


# What DB Administrators Need to Know About PPA

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A stylized silhouette of a mountain range in shades of teal, located at the bottom right of the slide.

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Dedicated to Helen Dobrow who passed away January 14.



# What We Will Cover

- ◆ Benefit restrictions: who they apply to and when they apply
- ◆ New rules for determination of the 417(e) lump sum
- ◆ New maximum deduction rules applicable in 2008
- ◆ New funding rules for minimum required contributions

# The New World Order

- ◆ Is it black helicopters circling?
- ◆ Is it the government secretly planting chips under our skin?
- ◆ No it's.....PPA 2006

# Can the Plan pay lump sums?

- ◆ Under PPA, a plan can only pay full lump sum benefits if its AFTAP (a measurement of its funded status) is 80% or more.
- ◆ What is the AFTAP?  $AFTAP = \frac{\text{Adjusted Funding Target Attainment Percentage} = \text{Assets} - \text{Credit Balances}}{\text{Target Liability}}$

Target Liability

with an adjustment for annuity purchases for NHCEs in the last two years

# Can the Plan pay lump sums?

- ◆ Target Liability = Value of accrued benefits at the beginning of the year, valued at segment rates

# Practical Impact of AFTAP Restrictions

- ◆ *Before* any benefit payments can be processed in the 2008 plan year
- ◆ *Before* any amendments to increase benefits in the 2008 plan year
- ◆ Must first determine AFTAP to see if any restrictions apply!

# Example

- ◆ At 1/1/08, assets = 1,000,000
- ◆ Credit balances = 100,000
- ◆ Target Liability = 1,200,000
- ◆ 2008 AFTAP =  $900,000 \div 1,200,000$   
= 75%
- ◆ We'll come back to this example later

# Restrictions

## If the AFTAP is less than 60%

- ◆ Accruals are deemed to be frozen
- ◆ **No** lump sums can be paid to anyone
  - **No** *deminimus* amounts (but this may possibly change via technical corrections)
- ◆ **No** amendments to increase benefits
- ◆ Notice requirement

# Restrictions: If the AFTAP is between 60% and 80%

- ◆ **No** amendments to increase benefits
- ◆ Lump sums are *restricted* to the lesser of  $\frac{1}{2}$  of the PVAB, or the PV of the max PBGC guaranteed benefit – again, no de minimus amount (but this will possibly change via technical corrections)
- ◆ No one can be paid more than  $\frac{1}{2}$  of their PVAB
- ◆ Notice requirement

# Restrictions: For New Plans (in existence less than 5 years)

- ◆ New plans: only restriction in first five years is the inability to pay lump sums
- ◆ But certification requirement still applies

# Annual Certification Requirement

- ◆ All plans must have an AFTAP certification done by an actuary every year, which must be provided in writing to the Plan Administrator

# Participant Notices

- ◆ All Participants must be notified within 30 days of any restriction
- ◆ Includes freezing of the plan
- ◆ Restrictions on lump sums
  - No lump sums, or
  - $\frac{1}{2}$  of PVAB

# The PPA Certification

- ◆ If the 2008 certification is not done by 10/1/08 (for a calendar year plan)
- ◆ Plan is deemed to be less than 60% funded
- ◆ All the associated restrictions and notice requirements apply
- ◆ *Until* the 2009 AFTAP certification is done

# The PPA Certification Practical Impact

- ◆ Must have the 12/31/07 data on every plan early enough for actuary to do all the 2008 AFTAP certifications by 10/1/08 at the latest to avoid the deemed freeze
- ◆ Big problem for sole props and partnerships (beginning or end of year valuations) – might not get the 2007 Sch. C income until after 10/15/08

# Do We Care on a 1 Person Plan?

## Yes, Because...

- ◆ The deemed freeze applies till the '09 AFTAP is certified
- ◆ Plan will probably need to be amended to apply accruals retroactively to the beginning of the year
- ◆ When the freeze is revoked, this will probably count as an amendment increasing benefits, so cannot count for the max deductible limit under the 50% cushion rule

