

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 = Adjusted Funding Target Attainment Percentage =
$$\frac{\text{Assets} - \text{Credit Balances}}{\text{Target Liability}}$$
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

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

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

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%*

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

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

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

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

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

$$\begin{aligned} & \left[\frac{D'_c}{D'_c} \text{ or } (1+i')^{-(C-CA)} \right] * \left[a_{\overline{CP}|i'}^{(12)} + \frac{N'_{(C)(CA+1)+CP'} - \left(\frac{11}{24}\right) * D'_{(C)(CA+1)+CP'}}{D'_c} - \left[\frac{N'_{CA+1} - \left(\frac{11}{24}\right) * D'_{CA+1}}{D'_c} \right] \right] + \\ & \left[\frac{D''_c}{D'_c} \text{ or } (1+i'')^{-(C-CA)} \right] * \left[a_{\overline{CP''}|i''}^{(12)} + \frac{N''_{(C)(CA+1)(CA+20)+CP''} - \left(\frac{11}{24}\right) * D''_{(C)(CA+1)(CA+20)+CP''}}{D''_c} - \left[\frac{N'_{CA+20} - \left(\frac{11}{24}\right) * D'_{CA+20}}{D'_c} \right] \right] + \\ & \left[\frac{D'''_c}{D'_c} \text{ or } (1+i''')^{-(C-CA)} \right] * \left[a_{\overline{CP'''}|i'''}^{(12)} + \frac{N'''_{(C)(CA+20)+CP'''} - \left(\frac{11}{24}\right) * D'''_{(C)(CA+20)+CP'''}}{D'''_c} \right] \end{aligned}$$

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 Ns and the Ds), you will not be able to check the calculations

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 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

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

Questions?
