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A publication of the ASPPA Government Affairs Committee

December 27, 2007 :: No. 07-32

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PBGC Issues PPA Transitional Guidance: Minimum Lump Sums and Standard Terminations

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Background

Section 302 of the Pension Protection Act of 2006 (PPA) changes the interest and mortality assumptions used to calculate minimum lump sum values, effective for post-2007 plan years. These PPA changes raise important timing issues for standard terminations—both for the timing of the amendment in relation to the termination date and the timing of the termination date in relation to when the PPA changes become effective. ASPPA *asap* 06-38 discussed the importance of adopting the PPA lump sum amendment on or before the plan's termination date, even though a later adoption date may be permitted for qualification purposes. We now focus on recent PBGC guidance in Technical Update 07-3 highlighting the importance of selecting a termination date—not just a distribution date—in the *2008* (rather than 2007) plan year to be able to use the PPA lump sum assumptions for 2008 distributions. (For convenience, this ASPPA *asap* assumes that the distribution date is the annuity starting date, as does PBGC Technical Update 07-3.)

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 (subject to projection-based increases 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 changes is to reduce lump sums. Because of the greater effect mortality has on lump sum values for older participants, however, 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 increases for post-2008 plan years) will then be recognized.

Applicability to Standard Terminations

In the context of a standard termination, practitioners have raised questions about whether and, if so, how the PPA lump sum changes apply if a plan with a pre-2008 termination date is amended, on or before that termination date, to reflect the new PPA lump sum rules for the anticipated post-2007 distributions that will be required to complete the termination. Similar questions arise where the termination date is in a transition plan year (2008–2011), but the distribution date is in a later transition or post-transition plan year—would the phase-in percentage and the applicable mortality table be those in effect for the plan year in which the termination date falls or in which the distribution date falls? The key issue is whether the legal framework governing the calculation of minimum lump sums is determined based on the distribution date (as with the variable interest rate normally used in the calculation) or instead is effectively frozen as of the plan's termination date.

PBGC Guidance

In Technical Update 07-3, "Minimum Lump Sum Assumptions for Terminating Single-Employer Plans; Effect of Pension Protection Act of 2006" (issued December 3, 2007, and available at **http://www.pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu16272.html**), PBGC provided guidance on some of these issues and stated its intent to provide additional guidance in the future. The guidance clarifies that it is the termination date, rather than the distribution date, that controls the legal framework governing minimum lump sums, at least insofar as the transition from pre-PPA to PPA assumptions is concerned:

> PBGC regulations clearly distinguish between, on the one hand, the plan provisions in effect as of the termination date that prescribe the basis or methodology for determining the section 417(e) interest rate and mortality assumptions, and, on the other hand, the specific assumptions, based on the distribution date, that are called for by those plan provisions. Accordingly, 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.
>
> Furthermore, because the PPA 2006 amendments to the applicable interest rate and the applicable mortality table under section 417(e)(3) of the Code are effective only for plan years beginning in and after 2008, plan provisions incorporating those requirements cannot take effect for purposes of ERISA section 4041 before the first plan year beginning on or after January 1, 2008. Therefore, such plan provisions (regardless of whether they were added to the plan before, or on or after, the plan's termination date) are not effective for a plan with a termination date before the beginning of its 2008 plan year, even if the distribution date is after the 2007 plan year.

PBGC regulations, at 29 CFR §4041.8, provide that an amendment adopted after a plan's termination date is taken into account to the extent the amendment does not decrease the value of the participant's or beneficiary's benefit under the plan's provisions in effect on the termination date. Technical Update 07-3, however, makes clear that, "in the case of a plan that has a termination date in the 2007 plan year, PBGC will not take into account an amendment adopted after the plan's termination date that *substitutes* the PPA 2006 assumptions for the pre-PPA 2006 assumptions, even if the amendment increases benefits for some participants" (emphasis supplied).

The Technical Update provides the following example to illustrate the effect of the guidance:

> [A]ssume a calendar year plan has a termination date of July 1, 2007, and makes the PPA 2006 amendments described above on June 30, 2007. Also assume that the plan has a one-month lookback and a one-month stability period. Because the plan terminated before PPA 2006 took effect, pre-PPA 2006 law (applicable interest and applicable mortality) applies. If the plan makes its final distribution of assets in February 2008, the applicable interest rate would be the 30-year Treasury rate for January 2008 (the month before the distribution date) and the applicable mortality table would be that in effect on July 1, 2007 (*i.e.*, the table provided in IRS Rev. Rul. 2001-62). The same would be true if the plan had not been amended but provided that section 417(e)(3) was incorporated by reference, without a specific description of the applicable actuarial assumptions.

Unresolved Issues

The Technical Update does not address issues relating to the assumptions that would apply "where a plan has a termination date in one plan year after the effective date of the PPA 2006 lump sum assumptions and makes distributions in a subsequent plan year; *i.e.*, whether the applicable interest rate percentage (the phase-in) 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 "intends to issue future guidance" on these issues.

Effect 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.” Although the Technical Update clearly does not have the force of law, practitioners would be well-advised to proceed with caution in using any “alternative approach” lest they run into problems in the event of a PBGC standard termination audit.