PRS PENSION REVIEW SERVICES

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Defined Benefit Pension Plans and the Pension Protection Act of 2006

Introduction

The 900-plus page Pension Protection Act of 2006 (PPA) rewrote the funding rules for Defined Benefit Pension Plans, and added benefit restrictions if certain funding thresholds are not met. This report briefly summarizes some of the changes that are effective for Plan Years beginning in 2008. Some of the rules and exceptions have not been included so that the Newsletter does not become too long and technical.

Funding Changes

The following table compares the new (after 2007) with the old (prior to 2008) Minimum Funding Rules for small plans. Because of the mandated funding and assumption changes and because the actuary has less flexibility in determining contribution amounts, the 2008 contribution may not be similar to the 2007 contribution. However, contributions greater than the Minimum Required Contribution can often be made.

Comparison of the new and old funding rules for small plans

Item	New rules	Old rules
Benefits used	Accrued or earned to date	Projected to retirement
Funding method, the mortality table, and the interest rate	Have to use Internal Revenue Service mandated values	The actuary had discretion in choosing these items.
Interest rate structure	3-segment rates based on an average of corporate bond rates	Single rate chosen by actuary

Measurement of Funded Status

To simplify, for small plans, starting with plan years plans beginning in 2008, the funded status of the Plan is measured by the ratio of Plan Assets to the Funding Target (the Present Value of Accrued Benefits determined using mandated assumptions) as of the first day of the plan year. Woe to the pension actuary as the jargon completely changes. For example, this item is known by its acronym AFTAP, which stands for the Adjusted Funding Target Attainment Percentage. Each year, the actuary must certify to the calculation and the amount of the AFTAP.

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Restrictions for Payment of Benefits

As noted above, if the funded status of the plan, as measured by the AFTAP, does not meet certain thresholds, then the benefits payable from the plan may not be able to be made in a single lump-sum payment. Instead either a reduced or no lump sum benefit can be paid. Benefits paid as a life annuity are not restricted.

If the AFTAP is at least 80%, then there are no restrictions. If the AFTAP is equal to or greater than 60%, but less than 80%, then only partial lump sum distributions can be paid. In other words, no participant may be paid his benefit in full. If the AFTAP is less than 60%, then lump-sum distributions cannot be made, and distributions that are greater than the amount payable as a life annuity cannot be made. There are some exceptions to these rules.

Restrictions on the Accrual of Benefits

If the AFTAP is less than 80%, then amendments to the Plan to increase benefits can only be made if sufficient contributions in addition to the minimum required contribution are made. If the AFTAP is less than 60%, then, in addition, all future benefit accruals under the plan must cease. These restrictions do not apply during the first five years of the plan.

Determination of the AFTAP and When Restrictions Apply

Once the AFTAP is certified, with respect to the accrual of benefits, the restrictions apply back to the beginning of the plan year; with regard to the payment of benefits, restrictions apply prospectively. Initially, the AFTAP for the current year is presumed to be the same as the preceding plan year. If the AFTAP is not certified by the first day of the fourth month of the plan year, and if the preceding year's AFTAP was either between 60% and 70%, or between 80% and 90%, then the AFTAP is presumed to be 10% less than the preceding year, effective as of the first day of that fourth month, or until the current year's AFTAP is certified. Finally, if the AFTAP is not certified for the current plan year by the first day of the tenth month, then the AFTAP is presumed to be less than 60% for the remainder of the year, and cannot be certified to until the following year.

Notice to Participants

If any of the restrictions apply, participants are to receive notification of the restrictions within 30 days of the effective date. A penalty of not more than $1,000 a day for each violation may be assessed by the Department of Labor.

What to Do

If you sponsor a Defined Benefit Pension Plan, and would either like to pay benefits in 2008 or have maximum flexibility for the 2008 contribution, be sure PRS has the data needed to prepare the 2008 valuation as soon as possible. Once the AFTAP is determined and certified by the actuary, decisions may have to be made as to whether or not to fund for any shortfalls to lessen the restrictions. Because the PPA is complex and only briefly discussed in this Newsletter, you should contact us if you have any questions.

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