



For your information

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IRS Explains Participant Notice Requirements for Funding-Based Pension Restrictions

[Notice 2012-46](#) offers IRS guidance on providing ERISA 101(j) participant notices about restrictions on benefit accruals and distributions from underfunded single-employer defined benefit plans. The guidance sensibly constrains the obligation to provide notices to just those participants and beneficiaries affected by restrictions under Code Section 436, provides model notice language, and adds a requirement to provide ERISA 101(j) notices in certain circumstances when the funding-based restrictions are lifted for plans written to allow a second chance at selecting a retirement benefit distribution option.

Background

The benefit restriction rules in Section 436 of the Internal Revenue Code (Code) (and parallel rules in Section 206(g) of the Employee Retirement Income Security Act (ERISA)) added to pension law by the Pension Protection Act of 2006 have a companion notice requirement in ERISA Section 101(j). ERISA 101(j) notices must be provided to participants within 30 days of the date certain funding-based restrictions go into effect. The IRS is responsible for providing guidance about the timing and content of these notices. The Department of Labor (DOL) is responsible for collecting penalties, under ERISA Section 502(c)(4), of up to \$1,000 per day from plan administrators for violations of the notice requirement.

The Section 436 funding-based restrictions are generally based on the plan's funding status. Funding status is measured by the plan's "adjusted funding target attainment percentage" (AFTAP), which is generally computed by determining the ratio of the plan's assets to the plan's benefit liabilities. Assets are adjusted for certain funding credit balances and distributions, if any. In the absence of an enrolled actuary's certification of the AFTAP, the AFTAP is based on certain presumptions using adjustments to prior year percentages, or a percentage of less than 60% at the beginning of the tenth month of the year. The Section 436 funding-based restrictions include:

Prohibition on the payment of UCEBs. Under this Section 436 restriction, plans are prohibited from paying unpredictable contingent event benefits (UCEBs) if the plan's AFTAP is less than 60% or if honoring UCEBs would push the AFTAP below the 60% threshold. UCEBs include shutdown benefits such as enhanced early retirement benefits that are paid solely because of "an event other than the

attainment of any age, performance of any service, receipt or derivation of any compensation, or occurrence of death or disability.”

Prohibition on amendments that increase plan benefits. Under this Section 436 restriction, plans are prohibited from implementing plan amendments that increase benefits, add new benefits, or change the rate of benefit accrual or vesting if the plan’s AFTAP is less than 80% or if honoring the amendment would push the AFTAP below the 80% threshold. *ERISA 101(j) notices are not required for this Section 436 restriction.*

Prohibition on lump sums and other accelerated payments. Under this Section 436 restriction, plans are prohibited from paying distribution options that deplete plan assets faster than life annuity options. Restricted options include lump sums, period certain annuities, and Social Security level income options. Section 436 limits any payment of these options if the plan’s AFTAP is below 60% or if the plan’s AFTAP is below 100% and the plan sponsor is a debtor in bankruptcy (or involved in a similar type of proceeding under federal or applicable state law). However, up to one-half of a participant’s benefit can generally be paid in one of these forms if the plan sponsor is not in bankruptcy and the plan’s AFTAP is below 80%, but at least 60%. The partial prohibited payment is limited to the value of the PBGC maximum guarantee under a plan termination.

Cessation of benefit accruals. Under this Section 436 restriction, future benefit accruals must cease if the plan’s AFTAP is less than 60%.

Who Must Be Notified?

Notice 2012-46 provides that, in general, the notice requirement applies to the participants who are covered under the plan (and any beneficiaries entitled to plan benefits) on the first date that the plan becomes subject to the restriction that is to be disclosed. As a result, notices would not have to be provided to individuals who become covered by the plan after that date (even if that is before the date the notice is provided).

Affected participants. Although ERISA 101(j) itself does not limit the notice requirement to just those plan participants and beneficiaries who are affected by a particular limit, in a 2009 newsletter ([October 2009 employee plan news](#)) the IRS agreed that ERISA 101(j) “does not require notice of a benefit restriction affecting the availability of lump sums to participants and beneficiaries in pay status who—without regard to any §436 restriction—can no longer elect a lump sum payment.”

