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Pension Relief Bill Passed by Congress

Congress has passed the Worker, Retiree, and Employer Recovery Act of 2008 (H.R. 7327), which President Bush is expected to sign into law shortly. The bill provides long awaited technical corrections to the Pension Protection Act of 2006 (PPA) along with limited defined benefit plan funding relief for plan sponsors due to the economic downturn.

This For Your Information *describes the provisions of the bill and discusses issues arising from these changes.*

Worker, Retiree, and Employer Recovery Act of 2008

Following extensive lobbying and outreach efforts for PPA technical corrections and pension funding relief due to the current economic crisis, Congress passed H.R. 7327 – the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA). Instrumental in these efforts were trade associations (e.g., the American Benefits Council, the ERISA Industry Committee, and the Chamber of Commerce), individual employers, and consulting firms (including Buck Consultants).

This *For Your Information* covers the provisions for funding relief as well as the PPA technical corrections. Some technical corrections, such as special funding relief for airline plans and those affecting small plans, are not addressed.

Unless otherwise noted, the provisions outlined are effective as if they had been included in PPA.

Relief Due To Economic Crisis

Limitation on Benefit Accruals

PPA imposes certain benefit limitations on underfunded defined benefit plans depending on a plan's adjusted funding target attainment percentage (AFTAP), which is determined as of the valuation date (generally the beginning of the plan year). (See our October 4, 2007 *For Your Information*.) In particular, benefit accruals must be frozen when a plan's AFTAP is less than 60% – unless the amount necessary to attain the 60% level is contributed to the plan in addition to the regular minimum required amount.

WRERA provides that for plan years beginning during the period October 1, 2008 through September 30, 2009, the prior year's AFTAP may be substituted for the current year's AFTAP (if the prior year's AFTAP was higher) for purposes of applying the restriction on benefit accruals. Thus, for example, a calendar year plan with a 2008

AFTAP of at least 60% will not have to be subject to the benefit accrual restriction for 2009, regardless of the plan's 2009 AFTAP.

Transition Funding Rule

Under PPA, the minimum required contribution for plans with a funding shortfall (i.e., the value of plan assets less credit balance is less than the funding target) is generally the sum of the target normal cost plus 7-year amortization of the current year's shortfall amortization base plus any remaining amortization payments from prior years' shortfall amortization bases.

A shortfall amortization base is not established if the value of plan assets is at least 100% of the funding target. PPA included a transition rule for this exemption under which a transition percentage of the funding target is used to determine whether a shortfall amortization base will have to be established (92% in 2008, 94% in 2009, 96% in 2010, and 100% thereafter). Under PPA, this transition rule did not apply to the amount of any shortfall amortization base required to be established. Also, plans that failed to meet the phase-in standard in any transition year (i.e., if a shortfall amortization base is established in any year) forfeited the transition relief for future years.

WRERA provides that these transition percentages apply in determining the amount of the shortfall amortization base, and also apply regardless of whether a shortfall amortization base was established in any prior year. Therefore, many plans need only fund up to the transition percentages, instead of to 100%, from 2008 through 2010. As under PPA, plans established after 2007 or plans subject to a deficit reduction contribution in 2007 are not eligible for this transition relief.

Minimum Required Distribution Relief for 2009

Under the Internal Revenue Code, benefit payments must begin for individual retirement accounts and annuities (IRAs) the April 1 following the year in which the individual reaches age 70½, and for participants in employer-sponsored plans the April 1 following the later of the participant reaching age 70½ or actual retirement. WRERA provides that these minimum required distribution rules will be waived during 2009 for qualified defined contribution plans and IRAs.

> ***BUCK COMMENT.*** *We understand that the IRS intends to issue similar relief for 2008.*

Multiemployer Plan Relief

PPA imposes additional funding rules on multiemployer defined benefit plans that are in endangered or critical status. These rules require the adoption of and compliance with a funding improvement plan in the case of a multiemployer plan in endangered status, and a rehabilitation plan in the case of a multiemployer plan in critical status. These plans are generally effective for a period of 10 years, beginning no later than two years after they are adopted, unless the plan emerges from critical or endangered status. (See our October 24, 2006 *For Your Information*.)

WRERA provides that for plan years beginning during the period October 1, 2008 through September 30, 2009, the sponsor of a multiemployer plan may elect to treat its status the same as its status for the prior year. Thus, for example, a calendar year plan that is not in critical or endangered status for 2008 may elect to retain its non-critical or non-endangered status for 2009, and a calendar year plan that was in either critical or endangered status for 2008 may elect to retain such status for 2009. Plans with plan years that begin in the last three months of 2008 technically have no PPA status from the prior year; however, WRERA offers these plans relief by allowing them to have their actuary certify their PPA status as of the beginning of the 2007 plan year as if PPA applied at that time and to carry over that status to the beginning of the 2008 plan year.