# Presumed AFTAP

- ◆ Can rely on 2007 AFTAP certification for paying benefits in 2008, until 2008 AFTAP certification is done, because:
  - The plan is presumed to be at 2007 AFTAP percentage less 10%, until 2008 AFTAP is certified.
- ◆ As long as 2007 AFTAP has been certified to be more than 90%, no restrictions in 2008, until the 2008 AFTAP is certified (which must be done by 10/1/08)

# Benefit Restrictions

- ◆ If neither the 2007 or 2008 AFTAPs have not been certified by April 1, 2008 the plan is deemed to be less than 60% funded on this date and the associated restrictions apply!
- ◆ Restrictions continue until the certifications are done
- ◆ If this happens, participants must be given notice of the restriction by April 30th
- ◆ Need to do all the 2007 AFTAP certifications ASAP unless 12/31/07 data is available to do an '08 certification!

# Sample AFTAP Certification

January 2, 2008

Administrator of the  
[Plan Name]  
[Address]  
[City][State][ZIP]

## Certification of Adjusted Funding Target Attainment Percentage (AFTAP)

The Pension Protection Act of 2006 (PPA) and Section 436 of the Internal Revenue Code require the calculation of a funding ratio called the Adjusted Funding Target Attainment Percentage (AFTAP) in order to determine whether the Plan is subject to new limits on plan amendments, lump-sum distributions and benefit accruals, starting in 2008.

### Determination of AFTAP as of January 1, 2007 (2007 AFTAP)

1. RPA '94 Current Liability \$103,000
2. a. Actuarial Value of Assets \$129,000  
b. Credit Balance in Funding Standard Account \$0  
c. Assets, not adjusted for Credit Balance \$129,000
3. Funding Target Attainment Percentage 125.2%  
(equals Line 2c divided by Line 1)
4. Adj. for Annuity Purchases for NHCE's last 2 years \$0
5. 2007 AFTAP is \$125.2%\*

\_\_\_\_\_  
Norman Levinrad, COPA, EA, FSA, MSPA  
Enrollment Number 05-03882

\_\_\_\_\_  
Date

- If AFTAP is 90% or higher, there are no benefit restrictions before October 1, 2008

# Sample cover to client

Dear Client:

The Pension Protection Act of 2006 has introduced new reporting requirements, one of which is an annual actuarial certification of your plan's funding level. This certification is used to determine if there are any restrictions on your plan's ability to pay benefits. This certification is referred to in the law as the "AFTAP certification". We have attached the 2007 AFTAP certification for your plan. The plan's funded level for 2007 is 125.2%, which means that the presumed funding level for 2008 is 115.2%, and because this exceeds 90% there are no restrictions on the plan's ability to pay lump sum payments from now until the 2008 AFTAP is certified.

The next step will be to certify the 2008 AFTAP. If the 2008 AFTAP is not certified by October 1, 2008, then your plan will be deemed to be less than 60% funded on that date, which means that accruals will be frozen; the plan cannot be amended to increase benefits, no lump sum payments can be made; and participants must be notified of this restriction by October 31, 2008. In order for us to do the 2008 AFTAP certification timely, we must have your December 31, 2007 census and trust data by August 15, 2008 at the very latest. If we get the data after this date, then there is no guarantee that we will be able to get this certification done timely and your plan could end up deemed to be less than 60% funded as of October 1.

Please call if you have any questions about this.

# End of Year Valuations for Small Plans (< 100 participants)

- ◆ Proposed regs gave no guidance
- ◆ Notice 2008-21 just issued – good faith compliance to follow the law until 2009 plan year, when proposed regs become effective
- ◆ Applicable for 2006, 2007, and 2008 plan years
- ◆ Determination of FTAP

Value of Net Plan Assets  
Current Liability + Increase in CL

# End of Year Valuations for Small Plans (< 100 participants)

- ◆ 2007 presumed FTAP: adjust value of net plan actuarial assets by:
- ◆ Increasing assets by 2006 contributions (regardless of when made)
- ◆ Adjust such assets to be within 90% - 110% of FMV corridor
- ◆ Subtract credit balance at end of 2006 plan year unless value of plan assets is greater than or equal to 90% of plan's current liability

