrictions become effective. These regulations do *not* include guidance on this participant notice.[3] However, a recent special edition of the IRS *Employee Plans News* declares that a benefit restrictions notice need not be sent to participants who, because they are already retired, cannot be affected by the benefit restrictions.[4]

[3] A proposed Treasury regulation states that provision of this notice satisfies the advance-notice requirement of ERISA section 204(h). See http://edocket.access.gpo.gov/2008/pdf/E8-5625.pdf

OPEN ISSUES

The regulations just released do not generally cover most issues related to cash balance and other hybrid plans. Similarly, they do not cover provisions that were added by the 2008 Worker, Retiree, and Employer Recovery Act, or quarterly contributions. It is also possible that future legislation could provide some relief from the current law's requirements.[5] Still, these regulations answer some of the outstanding questions, and will need to be reflected in planning for 2010.

As with all issues involving the interpretation or application of laws and regulations, plan sponsors should rely on their attorneys for authoritative advice on the interpretation and application of legal requirements. Sibson can be retained to work with employers and their attorneys to evaluate the impact of these regulations.

[4] The issue is available on the following page of the IRS Web site: http://www.irs.gov/pub/irs-tege/se1009.pdf

[5] For more information, visit http://www.americanbenefitscouncil.org/

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