

Pension Protection Act

Filling in the Gaps

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The Pension Protection Act (PPA) was signed into law by President Bush on August 17, 2006 with a stated goal of strengthening employees' retirement security. PPA affected all types of retirement plans, including defined benefit, defined contribution and non-qualified plans. For defined benefit plans, PPA contains stricter funding rules, changes to Pension Benefit Guaranty Corporation (PBGC) premiums and age discrimination relief for hybrid plans, such as cash balance plans. However, the statutes written and changed by PPA have created a necessity for the regulatory agencies, such as the IRS, Treasury Department and PBGC, to provide guidance interpreting the law. This article summarizes the major regulatory guidance issued in 2007 as it relates to defined benefit plans.

Notice 2007-6

This notice generally focused on cash balance plans. A lump sum payment equal to a participant's cash balance account is allowed without performing a "whipsaw" calculation (whereby a participant's account balance is first increased by the plan's interest crediting rate as of the date of calculation, and then immediately discounted back at the Treasury rate as of that date—thus the "whipsaw" effect) for distributions after August 17, 2006. Further, a safe harbor defining a market rate of return for crediting interest on the cash balance account includes either the interest rate on long-term investment grade corporate bonds or the 30-year U.S. Treasury rate. In light of the favorable age discrimination provisions of PPA, the IRS also lifted the moratorium on determination letter requests for cash balance plans and has begun processing the requests which have been held since 1999.

Notice 2007-7

This notice affected defined benefit plans that paid out large lump sums which were affected by statutory limits during 2006 and changes to notice requirements related to distributions. If a defined benefit plan paid a distribution in a form other than a life annuity (including lump sums) which was

affected by IRC Section 415 during 2006, PPA retroactively amended certain assumptions that could affect the amount of distribution. The notice also provides several methods of correction. A safe harbor is made available to plan sponsors for the notice requirements related to timing and content of distribution forms when a participant elects his or her benefits.

Final Section 412 Regulations

Final regulations containing new mortality tables were provided for use in determining minimum contributions to defined benefit plans for plan years beginning on or after January 1, 2007. Clarity was provided so that plan sponsors and their actuaries could begin work to determine minimum funding requirements of their defined benefit plans for the 2007 plan year. In general, the new mortality tables caused a slight increase in funding requirements.

Notice 2007-28

This notice, in question-and-answer format, focused on the maximum tax-deductible contributions to defined benefit plans for 2006 and 2007. Higher deductible contributions were allowed based on 150% of current liability, rather than 100%

of current liability, but the interest rate assumption used to determine current liability was limited. Employers who sponsor both defined benefit and defined contribution plans (such as 401(k) plans) may have their tax deductions to defined benefit plans limited if the employer makes contributions to a defined contribution plan. This would not affect plans that only allow employee elective contributions to a 401(k) plan.

Proposed Section 430 Regulations & Revenue Procedure 2007-37

Proposed regulations provide mortality tables, including substitute mortality tables, for determining present values and funding contributions for plan years beginning on or after January 1, 2008. The proposed regulations specify that the mortality tables for the new funding rules will begin in 2008. In addition, the revenue procedure provides the method that plan

sponsors would have to follow if they elect to use substitute mortality tables based on the plan's own experience in determining funding contributions. The issuance of the mortality tables for 2008 will allow actuaries to more accurately begin projecting the impact of new funding rules that become effective in 2008.

While the guidance issued by the regulatory agencies has been helpful in clarifying the changes made by PPA, there are still many unanswered issues. Some remaining concerns include asset-smoothing techniques and how to manage credit balances in satisfying minimum contributions and avoiding the various penalties applied by PPA. Hopefully, the regulatory agencies will continue to issue timely guidance as it relates to these issues to help plan sponsors implement PPA changes.

