ACOPA ACTUARIAL
SYMPOSIUM
AUGUST 9–10, 2019 • CHICAGO

GS4: 436 Tips and Traps

Larry Deutsch
James Holland

ACOPA
ASPPA College of Pension Actuaries
Part of the American Retirement Association

0

436 Tips and Traps

- This session will address the less-thought-of issues of 436
  - What is the AFTAP Certification for a plan year in which the valuation date changes from end of year to beginning of year?
  - If a plan is amended, is the amendment reflected in the AFTAP?
  - How is a 1-401(a)(4)-11(g) amendment done if the AFTAP is below 80%?
  - What is the AFTAP if a contribution is made after an AFTAP is certified?
  - If the AFTAP changes between certification and SB is a new certification required

1

AFTAP in Year of Change of Val Date

- The valuation date of a plan generally changes for one of three reasons
  - A voluntary election to change valuation date
  - A required change due to the increase in the number of participants
  - A required change in conjunction with a plan termination
- Note – Technically the law and regulations say that a small plan (as defined) can designate a valuation date as any date during the plan year. In practice, regarded as plan sponsor choice.

2

AFTAP if Voluntary Change in Val Date

- Under section 430(g), the valuation date for a small plan can be changed with the consent of the IRS. Certain changes are automatically approved either by regulations or by Rev. Proc. 2017-56.
  - There is no specific election to be made but there is no voluntary change until reported on the Schedule SB
  - The date of the decision could actually be after the due date of the AFTAP cert for the plan year
  - For example, the plan has a calendar plan year and on December 30, 2019 its decided to change the valuation date for 2019 from 12/31/2019 to 1/1/2019

ACOPA ACTUARIAL SYMPOSIUM ACOPA 3

3

AFTAP if Voluntary Change in Val Date

- Under Rev Proc 2017-56 the change of valuation date is automatically approved (assuming no change in past 4 years)
  - Of course, the AFTAP is required to be certified by September 30
  - Absent the change in the valuation date, because the prior year valuation date was end of the year, the AFTAP for the plan year would be based upon the Funding Target and Target Normal Cost as of the end of the prior plan year.

ACOPA ACTUARIAL SYMPOSIUM ACOPA 4

4

AFTAP if Voluntary Change in Val Date

- The easy answer would be that a timely certification of the AFTAP based upon the prior plan year would be the AFTAP for the plan year
- There is no guidance which indicates whether the AFTAP based upon the prior plan year or the current plan year controls

ACOPA ACTUARIAL SYMPOSIUM ACOPA 5

5

AFTAP if Voluntary Change in Val Date

- If the valuation date is the end of the plan year then the AFTAP is based upon the end of the prior plan year
- Taken literally that would mean that since the valuation date in the current plan year is not the end of the plan year, this rule would not apply, and the AFTAP must be switched to based upon the current year

ACOPA ACTUARIAL SYMPOSIUM ACOPA 6

6

AFTAP if Voluntary Change in Val Date

- That would mean that the AFTAP would need to be recertified (based upon the new valuation date)
- Does simply changing the date that the prior AFTAP was based upon cause a material change?
  - Under § 1.436-1(h)(4)(ii)(B), a material change would be a change which impacts the administration of the plan (i.e. changes the range)
  - So, if the new AFTAP is in the same range as the old AFTAP the answer would seem to be "no"

ACOPA ACTUARIAL SYMPOSIUM ACOPA 7

7

AFTAP if Voluntary Change in Val Date

- So, what if the AFTAP would change from just above 80% to just below 80%?
  - This could happen due to a decrease in the interest rate (particularly due to a change in the corridor) or due to the change in the mortality table
  - This could also happen due to a change in assumptions, like a change in the percent assumed to elect a lump sum

ACOPA ACTUARIAL SYMPOSIUM ACOPA 8

8

AFTAP if Voluntary Change in Val Date

- So, what if the AFTAP would change from just above 80% to just below 80%?
  - Such a change could cause cascading problems, including
    - A failure to provide proper notice to participants
    - A plan failure for paying a restricted benefit
- Could this mean that if the change in the valuation date would cause a material change in the AFTAP that the plan sponsor cannot voluntarily change the valuation date?

