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PBGC Issues PPA Guidance on Applying Minimum Lump Sum Changes in Standard Terminations

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Background

This ASPPA *asap* summarizes the guidance in PBGC Technical Update 08-4, "Minimum Lump Sum Assumptions for Single-Employer Plans that Terminate in a Plan Year Beginning on or After January 1, 2008" (issued December 31, 2008, and available at http://www.pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu16620.html).

Section 302 of the Pension Protection Act of 2006 (PPA) changed the interest and mortality assumptions used to calculate minimum lump sum values, effective with respect to post-2007 plan years. PBGC Technical Update 08-4 provides guidance on how to apply these changes in the case of a plan with a termination date in a plan year to which the changes apply and a distribution date in a later plan year (*e.g.*, a plan that terminates in its 2008 plan year and pays lump sums in its 2009 plan year). (For convenience, this ASPPA *asap* assumes that the distribution date is the annuity starting date, as does PBGC Technical Update 08-4.)

PPA Changes

PPA calls for the use of higher interest rates than under pre-PPA law (thereby reducing minimum lump sum values) and stronger mortality assumptions than under pre-PPA law (thereby increasing minimum lump sum values). The interest change is phased in for the 2008 through 2011 plan years, with 20% of the change recognized in 2008, 40% in 2009, 60% in 2010, and 80% in 2011. The mortality change, in contrast, is immediately effective starting with the 2008 plan year (with projection-based improvements in mortality for post-2008 plan years). An amendment to implement these changes may be adopted (in the case of an ongoing non-governmental plan) as late as the end of the 2009 plan year, and generally may be given retroactive effect without violating the anti-cutback rule.

Effect on Lump Sums

For the vast majority of participants, the net effect of the PPA changes is to reduce lump sums. However, because of the increasing effect of mortality and decreasing effect of interest on lump sum values as participant ages increase, some of the oldest participants could see higher lump sums. The likelihood of a higher lump sum is at its greatest in 2008, because only 20% of the interest change, but 100% of the mortality change (except for projection-based improvements in mortality for post-2008 plan years) is then recognized. Putting aside any changes in the applicable interest rates from one stability period to the next, lump sum amounts will tend to decrease from plan year to plan year until the interest rate change is fully phased in for the 2012 plan year.

Standard Termination Timing Issues

As discussed in two previous ASPPA *asaps*, these PPA changes raise important standard termination timing issues—both for the timing of an implementing amendment in relation to the plan's termination date and for the timing of the termination date in relation to the effective date of the PPA changes:

- ASPPA *asap* 06-38 discussed the importance of adopting an implementing amendment on or before the plan's termination date (even though a later adoption date may be permitted for qualification purposes) to be able to use the PPA lump sum assumptions for post-2007 plan year distributions.
- ASPPA *asap* 07-32, which had summarized the guidance in PBGC Technical Update 07-3, highlighted the importance of selecting a termination date—not just a distribution date—in a post-2007 plan year to be able to use the PPA lump sum assumptions for post-2007 plan year distributions.

PBGC Technical Update 07-3 did not address issues relating to the assumptions that would apply where a plan has a termination date in one plan year after the PPA lump sum

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assumptions became effective (*e.g.*, the 2008 plan year) and makes distributions in a subsequent plan year (*e.g.*, the 2009 plan year), *i.e.*, whether the applicable interest rate phase-in percentage and the applicable mortality table used in determining minimum lump sums are those in effect on the plan's termination date or those in effect on the distribution date. The PBGC guidance in Technical Update 08-4 addresses these issues.

▲PBGC Guidance

In Technical Update 08-4, PBGC referred back to the underlying principle it had relied upon in issuing the guidance contained in Technical Update 07-3: "As explained in Technical Update 07-3, the minimum lump sum value of a participant's accrued benefit is calculated using the definition of 'applicable interest rate' and 'applicable mortality table' based on the plan provisions reflecting the law in effect on the plan's termination date, but the time for determining the specific assumptions is based on the distribution date." Proceeding on the basis of this general principle, PBGC provided the following guidance regarding the "applicable interest rate" and the "applicable mortality table":

- *Applicable interest rate*. The [PPA] amendments to section 417(e)(3), including the applicable phase-in percentages for years 2008 through 2011, apply to plan years beginning after December 31, 2007. PBGC therefore believes it should treat the applicable phase-in percentages as part of the [PPA] change in assumptions. It follows that for a plan that terminates in 2008 through 2011, the applicable interest rate is determined based on the applicable phase-in percentage in effect for the plan year in which the lump sum is paid (not for the plan year in which the plan terminates). Accordingly, if a plan's termination date occurs during the phase-in period, the specific interest rates used to calculate the minimum value of a lump sum payment (determined in accordance with the stability period and lookback month in effect on the termination date) reflect the weighting of the 30-year Treasury yields and the new PPA rates under Code section 417(e)(3)(D) on the distribution date.
- *Applicable mortality table.* Annual updates to the applicable mortality table are part of the base mortality table prescribed by the Secretary of Treasury under section 430(h)(3) of the Code, which is projected to improve using specified factors. Because the annual updates are part of the base mortality table, they are included in the law in effect on the termination date. Accordingly, for a plan with a termination date on or after the first day of the first plan year beginning in 2008, a lump sum would be determined based on the applicable mortality table as specified by the Secretary of Treasury on the plan's termination date, taking into account projected mortality improvements under the table through the plan year containing the distribution date.

Technical Update 08-4 provided the following example to illustrate the effect of the guidance on the determination of the "applicable interest rate":

> [A]ssume a calendar year plan is amended in 2008 to reflect [PPA] minimum lump sum assumptions and terminates on July 1, 2009. Also assume that the plan has a one-year stability period and a two-month lookback. Therefore, a lump sum paid in 2010 is calculated based on the phase-in percentage for the plan year beginning in 2010 and the November 2009 rates. Accordingly, a lump sum paid in 2010 would be determined using a blended rate based on a 60 percent weighting of the November 2009 segment rates and a 40 percent weighting of the November 2009 30-year Treasury rate.

For a plan with a termination date during the 2008–2011 phase-in period and a distribution date in a later plan year, PBGC's guidance calling for the applicable phase-in percentage to be based on the plan year in which the lump sum is paid will result in a lower lump sum payment than if the applicable phase-in percentage were fixed based on the plan year in which the plan terminated.

PBGC clarified that the guidance in Technical Update 08-4 also applies to minimum lump sum calculations where: (1) a plan with a post-2007 plan year termination date provides plan benefits through the purchase of an annuity contract that provides for payment of lump sums in the future; and (2) a plan undergoing a distress termination with sufficient assets for at least all guaranteed benefits closes out in a manner similar to that required for a standard termination in accordance with applicable PBGC regulations.

▲Legal Status of Guidance

The Technical Update states that the "guidance represents PBGC's current thinking on this topic," and "does not create or confer any rights for or on any person or operate to bind the public." It goes on to note that, "[i]f an alternative approach satisfies the requirements of the applicable statutes and regulations, you can use that approach," and that "[i]f you want to discuss an alternative approach (you are not required to do so), you may contact the PBGC."