

Funding Your Pension

It Just Got a Little More Interesting

by Glen Gahan

Unfortunately, most pension plans have experienced huge asset losses in 2008. As a result, contribution requirements for pension plans will be significantly higher in 2009.

Many plans had a 2008 funded percentage of over 100 percent, but this will likely plummet to 80 percent or lower in 2009. For funding purposes, these large investment losses will be amortized over a period of future years and will result in much higher contributions. Employers' balance sheets will be weakened by unfunded pension liabilities; however, discount rates used for accounting purposes have risen considerably, which will lower plan liabilities and somewhat offset the impact of asset losses. This article will focus on funding implications for sponsors of private pension plans. Public pension plans face a similar funding crisis, with different implications due to the rules governing those plans.

Possible Benefit Restrictions

In addition to larger contributions, certain benefit restrictions may apply beginning in 2009:

- Partial restrictions on lump sum payments and annuity purchases apply if the plan's funded percentage is below 80 percent; full restrictions apply if less than 60 percent.
- Restrictions on plan amendments to increase benefits apply if the funding percentage is less than 80 percent.
- Restrictions on earning any additional benefits—temporarily freezing plan benefits—apply if the funding percentage is less than 60 percent.
- Prohibition of funding nonqualified retirement plans for executives if the qualified pension plan is underfunded and considered "at-risk."

With these restrictions is the requirement to notify plan participants and the Pension Benefit Guarantee Corporation of the restrictions. In addition, if your plan was less than 100 percent funded in the prior year, quarterly contributions are required for the current year.

The timing of restrictions depends on when your actuary certifies the 2009 funded percentage. For calendar plan years, the funded percentage is the ratio of plan assets to the present value of earned benefits (funding target) as of January 1, 2009. However, since the determination of the funded percentage is not known until that year's actuarial valuation is completed, funding rules presume that this funded percentage for the first three months of the plan year is the same as the 2008 certified funded percentage. If not certified by April 1, it is presumed equal to the 2008 funded percentage less 10 percent. For example, if the 2008 funded percentage is 103 percent, the presumed 2009 funded percentage as of April 1 is 93 percent. If the certification is not made by September 30, it is presumed to be less than 60 percent for the rest of the year. Until the actual 2009 funded percentage is certified by the plan's actuary, these presumed funded percentages are relied upon for any restrictions.

2009 Planning Opportunities

Plan sponsors should begin working with their actuaries now to plan for 2009. While planning, the following should be considered:

- An estimate of the 2009 funded percentage to reveal any restrictions for 2009.
- An estimate of the 2009 minimum required contribution. Investment losses will typically be amortized over seven years, with the possible elimination of carryover and prefunding balances to avoid benefit restrictions, further increasing the required contribution.
- The date that the 2009 funded percentage certification is made. Sponsors of plans that pay lump sums may have some discretion on the timing of the certification and any resulting restrictions. It may be beneficial to delay such

certification until September 30, since the actual funded percentage is likely to be less than the presumed one.

- Making additional or accelerated contributions for the 2008 plan year. Contributions for 2008 are reflected in the 2009 funded percentage.
- Using an asset valuation method that will average investment losses over two years. This could result in a 2009 value of plan assets that exceeds the market value, subject to a 10 percent corridor around market value. This may require a restatement of the 2008 actuarial valuation in order to use this method for 2009 or an application to IRS for permission to change the method for 2009. Use of such an asset method could decrease the volatility in the annual required contribution. Currently, however, most plans use the market value of assets because the IRS interpreted the averaging rules quite narrowly. These rules have made the averaging method unattractive, because over the long term, the average value will be less than market value.
- Interest Rate Selection – The assumed interest rates used to determine a plan's funding target are prescribed by the IRS. However, plan sponsors may select either the 3-segment interest rates based on the 24-month average corporate bond yields or the full yield curve based on

spot corporate bond yields. Currently, the latter rates are significantly higher, which results in a lower funding target and higher funded percentage. Current rules require the selected interest rates to be reflected consistently from year to year. Use of the full yield curve for 2009 may require a restatement of the 2008 actuarial valuation to also use the full yield curve or an application to the IRS for permission to change this method for 2009.

- If restrictions do apply, it must be decided how the plan should operate once the funded percentage exceeds restriction thresholds. For example, if benefits are frozen due to a funded percentage less than 60 percent, the plan provisions must indicate whether benefits are restored as if it were never frozen or whether only prospective benefits are earned. This will require a plan amendment.

Most of the implications of pension plan funded percentages are the result of the Pension Protection Act, which was effective beginning in 2008. Employer and professional associations have been lobbying Congress for relief from some of these new and complex rules. As of the writing of this article, it appears likely that some relief will be available for 2009.