ACOPA ACTUARIAL SYMPOSIUM ACOPA 9

9

AFTAP if Voluntary Change in Val Date

- Assuming that the correct answer is that the AFTAP can still be based upon the AFTAP based upon the prior year, what is reported on the SB?
- The instructions to the SB require that if the final, certified AFTAP "does not correspond to the valuation results reported on" the SB that an attachment is required to reconcile the changes between the final AFTAP certification and the results reported on the SB

ACOPA ACTUARIAL SYMPOSIUM ACOPA 10

10

AFTAP if Voluntary Change in Val Date

- Best solution seems to be to recertify the AFTAP (even if after September 30) and don't change the valuation date if it would cause a material change

ACOPA ACTUARIAL SYMPOSIUM ACOPA 11

11

AFTAP if Required Change of Val Date

- But what if there is no choice because the number of participants increased from under 100 to over 100?
- The small plan exception allows the use of an end of the year valuation date if the number of participants in the **prior** plan year was under 100
- On paper, that would seem to give plenty of warning that the change in the valuation date is coming

12

AFTAP if Required Change of Val Date

- On paper, the number of participants in 2018 should be known early in 2019, so early in 2019 the actuary would be on notice that the number of participants would increase, allowing plenty of time to do the 1/1/2019 valuation
- In reality, that is not always the case

13

AFTAP if Number of Participants Increases

- For what ever reason, there is always those few plan sponsors who wait until early September before they wake up and say “oh, that’s right, we actually need to get the data to the actuary so that the actuary can do the valuation”
- Particularly in a cash balance plan, where the contribution is going to be a nice, say, 5% of payroll, and the anticipation is that the contribution will be above the minimum required and below the maximum, there is no pressure to get the valuation

14

AFTAP if Number of Participants Increases

- So, the data for 2018 comes in on September 10, 2019
- In the data there is an unexpected jump in the number of participants from say 90 to 105
- Now the change in the valuation date is mandatory, and the lead time for the AFTAP is 20 days (or less)

ACOPA ACTUARIAL SYMPOSIUM ACOPA 15

15

AFTAP if Number of Participants Increases

- On the bright side, while a 1/1/2019 valuation must be done for the AFTAP, the only **required** difference between the 1/1/2019 valuation and the 12/31/2018 valuation for AFTAP purposes would be
  - The interest rate (using the 2019 vs. 2018 rates)
  - The mortality table (both the table used, and the application pre retirement)
- So hopefully the AFTAP valuation can be quickly done

ACOPA ACTUARIAL SYMPOSIUM ACOPA 16

16

AFTAP if Termination Changes Val Date

- The third type of change in valuation date is in conjunction with a plan termination

ACOPA ACTUARIAL SYMPOSIUM ACOPA 17

17

AFTAP if Termination Changes Val Date

- On a plan termination, the valuation date must not be later than the plan termination date
- If the plan is covered by the PBGC, then the plan termination date is the termination date for PBGC purposes
- If the plan is not covered by the PBGC then the plan sponsor can select the plan termination date, within certain constraints (which allows some flexibility on setting the termination date)

18

AFTAP if Termination Changes Val Date

- Because the 436 restrictions do not apply to a distribution to carry out a plan termination (see § 1.436-1(a)(3)(ii)(B)), it would seem that there cannot be a material change to the AFTAP certification in the year that the plan is terminated
- However, because a distribution prior to the termination distribution is impacted there can be a material change

19

AFTAP if Termination Changes Val Date

- Dr. John has a plan that covers him and 3 employees
- The total Funding Target as of January 1, 2019 is $1,100,000
- The present value of accrued benefits as of the termination date is $1,500,000
- The assets as of January 1, 2019 (including contributions for 2018) are $800,000
- This means that as of January 1, 2019 the AFTAP is below 80%

