

Recent Pension Plan Regulations Increase Flexibility in Plan Funding

by Glen Gahan, FSA

Final regulations are now in place, allowing for-profit and not-for-profit employers to add flexibility in pension plan funding.

Defined benefit plan sponsors have had concerns about the impact of the economic downturn of 2008 and early 2009 on retirement plans. For the immediate future, however, limited relief appears to be at hand. Employers may select among available interest rates and asset valuation methods used to determine the annual required contribution, with automatic IRS approval for the 2009 and 2010 plan years. This flexibility allows most plans that were considered well funded in 2008 (prior to the financial market meltdown) to be considered fairly well funded again in 2009. The funding relief defers the amount employers need to contribute to their pension plans, decreases the contributions otherwise required for 2009, provides employers with additional time to fund their plans and allows the markets to rebound. In addition, strong investment returns in 2009 will help moderate required contributions in 2010.

One hallmark advantage of pension plans is the ability plan sponsors have to fund more during good times and less during lean times. This benefit continues under current pension laws as long as the plan maintains at least an 80% funded ratio. Contributions in excess of the minimum required can be used to establish a "credit balance," which is available to offset future years' required contributions, thereby allowing employers to prefund their pension obligations, receive a current tax deduction and contribute a reduced amount (and possibly nothing) in later years when making a contribution might cause financial hardship.

Timing Contributions

Plans that are less than 100% funded are required to make quarterly contributions. This requirement is not an additional contribution, as these contributions count toward the plan's required minimum. They merely represent an accelerated timing. Credit balances may be used to satisfy these quarterly

contributions. Plan sponsors should take care to either make their quarterly contributions, or notify their actuary if they will use a portion of the credit balance to satisfy the quarterly contribution requirement in advance of each due date. Late contributions (or notification to use the credit balance) will be discounted by a 5% interest penalty for the period the contribution (or notification) is late. Also, employee notices are required if a contribution is over 60 days late.

Standing Elections

The recent final regulations also give employers the ability to make standing elections to use the credit balance to satisfy any end-of-year minimum required contribution and to automatically establish the maximum credit balance in years they make contributions in excess of the minimum required. Currently, standing elections to use the credit balance to satisfy quarterly contribution requirements are not available. The IRS has indicated that pending regulations covering quarterly contributions will address the use of credit balances to satisfy quarterly contribution requirements.

2010 Planning

Employers and actuaries should work together to determine the best assumptions and methods for 2010. These decisions will generally be used consistently for future years, without automatic IRS approval to change methods. The available methods differ in the smoothing, or averaging, period to determine plan asset values and discount rates used to determine plan liabilities. The longer the smoothing period, the less volatile the annual required contributions and funded ratios.