Notice 2012-46 builds on this relief and more broadly excludes from the notice requirement any participants or beneficiaries who are not expected to be affected by a limit triggered under Section 436, that is, the notice is only provided to those “to whom the relevant limitation applies or could apply.” In the case of a UCEB, for example, the plan administrator would have to provide a notice to plan participants who would receive enhanced early retirement benefits if their work location is shut down, but would not have to provide the notice to participants at a different location where there were no benefit enhancements for a shutdown. In addition, the plan administrator would not have to provide the

notice to participants at the affected location if they had already attained normal retirement age under the plan and could never become eligible for the early retirement enhancement.

For prohibited distribution forms, Notice 2012-46 repeats the example in the newsletter about benefits in pay status and adds that notice about these distribution restrictions would also not be required if the only non-annuity payment form is the distribution of small benefits in an amount not in excess of the \$5,000 cash-out limitation.

When Section 436 requires all future benefit accruals to cease, the notice must be provided to any participant who would otherwise be benefiting under the plan on the date the restriction first applies to the plan. Accordingly, a notice would have to be provided to every active participant but not to former employees or beneficiaries.

INSIGHT

Other situations that will benefit from this limit on the notice requirement include plans with multiple benefit structures due to mergers and amendments where prohibited forms of payment are only available for grandfathered benefits because of anticutback protections.

Short restriction windows. Another special rule in Notice 2012-46 allows the plan administrator to avoid providing notices when a triggered benefit restriction ceases to apply during the 30-day notice period. This can happen, for example, when a restriction is triggered by one of the funding presumptions under the Section 436 rules (described above) and either the plan's enrolled actuary subsequently, before the due date of the notice, certifies that the actual funding level of the plan is above the threshold triggering the restriction or the employer makes a Section 436 contribution to bring funding up to that level.

If a restriction no longer applies during the 30-day window, Notice 2012-46 states that the plan administrator need only provide the Section 101(j) notice to individuals who were affected during the period when the restrictions applied. The determination of whether a participant is affected takes into account factors such as plan provisions that automatically restore benefit accruals or that permit participants to modify payment options when restrictions are lifted.

When Is the Notice Due?

Plan administrators must provide the ERISA 101(j) notice within 30 days after the date on which the plan becomes subject to one of the distribution or accrual restrictions, that is, the restrictions on paying UCEBs or prohibited payments due to bankruptcy or because the plan's AFTAP falls below either the 60% or 80% thresholds described above, or when accruals must cease because the AFTAP is below 60%. In most cases the date a restriction is triggered will be the date of the enrolled actuary's certification or the date a presumption first applies.

Date for UCEB notice. The date a restriction is triggered can also be the date an unpredictable contingent event occurs that would make the funding level dip below 60%. In this case the notice must be provided within 30 days of the occurrence of the unpredictable contingent event. Notice 2012-46, however, also expands the notice requirement for UCEBs to set an earlier deadline for the notice at the latest of:

- If the employer is covered by the Worker Adjustment and Retraining Notification Act (WARN Act) and the related unpredictable contingent event is an event for which a WARN Act notice must be provided, the date on which the WARN Act notice is provided
- 60 days before the related unpredictable contingent event actually occurs
- 30 days after the date the employer makes a decision to cause the related unpredictable contingent event to occur (for example, a decision to shut down a plant)

Combining notices. Separate notice requirements are generally triggered for each event, but a single notice can cover certain multiple restrictions and notices are not required for events that do not change results. For example, if a plan issues a notice describing prohibited distribution options when the funding percentage falls below 60% or the plan sponsor is a debtor in a bankruptcy case and the plan later becomes subject to the other restriction, a new notice is not required. In addition, if the plan subsequently ceases to be subject to one of the restrictions but remains subject to the other restriction, then no additional section 101(j) notice is required to be provided describing either restriction. However, if the sponsor is not a debtor in bankruptcy and the AFTAP improves from less than 60% to 60% or more but less than 80%, notice to participants would be required to announce that just the 50% prohibited payment restriction would apply.

New cessation-of-restrictions notice. In Notice 2012-46, the IRS announced an additional event for providing a participant notice under ERISA 101(j). This additional notice is required of plans that allow participants to change the distribution option for their remaining benefits where the plan is subject to one of the restrictions on paying lump sums or other accelerated payments and the restriction ceases to apply. For such situations, an ERISA 101(j) notice now must be provided within 30 days after the date on which the restriction ceases to apply.

INSIGHT

Although it is doubtful that a plan administrator would have neglected to make such an announcement, adding this as a requirement under ERISA 101(j) means that the announcement must be made by the 30-day deadline to avoid attracting the ERISA 502(c)(4) penalty for late notices.

