KRAVITZ

Information Release

July 2009

# New Requirements Mandated by the Pension Protection Act for Cash Balance & Defined Benefit Plans

## Background

Last year we informed our clients that the Pension Protection Act of 2006 (PPA) substantially changed funding rules for defined benefit plans, including cash balance plans, starting for plan years beginning in 2008. Part of the new rules makes it clear that Congress wants sponsors of “underfunded” defined benefit plans and cash balance plans (plans that are less than 100% funded per IRS guidelines) to make contributions at least quarterly throughout the year with the intention that these plans be brought up to 100% funded status within seven years.

Quarterly contributions are not new. The original rules for making quarterly contributions were effective in the late 1980s.

## Quarterly Contribution Requirement

When a plan is less than 100% funded in the prior year, 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 less frequently than on a quarterly basis. In addition, there can be additional interest charges due the plan if contributions are not deposited quarterly, and in some cases additional forms are required to be filed with the PBGC.

When a plan is 100% or more funded in the prior year it is generally exempt from the quarterly contribution requirement in the current year.

## Other Adverse Consequences

Below are additional consequences that can occur if a plan is not fully funded, summarized in a color coded chart. Please note that regardless of the actual funded status of the plan, a plan could be considered underfunded 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.

| Funding Target Attainment % | Effect on Plan |
|---|---|
| 110% or Higher | Plan is fully funded<br>No Restrictions |
| 100% - 109% | Sufficient funding, however, distributions to top 25 paid employees who are also highly compensated employees (HCEs) may be restricted. |
| 90% - 99% | Sufficient funding; above restriction applies, plus must make quarterly contributions, or notify employees and potentially fund for missed interest. |
| 80% - 89% | Modest funding; all of the above restrictions apply, plus lump-sums 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. |
| 60% - 79% | Plan "At Risk"; all of the above restrictions apply, plus all lump-sums restricted (can pay 50% at participant's election); benefit increases not allowed. |
| Below 60% | Plan is "Distressed"; all of the above restrictions apply, plus all lump-sums are restricted and future benefits are frozen. |

- Each restriction is usually lifted the next time the actuary certifies the funded status exceeds the appropriate threshold outlined above. In certain instances, a restriction may be lifted at the first day of the next plan year.

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

## Certifying the Funded Status

A plan's funded status is verified by an actuarial certification that must be provided to the Plan Administrator before the 1st day of the 10th month of the plan year. This means an actuary must certify the funded status by September 30 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. For these reasons we recommend that our clients consider funding contributions earlier in the year. This will help us certify to the funded status sooner each year and help plans avoid any of the adverse consequences of underfunding.

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 earlier in the year.

- If it is anticipated that the plan will be more than 90% funded, we recommend all contributions be made no later than seven months after the plan year end (e.g., July 31 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., September 30 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, as discussed earlier, there may be additional interest amounts due the plan for making the payments later. We also cannot guarantee that our actuaries will be able to certify to the funded status by the deadline (e.g., September 30 for calendar year plans), unless we know about such deposits at least 60 days before the deadline.

## The Annual Funding Notice (AFN) for plans covered by the PBGC

Plans that are covered by the Pension Benefit Guaranty Corporation (PBGC) must also notify participants of the funded status of the plan via an AFN, which replaces the Summary Annual Report that accompanies Form 5500. If you sponsor a plan with 100 or more participants you must provide this notice within 120 days after the plan year ends (e.g., April 30th for a calendar year plan). If you sponsor a plan with less than 100 participants you must provide this notice before you file Form 5500.

## How is Kravitz Helping our Clients to Meet the New Requirements?

Last year we began certifying the funded status for plan years beginning in 2008. We also notified (or will notify) our clients each year about any quarterly contribution requirements, including providing the required notice to participants for those employers that do not wish to make quarterly contributions.

We plan to communicate the 2009 funded status to our clients by September 30, 2009 (later if your plan year is a non-calendar year), if we have all the required data from you (e.g., confirmation of the 2008 contribution, 2008 employee data, etc.) by July 31, 2009.

We have already provided the AFN for plans with over 100 participants for plan years ending on or before February 28, 2009. We will be providing AFNs for plans with less than 100 participants with the 2008 Form 5500 filing which for calendar year plans is due July 31, 2009 (October 15, 2009 with an extension).

In order to provide these additional services required under the Pension Protection Act, we have developed an additional menu of services and fixed fees. These fees (if any) will appear on future invoices.

## What Cash Balance and Defined Benefit Plan Sponsors 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 plan shortly after they are deposited.

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., September 30 for calendar year plans).

Please call your Kravitz consultant with any questions.

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