20

AFTAP if Termination Changes Val Date

- Dr. John has a plan that covers him and 3 employees
- The total Funding Target as of January 1, 2019 is $1,100,000
- The assets as of January 1, 2019 (including contributions for 2018) are $800,000
- This means that as of January 1, 2019 the AFTAP is below 80%
- The resolution terminating the plan is adopted on 5/1/2019
- Benefits are distributed on 9/1/2019 (not a PBGC plan)

21

AFTAP if Termination Changes Val Date

- Normally the present value of accrued benefits exceeds the Funding Target, so assume that the values are:
  - Dr. John $1,350,000
  - Employees $150,000
- The assets changed between 1/1/2019 and the 9/1/2019 to $1,200,000
- Assets are $300,000 short of the lump sums due
- Note we are assuming no accruals in 2019

22

AFTAP if Termination Changes Val Date

- There are 3 ways that Dr. John can deal with the underfunding
- 1) make an additional contribution
- 2) pay full amounts to employees with effect that his benefit is underfunded
- 3) have all employees share in underfunding (note this option is not available in a PBGC covered plan)

23

AFTAP if Termination Changes Val Date

- If Dr. John makes an additional contribution, the final AFTAP could reflect that contribution with proper elections, so the AFTAP would exceed 100%

24

AFTAP if Termination Changes Val Date

- If Dr. John does not want to fund enough for his benefit, while the AFTAP is below 80% it has no impact (in effect 436 has done its job) so no reason to not certify a below 80% AFTAP
- If the AFTAP is certified on 9/2/2019 it would seem no notice would be required (although there may have been a notice required due to a deemed AFTAP below 80% on 4/1/2019)

25

AFTAP if Termination Changes Val Date

- If the employees all share in the underfunding it would appear to have the same analysis as if Dr. John allowed his benefit to bear the brunt of the underfunding

26

Amendment Reflected in the AFTAP

- It seems basic, but what is a plan amendment?
  - Clearly, an amendment to the plan is a plan amendment
  - Increases in the 415 limit are treated as a plan amendment
  - Increases in the maximum compensation limit are treated as a plan amendment
  - Other automatic changes (such as new mortality table, new 417(e) rates) are not amendments

ACOPA ACTUARIAL SYMPOSIUM ACOPA 27

27

Amendment Reflected in the AFTAP

- The Funding Target for AFTAP purposes is generally the same as for minimum funding purposes
- In particular, the benefit valued for AFTAP purposes is the same as the benefit valued for funding purposes
- This means that changes in benefits due to an amendment are reflected for AFTAP purposes if and only if they are reflected for minimum funding purposes

ACOPA ACTUARIAL SYMPOSIUM ACOPA 28

28

Amendment Reflected in the AFTAP

- Natalie Inc. sponsors a plan
- Natalie Inc. adopts an amendment on 8/1/2019 increasing benefits
- Is the amendment reflected in the 2019 AFTAP?

ACOPA ACTUARIAL SYMPOSIUM ACOPA 29

29

Amendment Reflected in the AFTAP

- The answer is, it depends
- First of all, in order for the amendment to go in to force, the AFTAP reflecting the amendment must be at least 80% or Natalie Inc. must fully fund the increase in the funding target caused by the plan amendment

30

Amendment Reflected in the AFTAP

- The funding target absent the amendment is $900,000
- The funding target reflecting the amendment is $1,000,000
- If the assets are $900,000, then since the AFTAP reflecting the amendment would be 90%, the amendment is unrestricted
- If the assets are $750,000, then after the amendment the AFTAP would only be 75%

31

Amendment Reflected in the AFTAP

- Generally Natalie Inc. could resolve this problem by either making a $100,000 contribution (i.e. the increase in the Funding Target, which is what would be required if the AFTAP prior to the amendment was less than 80%), or
- Making a $50,000 contribution (which is what is required because the AFTAP prior to the amendment is more than 80%), so that the assets are 80% of the Funding Target after the amendment