Is a Section 101(j) Notice Needed If Accruals are Frozen by Plan Amendment?

If a plan is amended to cease all benefit accruals, an ERISA Section 204(h) notice of amendments significantly reducing the rate of future benefit accruals is needed to announce the change to plan

participants. The amendment does not trigger the need for an ERISA 101(j) notice. Notice 2012-46 clarifies that once all accruals stop, the plan administrator is not obligated to provide another notice stating that accruals are suspended due to a decline in the funding percentage below 60%. However, an ERISA 101(j) notice about the availability of UCEBs or prohibited payment forms may be needed.

Conversely, if an ERISA 101(j) notice has been provided to announce that accruals cease because the plan's AFTAP falls below 60%, Notice 2012-46 says an ERISA 204(h) notice will nonetheless be required so as to disclose that the plan was amended and that the accrual freeze will be permanent even if the funding percentage improves.

What Should the Notice Say?

Notice 2012-46 provides lists of specific information to be included in notices to participants including a list targeted at the new cessation-of-restrictions notice. The lists include identifying information such as the plan name, employer's identification number, plan number, contact information for obtaining additional information, the date the restrictions became effective (or ceased), and the class of individuals affected by the restrictions. The notice announcing benefit restrictions must also describe:

- The restrictions that apply (the benefits that cannot be paid or the fact that benefit accruals will cease) in sufficient detail to explain the difference between the plan's benefits with and without the restriction
- The reason for the restrictions (because of the plan's AFTAP level and/or bankruptcy status)
- The specific AFTAP percentage
- Whether the AFTAP that applies at the time a benefit restriction becomes applicable is a result of a certification issued by the plan's enrolled actuary or is the result of a presumption
- What will happen after the restrictions no longer apply (including a statement that a notice will be provided within 30 days after the restrictions no longer apply if the plan allows participants to change distribution elections)

When issued by a plan that allows participants to change the distribution option for their remaining benefits, the notice announcing that restrictions no longer apply must:

- Provide identifying information, as described above
- State that the restriction that had been imposed no longer applies
- Explain that the participant or beneficiary is eligible to elect the previously prohibited form of payment
- Describe any applicable deadlines and application procedures for making the new election

Notices must be written in a manner to be understood by the average participant. A single combined notice may be provided that describes multiple restrictions.

Can the Notices Be Provided Electronically?

A Section 101(j) notice must be in writing and may be furnished in any paper or electronic form that is reasonably accessible to the intended recipients. Permissible electronic methods include those permitted under DOL regulations about general disclosure rules for electronic media and those described in IRS regulations for providing ERISA 204(h) notices to participants about amendments significantly reducing the rate of future benefit accruals.

Effective Date and Request for Comments

The requirements of Notice 2012-46 are expected to be effective November 1, 2012 (beginning of the month at least 90 days after publication in the Internal Revenue Bulletin), but plan administrators are permitted to rely on the notice before that date. Plan administrators may also use a reasonable interpretation of ERISA 101(j) before that date.

The IRS seeks comments on whether additional notice requirements should apply, such as a requirement to provide notice whenever a restriction no longer applies or a requirement to provide notices to individuals who become participants or beneficiaries after the first date the applicable restriction applies. The IRS would also like comments on whether notices should be repeated on either an annual or a tri-annual basis.

Although these additional notices might be helpful to participants and beneficiaries, making such notices mandatory under ERISA 101(j) could subject plan administrators to additional \$1,000 per day penalties for failure to comply. That said, plan sponsors should consider providing notices meeting the new IRS standards or releasing general workforce announcements when funding improvements or changes in bankruptcy status eliminate the need for distribution restrictions that had previously been announced (for example, when the plan's percentage progresses from the 60% to 79% range to 80% or above).

In Closing

On balance, Notice 2012-46 is welcomed for providing certainty about the need to deliver notices to participants and beneficiaries who are truly affected by the Section 436 restrictions notwithstanding the addition of a 30-day requirement to announce restrictions that no longer apply in the limited circumstance described above.

Plan administrators will want to ensure that the content and delivery methods used for future notices comply with the standard set in this new IRS guidance. In addition, plan administrators should carefully document decisions about how they will handle notices and create records to memorialize the date on which notices are provided and the identity of participants to whom notice is provided.

Buck Can Help

- Prepare ERISA 101(j) notices in conformance with the requirements of Notice 2012-46
- Assist in creating controls and records to substantiate compliance with the notice requirements
- Frame protocols for determining which participants need to receive notices

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.
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