Pension Protection Act of 2006:
Single-employer Defined Benefit Plans

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CAVEAT

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Pension Protection Act of 2006:
Single-employer Defined Benefit Plans

- Single-employer funding requirements
- Cash balance plans
- Disclosure
- EGTRRA permanence
- Miscellaneous

- Not within the scope of this presentation:
  - Defined contribution plans
  - Government plans
  - Multiemployer plans

PPA 2006:
Single-employer Funding Rules

Funding During 2006-2007

- Extension of corporate bond interest rates for current liability
  - For 2006, rate stays at 5.77% instead of dropping to 5.10%, based on the 30-year Treasury rate
- Increase in deductible limit from 100% to 150% of current liability
  - Allows plan sponsors to make additional contributions to improve funding ratios before PPA's effective date in 2008

Additional Pre-PPA Funding

- If a deficit reduction contribution does not apply for 2007, the plan is exempt from shortfall amortization beginning in 2008. Extra contributions for 2006 to avoid 2007 DRC may reduce 2008 contribution requirements.
- If assets at the beginning of 2007 are less than 80% of liabilities, a credit balance cannot be used to meet contribution requirements. Extra contributions for 2006 can help you avoid this problem.
- If assets that are reduced by a credit balance at the beginning of 2007 are less than 65% of liabilities, higher "at-risk" amounts may apply for 2008. A permanent release of part of a credit balance in 2007 may allow you to avoid this problem (if permitted by IRS).

New Funding Rules Under PPA

- Total reform of minimum funding standards
- Restrictions on asset smoothing
- Use of yield curve to value liabilities
- New mortality table with projections
- Higher contributions for “at risk” plans
- Benefit restrictions for severely underfunded plans
- Increase in limit for deductible contributions

Reform of Minimum Funding Standards

- Funding target = 100% of present value of accrued benefits based on yield curve and new mortality table (phased in over three years starting at 92% in 2008)
- Target normal cost—present value of benefits accruing during the year, including the effect on salary increase on past service benefits
- Shortfall amortization—seven-year charge based on difference between funding target and assets (excluding credit balance)
- Funding waiver amortizations charges

Accelerated Amortization

- Shortfall amortization—seven-year charge based on difference between funding target and assets reduced by credit balance
- Faster amortization for amendment costs and assumptions changes
- Amortization bases eliminated when assets reduced by credit balance exceed liabilities
  - Release of credit balance can eliminate shortfall amortization
- Exempt from new shortfall base if assets reduced by *new* credit balance exceed liabilities
  - Additional contributions can avoid shortfall amortization charges

“At-risk” Rules

- Additional contribution requirements—if assets reduced by credit balance are less than 80% (phased in from 65% in 2008) of liabilities AND less than 70% of at-risk liabilities (no phase-in)
- Extra liability loads—if plan was “at-risk” in at least two of the preceding four plan years
- Extra contribution amounts phased in over five consecutive years of at-risk status
- Prior-year planning
  - Elective release of credit balance in a preceding plan year can avoid “at-risk” status
  - Extra “at-risk” contribution amounts may not be significant for some plans

Increased Deductible Limits

- Maximum tax-deductible contribution increased significantly
  - based on 150% of funding target including effect of future salary increases
  - wider range of permissible contributions gives plan sponsors greater flexibility in setting funding budgets

Illustration 1 – Underfunded Frozen Plan

Funding target	$ 11,492
Plan assets	5,898
Credit balance	813
Shortfall amount	6,407
Funding percentage	44%
Normal cost	$ 0
Shortfall amortization	1,137
Required contribution	1,137
Maximum deductible contribution	11,340

Illustration 2 – Well-funded Plan

Funding target	$ 33,048
Plan assets	37,811
Credit balance	394
Shortfall amount	0
Funding percentage	113%
Normal cost	$ 0
Shortfall amortization	0
Required contribution	0
Maximum deductible contribution	15,066

Illustration 3 – Large Credit Balance

Funding target	$ 13,802
Plan assets	12,985
Credit balance	3,324
Shortfall	4,141
Funding percentage	70%
Normal cost	$ 280
Shortfall amortization	0
Required contribution	280
Maximum deductible contribution	9,098

Restrictions on Asset Smoothing

- Asset values may be averaged over no more than 24 months
- Averaged asset values must be within 90%–110% of market values
- Actuarial value of assets is now likely to be more volatile, particularly during periods of extended gain or loss

Yield Curve

- Yield curve based on corporate bond rates
  - Three segmented rates—years 1–5, 6–20, and 20+
  - Reflection of cash-flow duration—liabilities and costs under a yield curve will be higher for more mature plans and plans with lump sums, e.g., cash-balance plans
  - Phased in over three years

Yield Curve

- Employer elections
  - Timing—may elect to use yield curve up to four months before valuation date
  - Full curve vs. segments—may elect to use full yield curve (for example, to more closely match an immunized portfolio of assets)

