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PBGC Implements Variable-Rate Premium Changes

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On March 21, 2008, PBGC published a final rule (73 Fed. Reg. 15065) that, among other things, implements the statutory changes to the variable-rate premium (VRP) that go into effect starting with the 2008 plan year. The final rule, according to PBGC, is "nearly the same" as the proposed rule published May 31, 2007 (72 Fed. Reg. 7755). This article briefly summarizes key provisions of the final rule, which is available at http://edocket.access.gpo.gov/2008/pdf/E8-5712.pdf

▲2008 PPA Changes to VRP

The Pension Protection Act of 2006 (PPA) made substantial changes to the VRP rules. Starting with the 2008 plan year, the full-funding limit exemption from the VRP is eliminated and the rules for determining unfunded vested benefits (UVBs)—on which the VRP is based—are coordinated with the new funding rules that (for most plans) also go into effect in 2008. In brief, a plan's UVBs equals the shortfall for its PPA funding target, using the fair market value of its assets, taking into account only vested benefits, and valuing benefits using special spot (rather than averaged) premium segment rates.

▲New "UVB Valuation Date"

Under PBGC's pre-PPA regulations, UVBs for the premium payment year (*i.e.*, the plan year for which the premium is paid) are determined as of the same premium "snapshot" date used to determine the participant count for purposes of the flat-rate premium for the premium payment year—generally the last day of the prior plan year. Starting with the 2008 premium payment year, there will be two premium snapshot dates—for UVBs, a "UVB Valuation Date" (*i.e.*, the *funding* valuation date for the premium payment year), and for the flat-rate participant count, a "Participant Count Date" (as before, generally the last day of the prior plan year). Thus, for example, in the case of a small calendar year plan using a December 31 valuation date for funding purposes, UVBs for the 2008 premium payment year will be determined as of December 31, 2008, and the participant count for the 2008 premium payment year will (generally) be determined as of December 31, 2007.

▲Determining Assets

UVBs will be determined based on the fair market value of the plan's assets on the UVB Valuation Date, without any reduction for any credit balance. Contributions for the prior plan year are taken into account (subject to an interest adjustment for post-2008 plan years) only if received by the date of the premium filing. However, contributions for the premium payment year are disregarded; any such contributions, along with any interest thereon, must be backed out of the asset value. Interest adjustments to contributions are made using the same effective interest rate used for funding purposes.

▲Determining Liabilities

In determining the premium funding target, accruals for the premium payment year are disregarded, consistent with the treatment of accruals under the funding rules.

Under the PPA statutory rules, as interpreted by PBGC, the interest rate structure to be used for premium purposes differs from that used for funding purposes in that: (1) the premium segment rates are spot rates rather than (as is generally the case under the funding rules) rates that are averaged over a 24-month period; (2) the full yield curve election that may be made for funding purposes is not available for premium purposes; (3) the "applicable month" for selection of the segment rates is the month preceding the month in which the premium payment year begins (*e.g.*, December 2007 for the 2008 calendar premium payment year) rather than

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(as for funding purposes) the month that contains the valuation date or any of the four preceding months (*e.g.*, September, October, November, December 2007 or January 2008 for the 2008 calendar plan year); and (4) the transition rule that applies (subject to certain exceptions) for funding purposes and that phases into the new segment rates from the prior current liability rate for the 2008 and 2009 plan years does not apply for premium purposes.

Under the final rule, filers will have the option of determining UVBs by using the same interest rate structure used for funding purposes instead of using the special premium segment rates. However, an election to base UVBs on this "Alternative Premium Funding Target" (*i.e.*, the vested portion of the plan's funding target as determined under the funding rules) will be irrevocable for five years, as will be any election to revert to the "Standard Premium Funding Target" (*i.e.*, the vested portion of the plan's funding target using the special premium segment rates). The deadline for making (or revoking) an election to use the Alternative Premium Funding Target for a premium payment year is the due date for paying the VRP for that year.

▲Methods for Determining UVBs

Under PBGC's pre-PPA regulations, the actuary has significant flexibility in choosing a method for determining UVBs. For example UVBs can be determined under the "General Rule" based on a valuation performed as of (1) the premium snapshot date (*i.e.*, generally, the last day of the prior plan year); (2) the first day of the premium payment year (subject to a possible one-day "roll-back"); or (3) the first day of the prior plan year (subject to a one-year "roll-forward"). Another option is to use the "Alternative Calculation Method," under which certain adjustments are made to the prior plan year's Schedule B entries that are required to be reported as of the first day of that prior year. Under the final rule, starting with the 2008 premium payment year, this flexibility is eliminated; the actuary must rely on a valuation as of the UVB Valuation Date for the premium payment year without any ability to rely instead on an earlier or later valuation with adjustments.

▲Due Date Changes

The final rule makes significant changes to the premium due date structure, with the new rules varying depending on whether the plan is small, mid-size, or large (based on the required flat-rate participant count for the plan year preceding the premium payment year).