32

Amendment Reflected in the AFTAP

- Let's assume that Natalie Inc. makes the $50,000 contribution, then second question is whether the amendment is reflected in the funding
- It would seem (but is not clear) that the answer to that question depends upon whether the valuation date is a beginning of the year or end of year valuation
- Note that (normally) the $50,000 would be a section 436 contribution and could not be used to meet the MRC

ACOPA ACTUARIAL SYMPOSIUM ACOPA 33

33

Amendment Reflected in the AFTAP

- If the valuation date is the beginning of the year, then under § 412(d)(2) the plan sponsor can elect to reflect an amendment that was adopted after the valuation date, but within 2 ½ months of the end of the plan year in the valuation
- Thus, whether the amendment is reflected is up to the plan sponsor
- (Read literally, § 412(d)(2) only applies to amendments made after the end of the plan year, not during the plan year, however regulations have applied the election to amendments during the plan year)

ACOPA ACTUARIAL SYMPOSIUM ACOPA 34

34

Amendment Reflected in the AFTAP

- If the "amendment" is an increase in the 415 limit, it would seem that is not "adopted" **after** the valuation date, so it must be reflected (assuming it goes in force) in the valuation

ACOPA ACTUARIAL SYMPOSIUM ACOPA 35

35

Amendment Reflected in the AFTAP

- If the valuation date is the end of the plan year, then amendments that occur during the plan year are prior to the valuation date, and therefore must be reflected for MRC purposes

ACOPA ACTUARIAL SYMPOSIUM ACOPA 36

36

Amendment reflected in the AFTAP

- Because a contribution made to allow an amendment to go into effect is not for a prior plan year, it would not be included in the assets
- If the contribution is made before the SB for the prior year is filed, by claiming the $50,000 is for the prior year, then the AFTAP after the contribution is the same, but the assets would reflect the $50,000 for funding, lowering the minimum required contribution
- Also, the contribution would not be a section 436 contribution

ACOPA ACTUARIAL SYMPOSIUM ACOPA 37

37

Amendment Reflected in the AFTAP

- So (for an end of year valuation) that would mean that the amendment would be reflected in the funding target for the current year, but the contribution to remove the 436 restriction is not a contribution for the current year, but is included in the assets as of the end of the current year.
- But the AFTAP for the current year is based upon the prior year end of year valuation which would ignore both the amendment and the contribution
- The next year AFTAP (based on current val) would reflect both

ACOPA ACTUARIAL SYMPOSIUM ACOPA 38

38

§ 1.401(a)(4)-11(g) amendments

- An -11(g) amendment can be made well after the end of the plan year
- It is an amendment increasing plan benefits, so it is subject to 436 restrictions for the year in which it is made

ACOPA ACTUARIAL SYMPOSIUM ACOPA 39

39

§ 1.401(a)(4)-11(g) amendments

- Suzy Publishing requires an -11(g) amendment for 2018, but it is not determined what that amendment will be until the valuation is done in September of 2019 (for 2018)
- The controlling AFTAP is the 2019 AFTAP, even though the amendment applies to the 2018 plan year
- If the valuation date is the end of the plan year, the 2019 AFTAP would be based upon the 12/31/2018 valuation, with the Funding Target increased by the -11(g) amendment

ACOPA ACTUARIAL SYMPOSIUM ACOPA 40

40

§ 1.401(a)(4)-11(g) amendments

- If the 2019 AFTAP after reflecting the -11(g) amendment is over 80% then there is no issue
- If the 2019 AFTAP is above 80% before the -11(g) amendment, but under 80% after the -11(g) amendment, then a contribution must be made to bring the AFTAP, after the amendment, up to 80%
- If timely made, that could be classified as a 2018 contribution so that it can be reflected in 2019 funding assets and not considered a section 436 contribution

ACOPA ACTUARIAL SYMPOSIUM ACOPA 41

41

§ 1.401(a)(4)-11(g) amendments

- If the 2019 AFTAP is between 60% and 80% before the -11(g) amendment, then the full increase in Funding Target must be funded
- Even if timely made, it would not work to classify it as a 2018 contribution unless it was so large as to bring the AFTAP above 80% after the amendment