New Mortality Table

- Treasury to issue new table to replace the 1983 Group Annuity Mortality Table
- New table will include projected mortality improvement up to valuation year and possibly into the future
- New mortality could increase liabilities by as much as 10% to 15%

Benefit Restrictions

- Restriction on lump-sum distributions—if adjusted assets are less than 80% of liabilities
- Restriction on accruals—if adjusted assets are less than 60% of liabilities
- Restriction on certain amendments—if adjusted assets are less than 80% of liabilities
- Restriction on shutdown benefits—if adjusted assets are less than 60% of liabilities

Benefit Restrictions – Additional Rules

- Presumption of applicability of restrictions
  - At fourth month if previous funded ratio is within 10 percentage points of a restriction
  - At tenth month for all other instances
- Forced release of credit balance
  - Restriction on lump sums—all plans
  - Other benefit restrictions—collectively bargained plans

Note: A sufficient additional contribution can avoid forced release of credit balance

Credit Balances

- Segregated between pre-2008 (“Carry-over Balance”) and post-2007 (“Prefunding Balance”)
  - Certain key rules reduce assets only by prefunding balance:
    - Exemption from establishing shortfall amortization base
    - Eligibility to use credit balances for minimum required contribution
  - Carry-over balances must be used or released before prefunding balances

Credit Balances – Additions and Subtractions

- Extra contributions –
  - If the extra amount is not made under benefit restriction rules
  - May elect not to have extra contributions increase prefunding balance
- Use for minimum required contribution
  - Available if assets reduced by prefunding balance are greater than 80% of liabilities

Credit Balances – Additions and Subtractions

- Elective release
  - Permanent elimination of ability to use for minimum contribution requirement
  - May help plan avoid other rules, such as at-risk status
- Forced release for benefit restrictions
- Investment experience
  - Increase or decrease in credit balances based on prior year investment experience of plan assets

Funding Budgets Under PPA

- Separate valuation of projected benefits
  - no restrictions on methods or assumptions
  - conservative projections to set a predictable budget at levels in excess of PPA minimum and fully deductible
- Projections and modeling
  - determine need for additional contributions or credit balance forfeiture before year end to avoid “at-risk” status or other undesirable results
  - initial projections should be made in 2006 for 2007

PPA 2006:
Cash Balance and Other Hybrid Plans

PPA 2006 – Hybrid Pension Plans

- Three-year cliff vesting
- Relief from whipsaw
- Age discrimination based on accrued benefit
- Plan terms for plan termination
- No inference

Hybrid Pension Plans Under PPA

- Three-year cliff vesting requirement
  - Required for all hybrid plans
  - Effective 2008
- Relief from whipsaw
  - Lump sum may be equal to account balance
  - Interest rate requirements: 0% to market rate

Hybrid Pension Plans Under PPA

- Age discrimination based on accrued benefit of similarly situated employees
  - Practical effect will be to legitimize typical hybrid plan design
  - No wearaway upon conversion ("A+B")
- Plan terms for plan termination
  - Plan must be amended to provide for protection of interest credits upon termination of plan
- "No inference"
  - Litigation and regulation of past practice unaffected by PPA

PPA 2006:
New Disclosure Requirements

Funding Notice

- New requirement for single employer plans
  - Effective for plan years beginning in 2008
  - To be provided **within 120 days after the end of the plan year**
  - Provided to:
    - PBGC
    - Participants and beneficiaries
    - Unions
  - DOL to issue model funding notice within one year

Benefits Statements

- Participants in defined benefit plans must be provided statements at least once every three years or notified annually of the availability of a statement upon request.
- DOL is to develop model benefit statement within one year after the date of enactment.
- Effective after 2006

4010 Disclosure to PBGC

- New standard for reporting beginning in 2008:
  - Pension plans that have a funding percentage of less than 80% (replaces the current threshold of $50 million in unfunded liabilities)
  - Must include plan actuarial and employer financial information including the amount of benefit liabilities (using PBGC assumptions), the funding target, and funding percentage

Other Disclosures

- Plans in a distress or involuntary termination situation must also provide any information provided to the PBGC to participants and beneficiaries within 15 days of either a request by an affected party or new information being provided to PBGC relating to a previous request.
- The Summary Annual Report requirement for DB plans will be eliminated in 2008.

PPA 2006:
EGTRRA Permanence

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- Eliminates 2010 sunset provisions
- Increased thresholds and limits
  - Potential GAAP reporting implications
- Simplification of top-heavy rules
- Deductibility rules

PPA 2006:
Miscellaneous Provisions

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- Restriction on funding of non-qualified deferred compensation for sponsors of certain underfunded pension plans
- 75% joint and survivor annuity option
- Notice and consent requirements
- Phased retirement
- 415 limit on lump-sum distributions

QUESTIONS ?