WRERA also allows sponsors of multiemployer plans to elect for a plan year beginning in 2008 or 2009 to extend the funding improvement or rehabilitation period by three years.

Technical Corrections to PPA

Asset Smoothing

In determining minimum contributions under PPA, assets may be valued either by using market value or an averaged market value. The method of determining averaged market value must provide for averaging of up to 24 months, and result in a value within a 10% corridor around market value. Proposed regulations provide a strict interpretation of the PPA language, generally producing averaged market values below market value over the long term. Therefore, many plan sponsors elected not to use averaged values.

WRERA clarified that the averaging method is to be adjusted for expected earnings, which results in “asset smoothing.” The expected earnings are to be determined by the plan’s actuary based on an assumed rate of return, not to exceed the applicable PPA third segment rate.

> ***BUCK COMMENT.*** *WRERA does not include any provisions enabling sponsors to change their asset method or other funding method elections (e.g., interest rate method) for 2009. For example, many sponsors made an election for 2008 not to use an averaged market value (i.e., to use market value) because smoothing was not permitted. Now that smoothing is available, and because of negative 2008 asset performance, many plan sponsors will want to change to a 2-year smoothing method for 2009. We hope the IRS will act quickly to permit sponsors to properly take advantage of these new rules. We also hope that Congress will consider, early in 2009, legislation permitting a 20% corridor around market value.*

Target Normal Cost

WRERA requires target normal cost (including target normal cost for at-risk plans) to include the amount of plan-related expenses expected to be paid from plan assets during the plan year. Importantly, this provision is effective for plan years beginning after December 31, 2008, but sponsors may elect to apply it for the 2008 plan year. WRERA also requires target normal cost to exclude the amount of mandatory employee contributions expected to be made during the plan year.

BUCK COMMENT. *WRERA does not define plan-related expenses. Buck expects the IRS to issue guidance on the elements of expense that will be permitted to be taken into account.*

Restrictions on Small Lump Sums

Under PPA, if a plan's AFTAP is less than 60 percent, accelerated benefit payments (e.g., lump sum payments) are prohibited. Also if a plan's AFTAP is at least 60 percent but less than 80 percent, the amount of accelerated benefit payments are restricted to, in most cases, half of their value. WRERA provides that small benefits that are involuntarily cashed out (e.g., present values of not more than $5,000) are not subject to these underfunded plan restrictions.

Maximum Deductible Contributions for Defined Benefit Plans with Overlapping Defined Contribution Plan Coverage

PPA provides that for 2006 and 2007, the combined plan deductible limit (i.e., the greater of 25% of pay or the contribution made to the defined benefit plan) that is applicable to employers whose employees participate in both a defined contribution and a defined benefit plan will only apply to the extent employer contributions to the defined contribution plan (excluding elective deferrals) exceed 6% of compensation. The IRS, in Notice 2007-28, interpreted this provision in a particularly restrictive manner.

WRERA confirms the more reasonable interpretation acknowledged by Treasury in a September 13, 2007 letter. That is, if employer contributions to the defined contribution plan do not exceed six percent of compensation, the overall deduction limit does not apply; if the defined contribution plan contributions exceed six percent of compensation, only the amount of such contributions in excess of six percent are counted toward the overall deduction limit.

Cash Balance Plan Vesting

WRERA provides that the PPA special 3-year vesting rule for hybrid (e.g., cash balance) plans applies only to those participants who have at least one hour of service after the effective date of the PPA provision (generally the plan year beginning after December 31, 2007).

Roth Account Rollovers to Roth IRAs

PPA permits distributions from tax-qualified retirement plans, tax-sheltered annuities, and governmental 457 plans to be rolled over directly to Roth IRAs, subject to certain conditions. The conditions include recognition of the distribution in gross income (except to the extent it represents a return of after-tax contributions) and limited ability to roll over based on adjusted gross income. WRERA provides that rollovers from a Roth-designated account in a tax-qualified retirement plan or tax-sheltered annuity to a Roth IRA is not included in gross income and is not subject to the adjusted gross income conditions.

Conclusion

The Worker, Retiree, and Employer Recovery Act of 2008 provides for some much needed funding relief for defined benefit plans due to the economic crisis – however, employers and employer groups had been hoping for much more. The technical correction provisions are long overdue and provide definitive interpretation of many PPA provisions.

Additional funding relief will be sought as the new Congress and the Obama administration come into office in early 2009. Buck will once again be active in this effort to help sponsors of defined benefit plans weather the economic downturn.

Buck's consultants are prepared to assist you in reviewing the implications of the WRERA provisions, in developing suitable strategies for the future, and assisting in efforts to achieve additional pension funding relief.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.