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IRS Finalizes Retirement Plan Funding Regulations

IRS has completed work on minimum funding regulations for ERISA single-employer defined benefit plans that had been proposed in 2008. Highlights of the highly technical instructions for actuaries of interest to plan sponsors include the ability to make a standing election to use available funding balances to pay for quarterly contributions, rules for a mid-year plan termination that can accelerate the due date for the plan's final mandated contribution, a modification adding interest credits on quarterly contributions paid early, and rational rules for applying the liquidity contribution obligation.

Background

The Pension Protection Act of 2006 (PPA) vastly changed the funding rules for ERISA defined benefit plans subject to the minimum funding requirements. For single-employer plans (including multiple-employer plans), the new funding paradigm mandated paying off unfunded liabilities over seven years, current payment for benefits that accrue during a year, and valuing liabilities based on either a 24-month average yield curve or a spot yield curve.

In response to the economic downturn that occurred shortly after PPA was enacted, the seven-year amortization requirement was modified in the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (PRA 2010) to allow plan sponsors options for stretching out payments (see our January 7, 2011 *For Your Information*). Further relief was provided in the form of changes to the mandated interest rates used for valuing liabilities in the Moving Ahead for Progress in the 21st Century Act (see our September 19, 2012 *For Your Information);* this was further modified in the Highway and Transportation Funding Act of 2014 (see our September 15, 2014 *FYI Alert)*.

IRS proposed regulatory guidance on the PPA changes in 2007 and 2008. Although some of the proposals were adopted in final form in 2009 as described in our October 28, 2009 *For Your Information*, select sections on determining the minimum required contribution remained incomplete.

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Regulatory Funding Guidance Released

On September 9, 2015, the open proposed regulations were issued in final form with few surprises.

Standing Elections

As expected, the final regulations allow plan sponsors to provide their plan enrolled actuary a written “standing election” calling for the use of the plan’s prefunding and carryover balances to satisfy quarterly contribution obligations. The standing election is deemed effective on the later of the last date for making the required quarterly contribution and the date the standing election is provided to the enrolled actuary. The election remains in effect until revoked, suspended, or replaced, or until the enrolled actuary is changed. The plan sponsor can provide a replacement election to the new actuary to permit continued use of the election. A replacement election can also be made for a plan year in which the amount of quarterly contribution is revised for updated valuation results.

Interest Credits on Quarterly Contributions

The final regulations add an interest credit at the plan’s effective interest rate on a contribution made to meet a required quarterly installment for the period from the contribution payment date to the due date for the installment. This will reduce the amount that needs to be contributed when making payments in advance of a due date.

Terminated Plans

The final regulation applies short plan year rules for mid-year plan terminations. This will change the due dates for quarterly contributions and the final contribution due 8 ½ months after the end of the plan year. As always with a plan termination, it is important that distributions to complete the termination are done promptly, else the short year calculation is lost and the plan sponsor may find that unpaid minimums are due and attract a late payment penalty.

> **Comment.** Treating the year of a mid-year termination as a short plan year for funding purposes doesn’t change due dates for other purposes, such as the Form 5500 filing due date or other reporting and disclosure obligations.

Liquidity Shortfall Contribution

Plans with insufficient liquid assets (generally the amount to pay for three years of disbursements) face an additional layer of contribution requirements aimed at assuring that a minimum level of plan assets are readily available to pay current benefits. Plan sponsors who fail to meet this obligation are subject to late payment penalties. Under the proposed regulations, it appeared that the late penalty would continue to apply in subsequent quarters even though the liquidity problem had been rectified — for example, by selling some of the illiquid investments.

Under the final regulation, the additional liquidity shortfall contribution obligation expires at the end of the quarter in which the quarterly contribution was due, leaving just the regular quarterly contribution as outstanding if it has not been paid. The liquidity contribution obligation would then be redetermined at the end of the quarter and may or may not remain a problem.

The final regulation also provides a special rule for multiple-employer plans that, if the liquidity requirement is satisfied for the plan as a whole, then it is deemed satisfied for each individual employer.

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Mergers and Spinoffs

No regulatory guidance had previously been proposed on adjusting minimum funding requirements to reflect plan mergers and spinoffs. Nothing has changed on that score — the section remains "reserved."

Effective Date

The final regulations apply to plan years beginning on or after January 1, 2016. In addition, for plan years beginning before 2016 and after 2007 when PPA came into effect, plans may rely on either these final regulations or the proposed regulations published in 2008.

In Closing

The regulation covers many technical details beyond the handful called out in this publication. These details provide important information for plan actuaries who are preparing their funding work for plan sponsors.

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