KRAVITZ

Information Release

August 2008

New Accelerated Funding Guidelines for Defined Benefit/Cash Balance Plans

Background

The Pension Protection Act of 2006 (PPA) substantially changed funding rules for defined benefit plans, including cash balance plans. These rules became effective for plan years beginning in 2008. Part of the new rules makes it clear that Congress wants defined benefit plans that are less than 100% funded to be funded at least quarterly throughout the year with the intention that these plans be brought up to 100% funded status within seven years.

Making quarterly contributions is not new. The original rules for making quarterly contributions if a plan was less than 100% funded were effective back in the late 1980s.

What is new is the need for an actuary to certify to the funded status of a plan each year. The funded status is determined by taking the ratio of assets to liabilities as determined by IRS guidelines. This must be done no later than the 1st day of the 4th month of the plan year (e.g. April 1 for a calendar year plan). The law recognizes this is a difficult due date to meet, so there is a six (6) month extension to the 1st day of the 10th month of a plan year (e.g., October 1 for a calendar year plan), during which the funded status is presumed to be the prior year's funded status minus 10% for those six months.

Actuarial Certification Needed

An actuarial certification must be provided to the Plan Administrator no later than the 1st day of the 10th month of the plan year (e.g., October 1 for a calendar year plan). In order to certify the funded status, the actuary needs to verify that contributions for the prior year were deposited.

There may be adverse consequences to the plan if it is certified to be less than 80% funded. There also could be quarterly contributions due for the following plan year if a plan is less than 100% funded. Both of these issues are discussed in further detail below, along with other restrictions that may be invoked.

For these reasons we recommend that our clients consider funding contributions earlier for plan years beginning in 2008. This will help us certify to the funded status sooner each year and help plans avoid any of the adverse consequences detailed below.

Ideally, we recommend contributions be made regularly during the plan year, instead of after the plan year end. However, we know this presents possible cash flow challenges for many of our clients. Therefore, we have the following recommendations.

- If there is a chance a plan will be less than 90% funded for a plan year, we recommend all contributions be made no later than 2½ months after the plan year end (e.g., March 15 for a calendar year plan), and that we are provided with confirmation that contributions were made by that date. This will allow the actuary to determine the funded status of the plan by the first due date outlined above (e.g., April 1 for calendar year plans).

- If it is anticipated that the plan will be more than 90% funded, we recommend all contributions be made no later than six months after the plan year end (e.g., June 30 for calendar year plans), and that we are provided with confirmation that contributions were made by that date. This will allow the actuary to determine the funded status by the final due date outlined above (e.g., October 1 for calendar year plans).

The minimum funding deadline of 8½ months following the plan year (e.g., September 15 for calendar year plans) is still available if there is a cash flow need to extend funding of the plan. However, there can be additional interest amounts due the plan for making the payments later; see reference to Quarterly Contribution Requirements below. We also cannot guarantee that our actuaries can certify to the funded status by the 1st day of the 10th month (e.g., October 1 for calendar year plans), unless we know about such deposits by the 1st day of the 8th month (e.g., August 1 for a calendar year plan).

Adverse Consequences

Below are some of the consequences that can occur if a plan is not fully funded. Please note that regardless of the actual funded status of the plan, a plan will be considered under funded if the actuary cannot verify the deposit of a contribution on a timely basis. This is why we need written confirmation that all deposits have been made.

- When a plan is at least 110% funded there are no restrictions on the plan.

- When a plan is less than 110% funded, lump-sum payments to certain highly compensated employees are restricted.

- When a plan is 80% to 89.99% funded, lump-sum benefit payments may be restricted in the following plan year until an actuary can certify that the plan is funded by 80% or more for the following plan year.

- When a plan is less than 80% funded, lump sum benefit payments may be restricted for all employees and the plan cannot be amended to increase benefits.

- When a plan is less than 60% funded, all of the above restrictions apply plus future benefit accruals are frozen.

- Participants must also be notified when lump-sum benefit payments are restricted or future benefit accruals are frozen for all participants.

Each restriction is lifted the next time the actuary provides an actuarial certification to the Plan Sponsor that certifies the funded status exceeds the appropriate threshold outlined above.

Quarterly Contribution Requirements

The funded status also affects whether or not there is a quarterly contribution requirement for the Plan.

- When a plan is 100% or more funded in the prior year, even after deducting any funding credit balances from plan assets, it is generally exempt from the quarterly contribution requirement.
- When a plan is less than 100% funded in the prior year, then it has a Funding Shortfall under IRS rules. Any plan with a Funding Shortfall in the prior plan year is required to make quarterly contributions during the current plan year, or alternatively, notify participants that those contributions will be made later than on a quarterly basis. In addition, there can be additional interest charges due the plan to reflect that contributions are being made later.

What is Kravitz Doing?

If you sponsor a defined benefit or cash balance plan, we will be working to certify your funded status for plan years beginning in 2008, by October 1, 2008 (later if your plan has a non-calendar year plan year). We will then communicate the funded status to you, including how much you will need to contribute for the plan to be 100% or better funded by the end of the plan year.

We also notify our clients each year about any quarterly contribution requirements, including providing the required notice to participants.

What Do You Need To Do?

If you are not currently depositing contributions in accordance with our guidelines as outlined above, we recommend you look at how to manage cash flow to accelerate the plan's funding to meet our proposed due dates. This includes letting us know in writing about deposits made to the trust shortly after they are made.

By doing this, you will help minimize any adverse consequences, including reducing any additional interest charges. We will also be able to certify the funded status within the nine (9) month deadline (e.g., October 1 for calendar year plans).

Please call your Kravitz consultant with any questions.

Kravitz is the largest firm of retirement consultants headquartered in California. We specialize in the design, administration, and management of virtually every type of retirement plan.