# Benefit Restrictions

- ◆ For purposes of the 2007 or 2008 AFTAP, we can include in the assets receivable contributions for 2007
- ◆ Only 2007 receivable contributions are counted!
- ◆ For years after 2007, only contributions actually made by the AFTAP certification date can be counted in the plan assets –
  - Wait to do the certification if those assets are necessary to avoid a restriction
- ◆ Credit balances must be “burnt” to the extent necessary to avoid a restriction

# Benefit Restriction Example

- ◆ At 1/1/08, assets = 1,000,000
- ◆ Credit balances = 100,000
- ◆ Target Liability = 1,200,000
- ◆ AFTAP =  $900,000 \div 1,200,000 = 75\%$
- ◆ \$60,000 of the credit balances are automatically “burnt” to avoid a restriction
- ◆ AFTAP =  $(1,000,000 - 40,000) \div 1,200,000 = 80\%$
- ◆ So this plan must burn \$60,000 of its credit balance to avoid a restriction.

# Restrictions = Consulting

- ◆ Actuaries will likely only issue the '07 and '08 certifications now if there are no restrictions
- ◆ If there are restrictions, actuaries will need to start the consulting process with the client to look at their choices:
  - Additional contributions
  - Impact of restrictions
- ◆ Should you allow benefits to be paid if not yet certified, but if you know they would be restricted if you certified?

# No AFTAP Restrictions: Can Lump Sums be Paid?

- ◆ The normal restrictions on paying the top paid 25 HCEs still apply
- ◆ Still restricted from paying lump sums to HCEs if the assets (after the distribution) do not exceed 110% of the current liability
- ◆ **NOTE:** Current liability is not defined for 2008 and later plan years

# How is the 417(e) lump sum calculated?

- ◆ As with pre-PPA, the lump sum is the maximum of:
  - Lump sum under plan rates, or
  - Lump sum under 417(e) rates
- ◆ 417(e) rate used to be a single rate
- ◆ Now it is tied to 3 segment rates, with a phase-in to the full segment rates over 5 years (80% old rules; 20% new rules for 2008)
- ◆ IRS issues the 3 segment rates monthly for 417(e) purposes, which already reflects the phase-in

# How is the 417(e) lump sum calculated?

- ◆ Based on October 2007 interest rates
- ◆ Pre-PPA basis: 4.77%
- ◆ PPA basis: 5.17%, 6.02%, 6.38%
- ◆ Weighted average for 2008
  - 4.85% [80% X 4.77% + 20% X 5.17%]
  - 5.02% [80% X 4.77% + 20% X 6.02%]
  - 5.09% [80% X 4.77% + 20% X 6.38%]

# Segment rates

- ◆ First rate applies to benefit payments in the first 60 months
- ◆ Second rate applies to payments in the next 180 months
- ◆ Third rate applies to payments more than 240 months away

# Example

- ◆ Assume segment rates are 5% for the first five years; 5.5% for the next 15 years; and 6% after 20 years
- ◆ This means payments in the first five years are valued at 5%; payments from 5 to 15 years are valued at 5.5%; payments after 20 years are valued at 6%

# Lump Sum Calculation

- ◆ So if a participant is exactly age 62, with an accrued benefit of \$100 a month for life, the 417(e) lump sum is valued as:
  - The PV at 5% of a temporary annuity of \$100 per month payable from 62 to 67; plus
  - The PV at 5.5% of a deferred and temporary annuity of \$100 per month payable from 67 to 82; plus
  - The PV at 6% of a deferred annuity of \$100 per month payable from 82

# More Examples

- ◆ Assume a terminated participant is age 25 with RA 65
- ◆ Benefits are more than 20 years away so the 3<sup>rd</sup> segment rate of 6% applies
- ◆ PV calc is the same as it was before:  
determine APR at age 65 at 6%;  
discount benefit at 6% from 65 to 25

