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PENSION ANALYST

Important information—Plan administration and operation



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IRS and PBGC provide MAP-21 guidance for single-employer defined benefit plans

Who's affected

These developments affect sponsors of most qualified single-employer and multiple employer defined benefit plans. They do not affect multiemployer plans, governmental plans or church plans that do not elect to be covered by ERISA ("non-electing church plans").

Background and summary

On July 6, 2012, President Obama signed into law the "[Moving Ahead for Progress in the 21st Century Act \(MAP-21\)](#)." The new law provides funding relief for plan sponsors by providing pension interest rate stabilization, which currently allows plan sponsors to use higher interest rates when calculating plan liabilities. The use of higher interest rates lowers the plan's liability, which allows plan sponsors to contribute less money to satisfy their plan funding obligations.

Recently, the IRS published [Notice 2012-61](#) (Notice), which describes the funding relief provided by MAP-21. The Notice provides guidance regarding:

- Interest rates;
- Statutory hybrid plans;
- Transition issues;
- MAP-21 elections; and
- Schedule SB reporting.

At the same time, the Pension Benefit Guaranty Corporation (PBGC) published Technical Update 12-02, which provides guidance on the effect of MAP-21 on annual financial and actuarial reporting under ERISA Section 4010 that applies to plan sponsors of certain underfunded plans.

Action and next steps

The guidance provided by the IRS and PBGC impacts plan funding and administration. Plan sponsors should read the information contained in this *Pension Analyst*. If you have any questions about the information discussed in this publication, you should contact the plan's enrolled actuary.

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MAP-21 interest rates

The guidance confirms that segment rates for determining a plan's target normal cost and funding target will be adjusted if they are outside a specified range (corridor) of the average of the corporate bond segment rates for the preceding 25-year period. The 25-year average corporate bond segment rates for a calendar year are the rates published by the IRS based on the average of the segment rates for the 25-year period ending on September 30 of the prior calendar year. The applicable corridors around the 25-year average segment rates apply for plan years beginning in a given calendar year, regardless of the valuation date.

The Notice clarifies that the MAP-21 segment rates apply for purposes of:

- Determining the minimum required contribution, including the target normal cost and funding target, any amortization installments, and the average value of plan assets;
- Applying the benefit restrictions for certain underfunded plans;
- Valuing lump sums for purposes of determining the funding liability; and
- Determining whether the plan is considered at risk for the successive year.

However, the revised segment rates do not apply for purposes of:

- Limits on deductible contributions;
- Lump sum payments;
- The amount of excess assets that can be transferred to a retiree health account or retiree group term life insurance;
- Financial reporting to the PBGC for certain underfunded plans (ERISA Section 4010 reporting); and
- PBGC variable rate premiums.

Statutory hybrid plans

Hybrid plans, such as [cash balance plans](#) and pension equity plans (PEPs), are a special type of defined benefit pension plan that combine features of a defined benefit plan and a defined contribution plan. Most hybrid plans express benefits as the value of a hypothetical account balance. Participants receive statements that reflect the accumulation of contributions and interest credited to their hypothetical accounts. A "**statutory hybrid plan**" is a defined benefit plan that contains a statutory hybrid benefit formula. A "**statutory hybrid benefit formula**" is a benefit formula that is either a lump sum-based benefit formula or a formula that has an effect similar to a lump sum-based benefit formula.

To satisfy the benefit accrual requirements, a statutory hybrid plan must use an interest crediting rate that does not exceed the market rate of return. An "interest crediting rate" is the rate applied under the terms of the plan to increase a participant's benefit to the extent the benefit increase is not the result of a participant's additional service or imputed service for the employer. Currently, the hybrid plan regulations provide that the first, second and third segment rates for calculating minimum funding are acceptable interest crediting rates and do not exceed the market rate of return.

Last year, the IRS published [Notice 2011-85](#), which extended the effective date for the regulations relating to interest crediting rates under cash balance plans. The regulations, when finalized, were intended to apply for plan years that begin on or after a date to be specified in the regulations that is not earlier than January 1, 2013. In addition, related provisions of the final hybrid plan regulations that were effective January 1, 2012, were also postponed.

