

CLIENT ACTION BULLETIN

December 18, 2008

CAB 08-24R

PPA Technical Corrections, Pension Funding Relief Enacted

SUMMARY In a surprising development, Congress approved and sent to the President the “Worker, Retiree, and Employer Recovery Act of 2008” (H.R.7327) (WRERA) during the final “lame duck” legislative session in December. The significant, coordinated lobbying efforts by employers and other retirement plan sponsors, benefits practitioners, labor organizations, and retirees led to the successful outcome: both the House and the Senate quickly approved the measure—introduced only on December 10—under unanimous consent agreements on December 10 and 11, respectively, despite strong concerns initially voiced by the Administration on some of the provisions. The President is expected to sign the bill into law.

The WRERA makes technical corrections to the 2006 Pension Protection Act (PPA), provides temporary funding relief to defined benefit plans in light of the current economic crisis, and grants a waiver of the required minimum distribution rules for 401(k), 403(b), 457(b), and other tax-qualified defined contribution retirement vehicles (including IRAs) for 2009. The WRERA eases the strains, both economically and administratively, immediately confronting retirement plan sponsors and could allow retirees to avoid distributions from accounts already depleted by investment losses.

This *Client Action Bulletin* focuses on the WRERA’s provisions that present immediate or near-term opportunities and activities for retirement plan sponsors.

DISCUSSION Defined Benefit Plan Funding Relief

For single-employer plans, the WRERA eliminates the so-called “cliff” transition rule, thereby allowing plans at or below the PPA’s 92% funding target in 2008 (or 94% in 2009, or 96% in 2010) to be eligible for transition relief. Plans that were not subject to the deficit reduction contribution (DRC) requirement will be able to determine contribution requirements for 2008 by comparing plan assets to 92% of the funding target (94% in 2009, 96% in 2010), and amortizing the shortfall over seven years. The WRERA does not grant relief for plans that were subject to the DRC in the 2007 plan year.

The WRERA also includes a “look-back” provision for purposes of determining whether a plan must be frozen. For plans that are less than 60% funded, the PPA required benefit accruals to cease, and prohibited certain payments (e.g., lump sums) and plant shutdown or similar “contingent event” benefits. For plan years beginning during October 1, 2008, through September 30, 2009, the WRERA allows plans to use the first day of the prior plan year as the date on which a plan’s funding level triggers the freeze. Note that this does not change the restrictions on benefits (such as lump sums and benefit improvements) from plans that are less than 80% funded.

Relief from Required Minimum Distribution (RMD) Requirements

In light of the current economic crisis, the WRERA provides a one-year waiver of the requirement that defined contribution plans (and IRAs) make minimum distributions to individuals who have attained age 70-1/2. The WRERA allows for RMDs not to be made for calendar year 2009 (i.e., where the amount would be based on the value of an individual’s account at the end of 2008). Because WRERA provides no relief for 2008, individuals who attained age 70-1/2 during 2008 must receive their 2008 RMD no later than April 1, 2009.

Other Key Provisions

The WRERA also addresses:

- **Asset smoothing** – The value of defined benefit plan assets may be adjusted—or “smoothed”—to reflect contributions, distributions, and expected earnings over a period of no more than 24 months. Under WRETA, this change has retroactive effect to January 1, 2008. As such, the PPA’s asset “averaging” (where assets are not adjusted by expected earnings) may no longer be available. The interest rate for expected earnings under the WRETA is capped at the third-segment rate used in the calculation of the plan’s funding target. For calendar year plans, this third segment rate was approximately 6.4%. The WRETA, however, does not alter the smoothing corridor, and thus the smoothed value must be at least 90% and not more than 110% of the fair market value of the plan’s assets.
- **Plan expenses** – In determining a plan’s “target normal cost,” amounts of plan-related expenses expected to be paid from plan assets during the plan year are included, effective beginning after December 31, 2008, and elective for the preceding plan year.
- **“Market rate of return” for governmental plans** – Defined benefit plans sponsored by state and local governments may use any rate of return or method of crediting interest established by state or local law that does not violate the Age Discrimination in Employment Act’s requirements.
- **Benefit restrictions** – Lump sums of less than \$5,000 that can be distributed without the participant’s consent will not be considered “prohibited payments” and may continue to be paid by plans that are otherwise subject to the benefit restrictions on plans that are less than 80% funded.
- **Cash balance/hybrid plan corrections** – For hybrid defined benefit plans, the WRETA clarifies that the PPA’s vesting rules are effective on the basis of plan years and apply to participants with an hour of service after the applicable effective date for the plan. In addition, the PPA’s interest crediting rules for plans in existence on June 29, 2005, apply to years beginning after December 31, 2007, unless the sponsor elects earlier application. The WRETA also clarifies the effective date of the vesting and interest crediting rules for collectively bargained plans.
- **Combined plan deduction** – The WRETA clarifies the combined plan deduction limit (i.e., 25% of compensation) for defined benefit and defined contribution plans covering the same employees. The WRETA also allows for an increase in the deduction limit for single-employer plans that are not covered by the Pension Benefit Guaranty Corporation.
- **Small defined benefit plans** – For plans with 100 or fewer participants, a fixed 5.5% interest rate may be used in determining maximum lump sums, effective for plan years beginning in 2009. For quarterly contributions and the determination of the applicability of benefit restrictions, special rules to be prescribed by the IRS will apply to small plans that have a valuation date other than the first day of the plan year.
- **For multiemployer plans**, the WRETA permits a sponsor to freeze its current funding certification for one year based on the previous year’s level, effective for plan years starting between October 1, 2008, and October 1, 2009. A plan sponsor making this election does not have to update the funding improvement or rehabilitation plan schedules until the following year. For example, if a plan was “green” (not endangered or critical) for a plan year beginning January 1, 2008, but would otherwise be endangered or critical in 2009, the plan sponsor may elect to retain the “green” status for 2009. The WRETA also provides sponsors an election to extend—from 10 years to 13 years—the current funding improvement or rehabilitation periods for plans in critical or endangered status in 2008 and 2009.

ACTION

The WRETA includes a broad range of much-needed corrections to the PPA and provides some targeted relief for plan sponsors during the current economic crisis. Plan sponsors should take these new rules into account in their continuing discussions with their actuaries as they plan their funding strategies for 2009 and beyond.

For additional information about the WRETA, please contact your Milliman consultant.