# Lump Sum Calculation

- ◆ Assume the participant is age  $58\frac{1}{2}$ , with RA 62
- ◆ The 417(e) PVAB is:
  - The PV at 5% of a deferred and temporary payment of \$100 per month payable for 18 months from 62 to  $63\frac{1}{2}$ , discounted 42 months from 62 to  $58\frac{1}{2}$ ; plus
  - The PV at 5.5% of a deferred and temporary payment of \$100 per month from  $63\frac{1}{2}$  to  $78\frac{1}{2}$ , discounted 60 months from  $63\frac{1}{2}$  to  $58\frac{1}{2}$ ; plus
  - The PV at 6% of a deferred payment of \$100 per month from  $78\frac{1}{2}$  for life discounted 240 months from  $78\frac{1}{2}$  to  $58\frac{1}{2}$

# Lump Sum Calculations

- ◆ If a participant's benefits are more than 20 years away, can still determine the lump sum based on age nearest and it will only change when the age nearest changes, or when the plan year changes;
- ◆ But if payments are within 20 years, then the lump sum amount changes monthly!
- ◆ Is it reasonable to assert that the lump sum can be held constant for 90 days from the annuity commencement date (unless the plan year changes)?

# Calculating the APR is now difficult!

## Generalized Present Value Formula for Three Tiered Segment Rates Under PPA with Certain Annuity of Any Length

$$\left[ \frac{D'_c}{D'_{CA}} \text{ or } (1+i')^{-(C-CA)} \right] * \left[ \ddot{a}_{CP'}^{(12)} + \left[ \frac{N'_{(C \leq [CA+5]+CP')} - \left(\frac{11}{24}\right) * D'_{(C \leq [CA+5]+CP')}}{D'_c} \right] - \left[ \frac{N'_{CA+5} - \left(\frac{11}{24}\right) * D'_{CA+5}}{D'_c} \right] \right] +$$

$$\left[ \frac{D''_c}{D''_{CA}} \text{ or } (1+i'')^{-(C-CA)} \right] * \left[ \ddot{a}_{CP''}^{(12)} + \left[ \frac{N''_{([C \geq [CA+5] \& [CA+20]+CP'') - \left(\frac{11}{24}\right) * D''_{([C \geq [CA+5] \& [CA+20]+CP'')}}{D''_c} \right] - \left[ \frac{N''_{CA+20} - \left(\frac{11}{24}\right) * D''_{CA+20}}{D''_c} \right] \right] +$$

$$\left[ \frac{D'''_c}{D'''_{CA}} \text{ or } (1+i''')^{-(C-CA)} \right] * \left[ \ddot{a}_{CP'''}^{(12)} + \left[ \frac{N'''_{(C \geq [CA+20]+CP''') - \left(\frac{11}{24}\right) * D'''_{(C \geq [CA+20]+CP''')}}{D'''_c} \right] \right]$$

Where:

CA = Current Age  
C = Commencement Age

$i'$ ,  $i''$  and  $i'''$  are segment rates 1, 2 and 3

$CP'$  = Certain Period overlap in first segment  
 $CP''$  = Certain Period overlap in second segment  
 $CP'''$  = Certain Period overlap in third segment

$D'$  = D using first segment rate  
 $D''$  = D using second segment rate  
 $D'''$  = D using third segment rate

$N'$  = N using first segment rate  
 $N''$  = N using second segment rate  
 $N'''$  = N using third segment rate

Notes

Use D/D in each term when using pre-retirement mortality, otherwise use (1+i) construct

This formula is predicated on pre-determining the values of  $CP'$ ,  $CP''$  and  $CP'''$

For example, if CA = 61.83333 and C = 65.33333 and certain period is 10 years, then  $CP'$  is 18 months, and  $CP'''$  is 8.5 years.

# Lump Sum Calculations

- ◆ Hard now to calculate lump sum values manually because of the complexity of calculating the APRs
- ◆ Without actuarial tools or knowledge of commutation factors (the  $N$ s and the  $D$ s), you will not be able to check the calculations

# PPA Deduction Rules for 2008 and Later



# Maximum Deduction Limit in 2008

- ◆ Target normal cost, plus
- ◆ 50% of the applicable funding target, plus
- ◆ An allowance for future pay or benefit increases, minus
- ◆ Plan assets

# PPA 404(a)(7) change

- ◆ Effective for fiscal years beginning January 1, 2008
- ◆ If a plan is covered by the PBGC
- ◆ The 404(a)(7) limit will not apply at all regardless of the level of PS contributions
- ◆ Allows a maximum PS and a maximum DB design for larger firms
- ◆ Design focusing on the minimum contribution for the employees necessary to pass the general test

# New Funding Rules For Defined Benefit Plans

The background is a solid teal color. At the bottom right corner, there is a silhouette of a mountain range in a slightly darker shade of teal.

