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PBGC proposes additional guarantee for rollover benefits

In a move aimed at encouraging plan sponsors to offer lifetime annuity benefits using funds accumulated in defined contribution plans, PBGC has proposed changes to its single-employer regulations on benefit guarantees to increase an individual's maximum guarantee by the amount of pension generated by rollover contributions to a plan.

Background

Participants in PBGC-covered plans that terminate in a distress or involuntary termination are insured against loss of plan benefits up to a specified dollar amount that is phased in over a five-year (30-years for substantial owners) period from the date the benefit is put into effect. The 2014 maximum lifetime pension guarantee is $59,318 for a 65-year-old retiree. This includes a participant's benefit from employee and employer contributions.

In 2012, the IRS issued four pieces of guidance aimed at increasing annuity options offered by plans. (See our February 27, 2012 *For Your Information*.) In one of these, Revenue Ruling 2012-04, the IRS provided a roadmap for plan sponsors willing to have their defined benefit plans accept rollovers from defined contribution plans. The IRS views such amounts as mandatory employee contributions and the accrued benefit derived from those contributions must be nonforfeitable. The plan will satisfy the nonforfeitability rules if the benefit from the rolled-over amount is the actuarial equivalent of the amount rolled over, determined by using the applicable interest rate and mortality table under Code section 417(e).

If there is a delay (generally beyond 180 days) between the rollover and the annuity starting date, interest is credited to the rollover contribution using the mandatory employee contribution rate (120% AFR). Because the amount from the defined contribution plan is considered a rollover, it is not included in determining the Code section 415 annual limits unless the plan uses a more favorable conversion basis for determining the benefit from the rollover. In that case, the difference between the actual benefit and the benefit based on the section 417(e) basis would be counted in assessing satisfaction of the section 415 limit.

At the time Revenue Ruling 2012-4 was issued, it was not clear how PBGC would treat the benefit from the rollover account. Would they view it as a voluntary contribution benefit in priority category 1, a mandatory contribution benefit in priority category 2, or an employer-provided benefit in categories 3, 4, 5 or 6?

PBGC proposes mandatory contribution treatment and additional guarantee

Following IRS' lead in Revenue Ruling 2012-04, PBGC proposes to amend their regulations for plans that terminate underfunded to provide that benefits from rollover amounts would be treated as an accrued benefit derived from mandatory employee contributions in priority category 2. Like IRS' rule for section 415, this treatment would be limited to the benefit determined using the section 417(e) interest and mortality rates and section 411 interest crediting rate (120% AFR). Any excess would be treated as an employer-provided benefit in lower priority categories.

> Buck comment. Although promoted as enabling rollovers from defined contribution plans, the amendment refers to rollovers in general and would encompass rollovers of lump sums from other defined benefit plans. This appears to allow an individual to obtain a greater guarantee from two defined benefit plans than would otherwise be available.

No lump sum. Unlike other priority category 2 benefits, benefits from rollover amounts would generally not be payable in lump sum form. PBGC reasoned that because the participant had the chance to take the distribution from another plan as a lump sum and chose to roll it into a plan to obtain annuity benefits, it would seem inconsistent to later allow the participant to convert the annuity back into a lump sum.

Add to guarantee. The participant's priority category 2 benefit from rollover amounts generally would not be subject to PBGC's maximum guaranteeable benefit limitation and would not be taken into account in applying that limitation to other plan benefits. However, the maximum guaranteeable benefit limitation would apply to any excess benefit resulting from the use of more favorable actuarial assumptions than the section 411 and section 417 rates described previously. An example of how the guarantee would work in the proposed amendment to the regulation is summarized in the following table:

<table>
<tr><th></th><th>Plan benefit</th><th>Guaranteed</th><th>Not guaranteed</th></tr>
<tr><td>Normal pension formula</td><td>$ 60,000</td><td rowspan="2">$ 59,000</td><td rowspan="2">$ 6,000</td></tr>
<tr><td>Excess from favorable assumptions</td><td>$ 5,000</td></tr>
<tr><td>Annuity based on mandated rates</td><td>$ 15,000</td><td>$ 15,000</td><td></td></tr>
<tr><td>Total</td><td>$ 80,000</td><td>$ 74,000</td><td>$ 6,000</td></tr>
</table>

No phase-in applied. The participant's accrued benefit (up to the section 411/section 417 value) resulting from rollover amounts would not be subject to the five-year or 10-year phase-in limitations on the guarantee of benefit increases. Any excess from more favorable actuarial assumptions would be subject to the phase-in limitations, with the phase-in period beginning on the date the rollover contributions were received by the plan.

> Buck comment. Using the date of the rollover is both administratively complex and a departure from the usual rule for calculating phase-ins. Normally, the phase-in is based on the later of the effective date or adoption date for the five-year phase-in and on years of active participation for the 30-year substantial owner phase-in.

In closing

The proposed amendments to PBGC's regulations would provide assurance to participants that annuitizing rollover funds through their employer's defined benefit plan will not work to their disadvantage though a reduction in their PBGC guarantee of other benefits. With the trend being for employers to de-risk and defease pension liabilities, however, this assurance is unlikely to spur plan sponsors to expand their plans to create this opportunity.

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