The IRS has now revised the effective date for those final regulations and has indicated that the final regulations will not be effective for plan years beginning before January 1, 2014. If a statutory hybrid plan uses a segment rate as the interest crediting rate, the Notice provides that plan administrators may make a reasonable interpretation as to whether the plan is meant to reflect the segment rates with or without the MAP-21 adjustments for that interest crediting rate. If a plan is amended to reflect the plan administrator's interpretation, the amendment will not be considered a reduction of protected benefits and will not require that an [ERISA section 204\(h\)](#) notice be distributed to participants.

Where a plan sponsor elects to use a MAP-21 adjusted segment rate for the plan's interest crediting rate, this rate must be applied to the beginning of the plan year in which the MAP-21 segment rates are first applied for minimum funding purposes. If a sponsor elects not to apply the MAP-21 adjusted segment rates for minimum funding purposes in the 2012 plan year, the sponsor may still elect to use the appropriate adjusted segment rate for interest crediting purposes in the 2012 plan year.

The IRS has not determined whether the MAP-21 segment rates will be included in the final regulations as acceptable interest crediting rates. If those regulations do not permit a statutory hybrid plan to use these rates, a plan that is using these rates must change the interest crediting rate in accordance with transition rules to be discussed in the final regulations.

Transition issues

Application of MAP-21 segment rates

MAP-21 segment rates are generally effective for plan years beginning after December 31, 2011. However, plan sponsors may elect to defer the application of MAP-21 segment rates to plan years beginning on or after January 1, 2013, either:

- For all purposes; or
- Solely for the purpose of determining the [funding-based benefit restrictions](#).

If MAP-21 segment rates are used to calculate minimum funding contributions for 2012, the new rates apply as of the first day of the 2012 plan year. Therefore, where MAP-21 segment rates are applied for minimum funding purposes, all quarterly installments are determined based on the MAP-21 segment rates, even those determined earlier in the plan year before MAP-21 was enacted and its provisions were applied.

Benefit restrictions

Plan sponsors may elect to apply MAP-21 segment rates either retroactively or prospectively for purposes of the funding-based restrictions for underfunded plans. In the absence of an affirmative election to apply the changes retroactively, the plan sponsor will be treated as having elected to apply any changes prospectively. Plan administration must be consistent with any election made by the plan sponsor.

If MAP-21 segment rates are applied retroactively for purposes of the funding-based restrictions for a plan year beginning in 2012, a plan must take corrective actions so that the plan's operation is consistent with the new funding percentage that incorporates the MAP-21 segment rates. For example, the new funding percentage may cause funding-based restrictions to no longer apply. As a result, a plan sponsor should consider the following:

- If unpredictable contingent event benefits that were previously restricted are now permitted to be paid, those benefits must become payable, retroactive to the period those benefits would have been payable under the terms of the plan.
- If a plan amendment with an effective date during a plan year beginning in 2012 could not take effect but is permitted to take effect later in the plan year as a result of the new funding percentage, the plan amendment must automatically take effect as of the first day of that plan year beginning in 2012 (or, if later, the original effective date of the amendment).
- If a payment was prohibited from being paid due to funding-based benefit restrictions, but may now be paid as the result of a new funding percentage, the plan must take corrective action to make the prohibited payment available to participants or beneficiaries that would have been eligible for the prohibited payment.
- If benefit accruals were not permitted but are now allowed to accrue, the plan must restore those benefits that accrued during the period to which the MAP-21 segment rates retroactively applied.

Any corrective actions should apply the principles and procedures of the [Employee Plans Compliance Resolution System \(EPCRS\)](#). If a participant or beneficiary is entitled to increased benefits due to the lifting of benefit restrictions, the correction must provide the participant with:

- Future benefit payments that are paid in the same manner and amount as if the participant had begun receiving the corrected payment at the original annuity starting date; and

- A make-up of past underpayments. The make-up for past underpayments is equal to the difference between the prior payments actually received and the amounts that would have been received had the benefit commenced in the correct form of payment at the participant's original annuity starting date, plus interest to the date of correction. The make-up payment may be paid as a single-sum payment or an actuarially equivalent increase in the amount of future benefit payments.

Credit balances and prior contributions

Plan sponsors may have elected to use a credit balance to avoid or remove benefit restrictions. The Notice provides that this election may be reversed if the:

- Reduction election was made on or before September 30, 2012; and
- MAP-21 segment rates were used to determine the minimum required contribution for that plan year.