# Old Funding Rules

- ◆ Actuary had a choice of different funding methods and selected the interest and mortality assumptions, as well as other assumptions (turnover, salary scale, disability rates, rates of retirement etc.)
- ◆ Funding method governed minimum required and maximum deductible contributions
- ◆ Plans with more than 100 participants could be subject to accelerated contributions if insufficient funding (deficit reduction contribution)
- ◆ Maximum deductible contribution: 100% of current liability less current assets

# New Funding Rules for Defined Benefit Plans

- ◆ Effective in 2008: Single actuarial method for computing minimum contribution
- ◆ Prescribed interest rates and mortality table (actuary still selects other assumptions)
- ◆ Switch from two-tier to single-tier system
- ◆ Amortize unfunded liabilities over 7 years
- ◆ “At-risk” rules for poorly funded plans – only plans over 500 parts can be at risk

# New Funding Lingo and Rules

- ◆ Funding Target: Present value of benefits accrued at the beginning of the plan year
- ◆ Target Normal Cost: Present value of benefits accrued during the plan year
- ◆ Funding Target Attainment Percentage (FTAP)
  - Assets expressed as a percentage of the funding target
  - Without adjustment for “at-risk” status
- ◆ Funding Shortfall
  - Funding target less assets
  - Used to determine amortization bases
- ◆ Assets generally reduced by carryover and prefunding balances

# Interest Rates

- ◆ Funding Target and Target Normal Costs determined based on segmented yield curve issued by Treasury
- ◆ Based on corporate bonds maturing in
  - First 5 years
  - Next 15 years
  - After 20 years
- ◆ Uses top 3 quality levels
- ◆ Averaged over 24 months
- ◆ Phased in over 3 years starting in 2008
- ◆ Option: Use full yield curve without 24 month averaging and without phase-in

# Asset Valuation

- ◆ Use fair market value
- ◆ Can elect to use averaging (smoothing)
  - Method must be permitted by Treasury regulations
  - Limited to 24-month period
  - Average must be in range of 90% - 110% of fair market value (old rule was 80% - 120%)

# New Funding Rules for Defined Benefit Plans

## ◆ Annual Funding Obligation

- Plan's target normal cost, plus
- Shortfall amortization installment
- Reduced for carryover of old credit balance or pre-funding balances

## ◆ Shortfall Amortization Base

- Funding shortfall for the year, minus
- Present value of the future shortfall amortization installments, minus

## ◆ Shortfall Amortization Installment

- Level amortization of shortfall amortization base for a plan year over 7 years
- Using segment rates in effect for the year the base is established

# New Funding Rules for Defined Benefit Plans

- ◆ Exempt from establishing a new base if assets exceed 100% of funding target
  - Without reduction for carryover and pre-funding balances
- ◆ Transition Relief for Shortfall Amortization Installments
  - 2008: 92%
  - 2009: 94%
  - 2010: 96%
- ◆ Not available for plans established after 2007 or plans subject to the deficit reduction contribution

# Credit Balances under PPA

- ◆ Plans will maintain two balances
  1. Pre-funding balance (reflecting post-2007 contributions in excess of the minimum)
  2. Funding standard carryover balance (credit balance in the plan at the end of the 2007 plan year)
- ◆ Both balances are increased/decreased by plan's actual rate of return after 2007
- ◆ Sponsor may choose to eliminate these amounts at any time
- ◆ May be used to offset minimum contribution if Funding Target Attainment Percentage in preceding year is at least 80%
  - Carryover balance must be used first

# Contribution Timing

- ◆ Contribution Date for Minimum Funding Purposes
  - Still dealing with 8½ month minimum funding date
  - Contribution requirement is increased for interest between the valuation date and the contribution date at the effective interest rate
  - This applies for every plan.
- ◆ Required Quarterly Contributions
  - If plan has funding shortfall in prior plan year and fails to make required installments

Questions?

