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Outline of Issues for the Public Hearing on Proposed Regulations Regarding Benefit Restrictions for Underfunded Pension Plans

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Internal Revenue Service
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Issues to be discussed:

- I. Coordination of Internal Revenue Code (IRC) §§430 and 436 with regard to the funding of benefit increases to avoid benefit limitations.**
 - A. Under the Proposed Regulations, if a plan makes a contribution for the current year to avoid a benefit restriction (e.g., to allow for a benefit increase), the contribution and the increase in liability associated with the amendment are not included in the presumed AFTAP for the next year.
 - B. Example: A plan has a funding target of \$1 million and assets of \$750,000, with an AFTAP of 75%. The employer wants to adopt an amendment increasing benefits that will double liabilities. The minimum contribution to have this increase is \$850,000. The funding target will then be \$2 million and the assets would be \$1.6 million. Under the Proposed Regulations, the presumed AFTAP for the following year will be 75% - not the 80% AFTAP for which the employer paid.
 - C. ASPPA recommends that final regulations should coordinate IRC §§430 and 436 such that the liability and IRC §436 contribution associated with any benefit increase are included in the plan's IRC §436 target liability and assets for the year containing the amendment, and the presumed AFTAP for the next plan year, if the plan sponsor funds up to enable the amendment. Thus, each time a contribution is made under IRC §436, or a plan amendment takes effect, the FTAP and AFTAP are redetermined for all IRC §436 purposes reflecting both the additional contribution and the plan amendment.

II. Non-distress termination of a plan with an AFTAP of less than 80%.

- A. The Proposed Regulations do not provide that the benefit restrictions end at plan termination. Thus, plans with an AFTAP of less than 80%, but sufficient assets to pay benefits due upon plan termination, find themselves in a “catch-22” situation. If the restrictions do not end at plan termination, it appears these plans cannot distribute lump sums or purchase annuities. These plans cannot terminate if they cannot distribute benefits.
- B. Examples of affected plans include non-PBGC covered plans, plans where majority owners elect to accept a lower benefit to allow all other benefit liabilities to be met, and other plans with an AFTAP less than 80% but with assets in excess of termination liabilities (e.g., plans where the funding target exceeds termination liability and plans where sponsors agree to make contributions to terminate).
- C. ASPPA recommends that final regulations should specifically provide that the benefit restrictions cease as of the date of plan termination for a plan that is not covered by PBGC or a plan that terminates in a PBGC “standard termination.”

III. Final regulations should provide that the range certification remains in effect until the final certification is completed.

- A. Under the Proposed Regulations, plans that use a range certification must have a final certification completed by the first day of the tenth month of the plan year. The final certification must be a single AFTAP number using data of Schedule B quality. If a final certification is not rendered by the first day of the tenth month, the Proposed Regulations appear to provide that the initial range certification becomes invalid. The first day of the tenth month expiration for a range certification is not mandated by the statute and produces troublesome results.
- B. Example: Consider a calendar year partnership—with a calendar year plan. It is not uncommon for the partners’ income for the prior year to not be finalized until after September 30, as the firm’s tax return is not due until October 15th. In this case, it would be impossible for a final AFTAP to be certified until after September 30th (assuming actual data is required). This means that, even if the actuary is certain that the plan is more than 100% funded, on October 1, the range certification will lapse and the plan will be deemed less than 60% funded, with accompanying restrictions. The proposed regulations also imply that, with no final certification in place, the original range certification will become retroactively invalid on October 1. Thus, the restriction could, in theory, apply retroactively.
- C. ASPPA recommends that the range certification remain in effect until the final certification is completed. The regulations carry harsh penalties in the event that the range certification is wrong so there appears to be little risk in providing for this suggested change.

IV. Final regulations should provide that the actuary can certify a minimum AFTAP.

- A. Proposed Regulations provide that the range certification must classify the plan as being in one of three categories: between 60-80% funded; between 80-100% funded; or at least 100% funded. The penalty for a range certification being different than the actual result is potential plan disqualification, because the plan will have applied benefit limitations to which it was not subject. This effectively eliminates the range certification as an option for plans near the end points of the certification ranges.
- B. Example: The actuary may know that the AFTAP is over 60%, but it is so close to 80% that the actuary is not sure whether it is above or below 80%. The actuary cannot certify above 60% (and thus avoid restrictions on benefit accruals) without taking a potentially fatal position on the 80% issue.
- C. ASPPA recommends that the plan's actuary be permitted to certify a minimum AFTAP. For example, the actuary could certify that the AFTAP is at least 71%.

V. The definition of annuity starting date under IRC §436 should be coordinated with the definition under IRC §417 and specifically accommodate the administrative timing of the existing IRC §417 rules.