ACOPA ACTUARIAL SYMPOSIUM ACOPA 42

42

§ 1.401(a)(4)-11(g) amendments

- If the 2019 AFTAP is below 60% then the amendment cannot be made without first bringing the AFTAP up to 60%

ACOPA ACTUARIAL SYMPOSIUM ACOPA 43

43

§ 1.401(a)(4)-11(g) amendments

- Suzy Publishing has 20 employees
- On 1/1/2018 the Funding Target was $900,000 and the assets were $900,000, so the AFTAP is 100%
- During 2018, before Suzy accrues an additional benefit, but after an additional contribution is made, Suzy takes a lump sum payment of $1,200,000
- After Suzy's distribution the value of the remaining benefits is $100,000 and the assets are $110,000

ACOPA ACTUARIAL SYMPOSIUM ACOPA 44

44

§ 1.401(a)(4)-11(g) amendments

- After Suzy takes her distribution, employees (including her) accrue additional benefits, but no additional contribution is made
- On 1/1/2019 the Funding Target is $200,000 but the assets are only $100,000, so the AFTAP is 50%
- Business is bad, and Suzy Publishing can't afford to make a contribution
- On 10/1/2019 it is discovered that the plan fails § 401(a)(4)

45

§ 1.401(a)(4)-11(g) amendments

- In order to pass § 401(a)(4) an -11(g) amendment must be made
- The increase in the Funding Target due to the amendment is $50,000
- In order to have the -11(g) amendment go into effect, first the AFTAP must be brought to 60% (at a cost of $20,000) then the increase in the Funding Target must be fully funded (for an additional $50,000)

46

Contributions After AFTAP Certification

- If a contribution is made after the AFTAP certification is made, then a new certification may be required if the contribution was made to remove a restriction on a plan amendment, an unpredictable contingent event or benefit accrual
- If a contribution is made after the AFTAP certification is made, and, for example, the AFTAP certification is above 80%, then no new certification is required unless a section 436 contribution is required to bring the AFTAP up to 80% on account of the amendment (see § 1.436-1(h)(4)(v)(B))

47

Contributions After AFTAP Certification

- The Alpha-Omega plan on 1/1/2019 has a Funding Target of $1,000,000, and assets of $700,000, so has an AFTAP of 70% certified on March 1, 2019
- No amendments are made to the plan
- The plan does not provide benefits for unpredictable contingent events
- On July 1, 2019 Alpha-Omega makes a contribution for 2018 of $300,000

ACOPA ACTUARIAL SYMPOSIUM ACOPA 48

48

Contributions after AFTAP certification

- The AFTAP is now above 80%, the change in AFTAP is deemed immaterial, and a certification is required as soon as practical (see § 1.436-1(h)(4)(v)(D))
- Assuming that the prior year effective rate is 4%, the value of the contribution would be $294,000, increasing the assets to $994,000, and the AFTAP to 99.4%

ACOPA ACTUARIAL SYMPOSIUM ACOPA 49

49

AFTAP Adjustment After Certification

- The AFTAP may change after an AFTAP is certified due to multiple causes, such as
  - Incorrect determination of Funding Target
  - Incorrect value of assets
  - Additional contributions
  - Reflecting a plan amendment

ACOPA ACTUARIAL SYMPOSIUM ACOPA 50

50

AFTAP Adjustment After Certification

- If the change is material, then the actuary must certify the new AFTAP
- A contribution to remove a restriction on a plan amendment, an unpredictable contingent event or benefit accrual may require a re-certification
- If the change is immaterial or is deemed immaterial, including due to a contribution for a prior year, then a new certification by the actuary is optional in certain cases

ACOPA ACTUARIAL SYMPOSIUM ACOPA 51

51

AFTAP adjustment after certification

- If the final certification by the actuary is not consistent with the SB (for example doesn't reflect some contribution) an attachment to the SB is required.

ACOPA ACTUARIAL SYMPOSIUM ACOPA 52

52

Questions

ACOPA ACTUARIAL SYMPOSIUM ACOPA 53

53