However, plan sponsors may not reverse an election used to offset a quarterly contribution, except to the extent such election exceeds the minimum funding requirement for the plan year. The election to reverse a credit balance must be made in writing by the plan sponsor and provided to the plan's enrolled actuary by the end of the plan year.

Plan sponsors may also redesignate a 2011 plan year contribution as a 2012 plan year contribution, even if the 2011 Schedule SB has already been filed, provided the contribution was made:

- After the end of the 2011 plan year; but
- On or before September 30, 2012, or 8½ months after the close of the 2011 plan year, whichever is earlier.

MAP-21 elections

Plan sponsors must provide written notice of their elections to the:

- Enrolled actuary; and
- Plan administrator.

The written election notice must specify the:

- Name of the plan;
- Employer identification number and plan number; and
- Reason for the election and applicable supporting details regarding the election. For example:
 - The election to defer implementation of some or all of the provisions of MAP-21 must include whether MAP-21 provisions are deferred for all purposes or only for benefit restriction purposes. The election to defer is irrevocable.
 - The election to apply MAP-21 segment rates for restriction purposes retroactively must include the date to which retroactive application applies. This election is irrevocable.
 - The election to reverse a prior election to reduce a credit balance must specify the amounts of the election.

Elections must be made by the deadline for filing the Form 5500 (including extensions) for a plan year beginning in 2012, or the date the form is actually filed.

Schedule SB reporting

The information reported on the 2012 Schedule SB should reflect the assumptions used to determine the minimum funding contribution. Therefore, the funding target, interest rate and target normal cost reported on lines 3 through 6 and the rates reported on line 21 of the 2012 Schedule SB must reflect the MAP-21 segment rates if those rates are used to determine the 2012 minimum required contribution. If the 2012 minimum required contribution is calculated without the MAP-21 segment rates, the information reported should be reflected on the Schedule SB.

In addition, the funding percentage reported on line 15 of the 2012 Schedule SB is the final certified funding percentage for that plan year, incorporating any adjustments to reflect MAP-21 segment rates. If the plan sponsor elects to defer the use of MAP-21 segment rates until the plan year beginning on or after January 1, 2013, the funding percentage reported on line 15 of the 2012 Schedule SB must not reflect the MAP-21 segment rates.

The Notice also provides guidance on how to report the reversal of prior elections to reduce credit balances or to redesignate contributions made on or before September 30, 2012, which were originally applied to the 2011 plan year.

PBGC guidance

ERISA requires sponsors of certain underfunded pension plans and their controlled group members to report annual financial and actuarial information ("4010 filings") to the PBGC, if:

- Any plan maintained on the last day of the plan year by a contributing sponsor or any member of the controlled group has a funding target attainment percentage (FTAP) that is less than 80% ("Gateway Test") and the total underfunding across all plans within the controlled group is more than \$15 million;
- The controlled group has missed contributions in excess of \$1 million; or
- The controlled group maintains a plan with a funding waiver that exceeds \$1 million.

In [Technical Update 12-2](#), the PBGC provides that the MAP-21 segment rates do not apply for purposes of determining the FTAP required to be reported in the 4010 filing, nor do they apply for determining whether a plan fails to meet the Gateway Test.

The guidance also confirms that for other 4010 reporting amounts involving minimum funding-related determinations affected by MAP-21, MAP-21 segment rates apply. For example, to the extent the MAP-21 segment rates are used for minimum funding purposes, they should also be used in determining whether the total underfunding across all plans in the controlled group is more than \$15 million, which would then require 4010 reporting.

The PBGC also released [Technical Update 12-1](#), which confirmed that the MAP-21 segment rates do not apply for purposes of determining the premium funding target used to establish the variable-rate premium to be paid to the PBGC for a plan.

Next steps

Plan sponsors will need to make several important decisions regarding the implementation of the guidance discussed in this *Pension Analyst*. For example, they will need to decide whether to apply the MAP-21 segment rates to the 2012 plan year or defer until 2013. If they have previously elected to reduce a credit balance for the 2012 plan year, they must decide whether to reverse that election. Finally, if they sponsor a cash balance plan that uses segment rates for interest crediting purposes, they must decide whether or not to apply the MAP-21 segment rates.

Plan sponsors should consult with their plan's enrolled actuary before making any final decisions. Prudential Retirement's enrolled actuaries are well prepared to respond to your inquiries regarding the effect of this guidance on your plan and suggest solutions to comply with this recent guidance.

Pension Analyst by Prudential Retirement

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