- A. IRC §436(d) imposes limits on prohibited distributions for annuity starting dates that occur during a restricted period. The term "annuity starting date" is defined by the rules of IRC §417 and has long been established under existing rules as an "as of" date primarily constrained based on the timing of the delivery of the QJSA notice. The Proposed Regulation adds a new constraint to the existing rules—just for purposes of IRC §436—that is, the actual signature date of the plan participant. Adding a special requirement for this rule that does not apply for other IRC §417 purposes will lead to administrative complexity and imposes limitations that have no basis in the statute.
- B. ASPPA recommends that the definition of annuity starting date under IRC §436 be conformed to the definition under IRC §417 and specifically accommodate the administrative timing of the existing IRC §417 rules.

VI. Final regulations should provide that a plan may operate during the Pension Protection Act of 2006 (PPA) remedial amendment period as if it has an amendment to automatically restore benefits, provided the plan is indeed amended by the extended PPA amendment deadline to memorialize operations.

- A. A plan may either provide that benefits are restored automatically when the plan's funded status increases or the plan may be silent on the issue in which case a plan amendment is required to restore benefits. The Proposed Regulations are unclear

on whether during the PPA remedial amendment period a plan may operate as if it has language providing for automatic restoration.

- B. ASPPA recommends that a plan be permitted to operate during the PPA remedial amendment as if it had an amendment to automatically restore benefits, provided the plan is indeed amended by the extended PPA amendment deadline to memorialize operations. For example, a calendar year plan does not amend to insert automatic reinstatement language until December 31, 2009, but would operate as if such amendment were in place effective January 1, 2008. Thus, IRC §436(c) would not be triggered by a reinstatement of accruals limited by IRC §436(e) if the reinstatement is operationally effective within 12 months.

VII. Final regulations should provide for a reasonable administrative delay between the date the plan administrator receives the AFTAP certification from the actuary and the effective date of any restriction.

- A. The statute seems to indicate, and the Proposed Regulations clearly reflect, that any benefit restriction applies as of the date the actuary certifies the AFTAP. This clearly causes administrative problems since it is virtually impossible for these coordinated events (i.e., AFTAP certification and benefit processing) to occur simultaneously.
- B. ASPPA recommends final regulations provide for a reasonable administrative delay between the date the AFTAP certification is received by the plan administrator from the actuary and the effective date of any restriction. ASPPA also recommends that the certification be limited to a specific document identified as the AFTAP certification rather than any informal preliminary email or other correspondence.

VIII. If a plan adopts an amendment in 2008 for 2007 (within 2 ½ months), is the amendment restricted?

- A. The Proposed Regulations are silent on the treatment of retroactive amendments adopted within 2 ½ months of the end of a year, effective for the previous year.
- B. Recently proposed funding regulations make it clear that IRC §436 restrictions are ignored in determining the funding target under IRC §430, but clear guidance is needed on the application of IRC §436(c).
- C. There is a need for immediate guidance, since many plans will be amended in 2008, by March 15, with improvements to be effective for 2007. Many of these plans will not have a certified AFTAP for 2007.

IX. If a plan amendment adopted (and effective) in a given year includes increases to be applied in future years, are the future increases restricted?

- A. The Proposed Regulations (and the statute) describe the limitation on plan amendments that increase liability for benefits as applicable to increases that “take effect” during any plan year. Clarification is needed regarding when an amendment “takes effect.”
- B. Example: Plan A has a benefit formula of 1% of highest three-year average pay. An amendment is adopted January 1, 2009, that increases the formula to 1.1% for terminations on or after January 1, 2009, then 1.2% for terminations on or after January 1, 2011. Since the amendment was adopted and effective in 2009, does the 2011 increase get a “free pass”? Or must the increase scheduled for 2011 be considered in determining the AFTAP for 2009?
- C. ASPPA recommends that final regulations specifically address whether an amendment is treated as a single amendment for purposes of IRC §436(c), or whether improvements taking effect in different plan years are treated as separate amendments.

X. New plans should be considered as having a 100% AFTAP, not 0% AFTAP.

- A. Under the proposed regulations, the only limitation applicable to new plans is the restriction on accelerated forms of distribution. However, for this purpose, the AFTAP is treated as 0% (because assets are zero).
- B. *ASPPA recommends that the AFTAP for a new plan be set at 100%, (as was done for prior year FTAP’s under proposed at-risk funding rules.* At a minimum, relief from notice requirements should be provided to new plans. Since some new plans are not adopted until the end of the year, it may not only be meaningless, but impossible to comply with the notice requirements.