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PPA Lump Sum Amendments in Standard Terminations: Watch Out!

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The Pension Protection Act of 2006 (PPA) changes the interest rate and mortality table used in calculating minimum lump sum values, effective for distributions in plan years beginning after December 31, 2007. Special care is called for when adopting an amendment to implement this change in the context of a standard termination. An important lesson can be learned from the unfortunate experience of a number of practitioners in connection with the earlier GATT lump sum changes.

The GATT Experience

GATT had substituted 30-year Treasuries (along with a prescribed mortality table) for PBGC rates as the basis for minimum lump sum values, with the change statutorily exempted from the anti-cutback rules of IRC §411(d)(6). Consider the case of a plan that was undergoing a standard termination and that sought an IRS determination letter upon termination. After the plan's termination date, but within the remedial amendment period, the plan was amended to substitute 30-year Treasuries (along with the prescribed mortality table) under GATT for the pre-GATT PBGC rates. The IRS then issued a clean determination letter, and the GATT-based lump sums were paid during the permitted distribution period in the standard termination.

The PBGC, upon audit of the standard termination, took the position that the lump sums were underpaid because they should have been calculated based on PBGC rates where (as was virtually always the case) that produced a larger lump sum. This audit position was based on a PBGC regulation (29 CFR §4041.8) that limits the effectiveness of amendments adopted after a plan's termination date when determining plan benefits in a standard termination.

Under this regulation, amendments adopted after the plan's termination date generally may not be taken into account to the extent they decrease benefit values, as would be the case with most GATT lump sum amendments. However, the regulation goes on to explicitly permit post-termination amendments to decrease benefit values "to the extent the decrease is *necessary* to meet a qualification requirement under section 401 of the Code" (emphasis added). This led many practitioners to believe that the GATT amendments *could* be taken into account in determining lump sum values, as the plan was clearly required to adopt the GATT assumptions to meet qualification requirements.

The PBGC nixed this argument, based on the theory that the plan could have met qualification requirements by adopting the GATT assumptions *while preserving the pre-GATT PBGC rates as an alternative basis for determining lump sums*. Therefore, according to the PBGC, a GATT amendment simply *substituting* the GATT rates for the PBGC rates was not "necessary" to meet qualification requirements and, thus, the plan could not rely on the GATT amendment to decrease lump sum values. The PBGC also rejected the argument that it was bound in a standard termination audit by a clean IRS determination letter that, in substance, blessed the GATT amendment, noting that the determination letter is not determinative of benefit entitlements under Title I of ERISA and does not, in any event, bind the PBGC.

PPA: *"Déjà Vu"*

The PPA lump sum change presents essentially the same set of issues for practitioners. The new assumptions will generally serve to decrease lump sum values (with the decrease cushioned based on a transition rule for distributions in the 2008 through 2011 plan years). This change, like the GATT change, is statutorily exempted from the anti-cutback rules of IRC §411(d)(6). An implementing amendment need not be adopted for ongoing non-governmental plans until the end of the 2009 plan year (and perhaps even later if IRS extends the remedial amendment period). Finally, the PBGC's position on post-termination amendments has not changed.

The Lesson for Practitioners

The lesson for practitioners is simple. If you intend to use the PPA assumptions (subject to the transition rule) to determine lump sum values for post-2007 distributions as part of a standard termination, you will need to ensure that the PPA lump sum amendment is adopted on or before the plan's termination date, even though a later adoption date may be permitted for qualification purposes.

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Note: ASPPA, through its Government Affairs Committee, has expressed its concerns to the PBGC about this set of issues in the context of the GATT lump sum amendments, and has requested that the PBGC find a better solution in the context of the PPA lump sum amendments.