- *Small plans.* For small plans (fewer than 100 participants), the due date for both the VRP and the flat-rate premium will be the last day of the sixteenth month that begins on or after the first day of the premium payment year (*e.g.*, April 30, 2009, for the 2008 calendar premium payment year).
- *Mid-size plans.* Mid-size plans (100 to 499 participants) will face the same due date as under pre-PPA rules (*e.g.*, October 15 of the premium payment year for both the VRP and the flat-rate premium for a calendar year filer). However, they will be allowed to base the VRP on estimated liabilities (but not on estimated assets), with the ability to pay any remaining amount due without penalty by the extended due date that applies to small plans. The estimate must be certified by the enrolled actuary and will be subject to PBGC audit.
- *Large plans.* For large plans (500 or more participants), the same rules apply as for mid-size plans, except that the requirement to pay the flat-rate premium early in the premium payment year (*e.g.*, by February 28 for a calendar-year filer) will continue to apply, subject to a revised version of the "safe-harbor" rules that provide relief for estimated flat-rate premium payments.

▲Special VRP Rule Changes

The final rule makes several changes to the VRP special rules in PBGC's pre-PPA regulations.

- *Old rules dropped.* Consistent with PPA, the full-funding limit exemption from the VRP is eliminated. Three other special rules—all of which "represent compromises between the need for accuracy in the determination of the VRP and the reporting of VRP data on the one hand and the need to reduce the burden of compliance on the other"—are also eliminated because they have "lost their justification": (1) the rule that exempts small plans (fewer than 500 participants for the premium payment year) from having to report their UVBs if the actuary certifies that they have no UVBs; (2) the rule that allows large plans (500 or more participants for the premium payment year) to base their UVBs on full accrued rather than just vested benefits; and (3) the rule that allows any plan to base its UVBs on the funding interest rate if that is lower than the premium interest rate.

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- *New rules added.* The final rule adds two new relief rules: (1) as discussed earlier in this article, filers may elect (subject to a five-year commitment) to base UVBs on the Alternative Funding Premium Target or to revert to the Standard Premium Funding Target; and (2) plans of small employers that qualify for the PPA cap on the VRP (*i.e.*, $5 times the square of the participant count) need not report their UVBs if they pay the full capped amount.

▲PBGC Interpretation of "Vested"

The final rule, after noting PBGC's "belie[f] that there is some uncertainty among pension practitioners as to the meaning of the term 'vested' as used [for premium purposes]," sets forth PBGC's interpretation "for premium purposes only," applicable starting with the 2008 premium payment year:

> [There are] two circumstances that would not prevent a participant's benefit from being vested for premium purposes. One circumstance is that the benefit is not protected under Code section 411(d)(6) and thus may be eliminated or reduced by the adoption of a plan amendment or by the occurrence of a condition or event (such as a change in marital status). PBGC considers such a benefit to be vested (if the other conditions of entitlement have been met) so long as the benefit has not actually been eliminated or reduced. The other circumstance—applicable to certain benefits payable upon a participant's death—is that the participant is living. The benefits to which this would apply are (1) a qualified pre-retirement survivor annuity, (2) a post-retirement survivor annuity such as the annuity paid after a participant's death under a joint and survivor or certain and continuous option, and (3) a benefit that returns a participant's accumulated mandatory employee contributions. PBGC considers such benefits to be vested (if the other conditions of entitlement have been met) notwithstanding that the participant is alive.
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> [A] pre-retirement lump sum death benefit (other than one that returns mandatory employee contributions) is not considered vested for premium purposes where the participant is living and ... a disability benefit is not considered vested for premium purposes where the participant is not disabled.

PBGC stated that it "has made no determination as to the position it may take" regarding the interpretation of "vested" for pre-2008 premium payment years and that it "currently has no plans to focus on this issue in audits of premium filings for plan years beginning before 2008."

▲Recordkeeping and Audit Changes

The final rule "clarifies and strengthens" the record-keeping and audit provisions in PBGC's premium regulations by: (1) adopting a broad interpretation of the "records" that must be retained; (2) providing that PBGC may require a demonstration of the effectiveness of, and reliability of results produced by, any system used to determine premiums or premium-related information; (3) allowing PBGC, where it determines upon audit that the plan's records fail to establish the plan's UVBs, to rely on data it obtains from other sources to "presumptively establish" UVBs; (4) providing for faster production of records that are audited "on-site"; and (5) allowing PBGC to shorten the time period for providing record information in broader circumstances than under PBGC's pre-PPA regulations.

▲Other Non-PPA Changes

The final rule makes several other non-PPA-related changes, including: (1) making clear that the first day of a new plan's first premium payment year is the effective date of the plan, thereby "obviat[ing] the need for plan administrators to choose between the effective date and the adoption date as the first day of the plan year for premium filing"; and (2) providing explicitly that a filing that does not comply with the current e-filing requirements (*e.g.*, a filing on paper) does not satisfy the filing requirement and is subject to penalties under ERISA section 4071.

▲Applicability

All changes made by this final rule apply to premium payment years beginning on or after January 1, 2008.